

10 July 2001

**International Power plc's proposed
acquisition of TXU Europe's
Rugeley B power station**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the proposed acquisition of Rugeley B power station by International Power plc;
- ◆ explains the merger control process for this transaction; and
- ◆ requests comments on the regulatory issues arising from the proposed transaction.

1.2 Ofgem will make recommendations to the Director General of Fair Trading in relation to the merger. In order to allow comments to be considered, Ofgem needs to receive these not later than 5pm on 24 July 2001.

2. Details of the proposed acquisition

- 2.1 Rugeley B is a 1046MW coal fired power station located in Rugeley, Staffordshire. Prior to this transaction, Rugeley B was owned by TXU Europe Group plc and operated under licence by Eastern Merchant Generation Ltd, which is part of the TXU Europe Power subsidiary of the parent company.
- 2.2 Under the transaction, ownership and operation of Rugeley B will transfer to International Power plc (IP) for a consideration of £200 million. However, as part of the acquisition IP is entering into a tolling agreement with TXU Europe under which TXU Europe will supply all the coal to Rugeley B and buy all of its output. The agreement will run until the end of 2005.
- 2.3 On June 18 2001 the parties notified the proposed transaction to the Office of Fair Trading (OFT) for a decision by the Secretary of State to clear the transaction or to refer it to the Competition Commission.

3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the value of the Rugeley B assets exceeds the £70 million threshold under the Fair Trading Act 1973 (FTA). The transaction will therefore be assessed under the provisions of the FTA and the Secretary of State for Trade and Industry may refer the transaction to the Competition Commission if the transaction may, in the Secretary of State's opinion, give rise to significant competition concerns.
- 3.2 It is the responsibility of the OFT, headed by the Director General of Fair Trading (DGFT), to advise the Secretary of State as to whether transaction should be referred to the Competition Commission. In accordance with the concordat between the OFT and Ofgem, the OFT will consult Ofgem before advising the Secretary of State. Where the OFT advises that the transaction should be referred to the Competition Commission, the OFT may in lieu of such a reference advise that the Secretary of State invites binding undertakings from the parties to the transaction which would remedy any adverse effects on competition identified by the OFT.
- 3.3 If the Secretary of State decides to refer the transaction to the Competition Commission, the Competition Commission has to consider whether the transaction operates, or is likely to operate, against the public interest. If the Competition Commission finds in favour of the transaction, the Secretary of State must clear the transaction. However, if the Competition Commission makes an adverse finding, the Secretary of State may (but he does not have to) take remedial action.
- 3.4 If the Secretary of State decides to clear the transaction, Ofgem will need to consider what modifications might be needed to the licence held by IP and whether any assurances and/or undertakings are necessary.

4. Details of the Parties

TXU Europe Group plc

- 4.1 TXU Europe Power (TXU) is a wholly owned subsidiary of the TXU Europe Group plc. It operates and has significant investments in four principal markets – the UK, the Nordic Region, Northern Europe and Iberia. In the UK electricity market, TXU is a vertically integrated company with generation, distribution and supply licences, and it trades on the wholesale market. TXU also trades gas in the UK in both wholesale and retail markets.
- 4.2 TXU is one of the largest electricity generating companies in England and Wales. After the sale of Rugeley, TXU will continue to own and operate six merchant generation stations in the UK with a total capacity of 5688 MW. TXU's share of output in the England and Wales generation market will be 6 per cent.
- 4.3 The distribution business of TXU is carried out under licence by Eastern Electricity, a subsidiary of Eastern Group. In addition, last year Eastern Electricity set up a joint venture company with London electricity, 24:seven, in order to operate both companies' networks.
- 4.4 TXU owns two retail supply businesses in England and Wales, Norweb Energi and Eastern Electricity. It purchased Norweb Energi in August 2000. TXU currently supplies electricity to 4.5 million customers in England and Wales, or 15.9 per cent of the market.

International Power (IP)

- 4.5 IP was created in October 2000 through the demerger of National Power plc, and is in effect the old international arm of National Power. It has electricity generation interests in thirteen countries ranging from North America, the Middle East and Europe.
- 4.6 Prior to this transaction, IP owned one power station in England and Wales, a 500 MW combined cycle gas turbine plant at Deeside in north Wales, for which it holds a generation licence. The capacity of Deeside represents 0.73 per cent

of total generating capacity in England and Wales. This represents 1 per cent of output in England and Wales.

- 4.7 IP also holds a second tier licence to supply electricity to customers in England and Wales. At present, though, it is not an active supplier and has no customers.

Rugeley B Power Station

- 4.8 The Rugeley B power station is thirty-one year old coal-fired power station located in Rugeley, Staffordshire. Rugeley B has a generating capacity of 1046 MW, which is the equivalent to 1.53 per cent of total generating capacity in England and Wales.

5. Issues arising from the proposed acquisition

Concentration of generation interest in Great Britain

- 5.1 Ofgem will need to consider whether the acquisition of Rugeley B by IP represents a concentration in the generation market of England and Wales.
- 5.2 IP's cumulative capacity, including both Deeside and Rugeley B power stations, would be 1546 MW. Given that total installed capacity in England and Wales is 68GW, IP would have a market share of approximately 2.27 per cent. Deeside and Rugeley B together accounted for about 1.7 per cent of output in England and Wales in 2000/1. As a result of the transaction, TXU's share of the England and Wales generation market would fall from 7 per cent to 6 per cent.
- 5.3 Under the terms of the tolling agreement between TXU and IP, commercial control over the output of Rugeley B will remain with TXU until the contract expires in 2005. In the short to medium term, therefore, the acquisition will have no effect on competition in the generation market in England and Wales. However, both parties envisage that IP will assume commercial control of Rugeley's output after 2005. In that event, the acquisition would result in a deconcentration in the generation market in England and Wales. We welcome views on this matter.
- 5.4 Ofgem considers that there is scope for generators who, by normal competition standards, have relatively low market shares, to manipulate the market and damage competition and/or harm customers. Ofgem considers that this is a result of the special features of the electricity market, including the inability to store electricity other than at very high cost, the complexity of the market rules, and the relatively inelastic demand and supply conditions, particularly close to real time.
- 5.5 At present there are limited regulatory safeguards against non-dominant companies manipulating the market, in particular in relation to the potential gaming of transmission constraints, complex market rules or the withdrawal of generation capacity. Given these concerns, Ofgem will have to consider carefully the impact of the transaction on competition in the wholesale electricity market.

- 5.6 The DTI has consulted on a proposed generation licence conditions regarding system balancing and capacity withdrawal. If the DTI introduces the proposed licence conditions in generation licences, Ofgem will have regulatory safeguards against the manipulation of the wholesale markets.

Vertical integration

- 5.7 At present, TXU is one of the largest generators of electricity in England and Wales. It is also the largest retail supplier of electricity in England and Wales. After this transaction, IP will own around 2 per cent of the England and Wales generation market. As stated above, IP's electricity supply licence holder currently has no customers. By transferring ownership of Rugeley B power station from TXU to IP, the transaction may reduce the extent of vertical integration in the electricity market in England and Wales in the long term. Views are invited on this matter.

Tolling agreement between IP and TXU

- 5.8 As stated above, as part of the acquisition IP is entering into a tolling agreement with TXU under which TXU will supply all the coal to Rugeley B and buy all of its output. Ofgem will need to consider whether this agreement gives rise to any competition concerns, or whether it should be viewed as ancillary to the transaction. Views are welcome on this issue.

6. Way forward

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of Rugeley B power station by IP, so that the Authority may make recommendations to the Director General of Fair Trading.
- 6.2 Responses will normally be available in the Ofgem library unless there are good reasons why they must remain confidential. Respondents should mark the part of their response (or whole response) which is to remain confidential, if this is the case, and where possible should consign any confidential material to appendices.
- 6.3 Comments on the proposed acquisition should be sent, by 5pm on 24 July 2001, to:

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