

**September 2001**

**Centrica plc's proposed acquisition  
of TXU Europe's King's Lynn and  
Peterborough power stations**

**A consultation paper**

# 1. Introduction

## *Purpose of this document*

1.1 This document:

- ◆ gives details of the proposed acquisition of King's Lynn and Peterborough power stations by Centrica 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 this acquisition. In order to allow comments to be considered, Ofgem needs to receive these not later than 5pm on Wednesday 19 September 2001.

## 2. Details of the proposed acquisition

- 2.1 TXU Europe Group plc (TXU) owns both the gas fired power station businesses at King's Lynn and Peterborough. TXU is proposing to sell these businesses to Centrica plc (Centrica).
- 2.2 Both King's Lynn and Peterborough are wholly owned subsidiaries of TXU - namely Anglian Power Generators Limited (APGL) and Peterborough Power Limited (PPL), respectively. Centrica has entered into a binding contract with TXU, PPL and APGL to acquire the leaseholds and other interests in the power station businesses of PPL and APGL.
- 2.3 Centrica announced the proposed acquisition on 24 August 2001. The parties have notified the completed 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 for further investigation.

### 3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the value of Centrica's 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 the 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 concludes that the proposed transaction is not likely to operate against the public interest, the Secretary of State has no power to prevent the merger. If the Competition Commission decides that an adverse effect can be expected, the Secretary of State has the power to block the transaction or attach conditions to it, or to ask the DGFT to negotiate undertakings to be given by the parties to counter the adverse effects identified; though the Secretary of State is under no obligation to use these powers.
- 3.4 In advising the OFT, Ofgem will need to consider what modifications might be needed to the licences held by Centrica and whether any assurances and, or, undertakings are necessary should the transaction proceed.

## 4. Details of the Parties

### *Centrica*

4.1 Centrica was formed in 1997 by the de-merger of British Gas. It is a customer services company with significant energy interests. Its principal energy businesses in the UK include;

- ◆ upstream interests, including the North and South Morecambe gas fields managed by Hydrocarbon Resources Ltd and upstream interests acquired from Powergen in 1998 and now managed by the subsidiary Centrica Resources Ltd. The acquisition included both producing and undeveloped fields in the South North Sea and the East Irish Sea, close to Centrica's Morecambe fields operation. The market share of the Morecambe Bay field is about 12% of marketable UK gas production and the remaining production interests have a share of 0.7%. Centrica has continued to invest in its production assets and it is expected that the delivery capability of the Morecambe field will increase by 12% per annum over the next 5 years;
- ◆ electricity and gas trading, through Accord Energy, which is involved in the sale and purchase of electricity and gas in the wholesale and forward markets;
- ◆ gas shipping, through its two licensed wholly owned subsidiaries British Gas Trading Ltd and Accord Energy Ltd, who between them flowed 41% of all gas going through the National Transmission System;
- ◆ gas supply, through its wholly owned subsidiary British Gas Trading Ltd, with approximately 13.5 million domestic gas customers in Great Britain, representing around a 69% market share. BGTL also supplies gas to industrial and commercial users and combined cycle gas turbine plants, its share of these markets is approximately 14% and 20% respectively;
- ◆ electricity supply, through its two wholly owned subsidiaries British Gas Trading Ltd (which holds separate second tier electricity supply licences for its activities in England and Wales and for Scotland) and Accord Energy Ltd, with a total of 4.5 million retail electricity customers in Great Britain, giving it a 15.8% share; and
- ◆ electricity generation, through a 60% share in Humber Power Limited, with a total capacity of approximately 1,312MW. Centrica also has an effective 50% interest in a project to develop a generating facility in Spalding in Lincolnshire. If this project is

completed, the expected capacity of the generation facility will be approximately 840MW.

Centrica is also involved in telecoms, owns the AA and provides various financial services through its brand Goldfish.

### ***TXU***

4.2 TXU Europe Power is a wholly owned subsidiary of the TXU Europe Group plc (TXU). It operates and has significant investments in four principal markets – the UK, the Nordic Region, Northern Europe and Iberia. In the UK energy market's its principal businesses include;

- ◆ electricity and gas trading, through TXU Europe Energy Trading, involved in the sale and purchase of electricity and gas in the wholesale and forward markets. TXU Energy Trading is one of the largest energy traders in the UK. In 2000 they traded 308TWh of electricity and 1,489TWh of gas in the UK;
- ◆ gas supply, through wholly owned subsidiaries including Norweb Gas and Eastern Natural Gas (Retail) Ltd, currently supplying just over 1 million gas customers;
- ◆ gas shipping, through its subsidiary TXU Europe Energy Ltd;
- ◆ electricity supply, through TXU Energi (previously Eastern Energy and Norweb Energi), currently supplying about 4.5 million electricity customers in total;
- ◆ electricity distribution, through Eastern Electricity, and a joint venture with London Electricity, 24:seven, with approximately 3.4 million customers connected to the distribution network; and
- ◆ electricity generation, through TXU Europe Power, which owns (either outright or in part) seven generation stations in the UK (not including Shotton, a 240MW CHP which provides power to a local paper mill, exporting any excess power onto the system). TXU has a total capacity of 5,847MW. It's share of total capacity of the system in the England and Wales generation market will be approximately 7.4% accounting for the disposal of King's Lynn and Peterborough.

### ***King's Lynn power station***

4.3 King's Lynn power station is a 350MW combined coal and gas turbine power station operated by APGL, based in King's Lynn in Cambridgeshire. It was commissioned in 1996. The power

station's capacity represents 0.5% of total generation capacity available in England and Wales. In 2000, the actual output of the power station was 1,287GWh representing less than 1% of total generation output in England and Wales.

- 4.4 The station's capacity will represent approximately 7% of British Gas Trading Limited's forecast for peak customer demand.

***Peterborough power station***

- 4.5 Peterborough power station is a 405MW combined coal and gas turbine power station based in Peterborough in Cambridgeshire and operated by PPL. It was commissioned in 1993. The power station's capacity represents approximately 0.6% of total generation capacity available in England and Wales. In 2000, the actual output of the power station was 2,564 GWh, representing 1% of total generating output in England and Wales.

- 4.6 The station's capacity will represent approximately 8% of British Gas Trading Limited's forecast for peak customer demand.

## 5. Issues arising from the proposed acquisition

### *Concentration of generation interests in Great Britain*

- 5.1 Ofgem considers that there is scope for generators to manipulate the market and so damage competition and/or harm customers. Ofgem considers that this ability 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 relatively inelastic demand and supply, particularly close to real time. Generators may be able to do this despite holding relatively low market shares.
- 5.2 At present there are limited regulatory safeguards or precedent regarding companies with relatively low market share manipulating the market, particularly in relation to the potential gaming of transmission constraints, complex market rules or the withdrawal of generation capacity.
- 5.3 The DTI is consulting on a proposed generation licence condition regarding system balancing and capacity withdrawal. If the DTI introduces the proposed licence condition in generation licences, Ofgem will have explicit regulatory safeguards against the manipulation of the wholesale markets.
- 5.4 Ofgem will need to consider in the context of existing regulatory safeguards whether the acquisition of PPL and APGL represents a concentration in the generation market of Great Britain. Centrica had not been active in this market until its acquisition of 60% of Humber Power Limited earlier this year, which constitutes 787MW of capacity.
- 5.5 Centrica also has a 50% interest in a project to develop the Spalding power station. Spalding will have a capacity of approximately 840MW, which if completed, which would bring Centrica's cumulative capacity total to 1,207MW. Total installed capacity in England and Wales is 68GW, Centrica's cumulative market share, at present and including Spalding, represents approximately 1.8% of this. If Centrica were to acquire PPL and APGL, its total capacity would be 1,962MW, or about 2.9%, of total installed capacity in England and Wales.
- 5.6 However, Ofgem notes that arguably this transaction would enhance competition in generation as it would see further deconcentration of the market. Following the acquisition, TXU's market share would fall and Centrica's rise but to a relatively modest level (i.e. from 1.8% to 2.9%). Ofgem invites views on the change in concentration in the market.



### ***Arbitrage***

- 5.7 Given Centrica's position in the gas supply market, Ofgem will need to consider whether distortions in competition may arise as a result of arbitrage between the gas supply and electricity generation markets. Ofgem invites views on this issue.

### ***Restriction on own generation capacity***

- 5.8 In the past, generation limits have been included in Public Electricity Supply (PES) licences to prevent vertically integrated companies with a captive customer base, purely supplying their own designated customers at excessive prices. In previous acquisitions, generation limits have been included in the PES licence, and restrictions on electricity sale contracts between designated supply and associated generation businesses have been considered. Centrica does not hold a PES licence in England and Wales and all customers who have switched to Centrica's electricity portfolio have been gained in a competitive environment and are free to choose an alternative electricity supplier. Accordingly, Ofgem does not consider it necessary to impose any such restrictions so as to protect the customers that Centrica has gained through competition. We welcome comments on the issue.

### ***Vertical integration***

- 5.9 In gas Centrica is already a vertically integrated participant. As a result of Centrica's previous acquisition of Humber Power Limited, it became a vertically integrated participant in the electricity market as well. Centrica has approximately 15% of the Great Britain market for the retail supply of electricity customers and is at present joint largest supplier with TXU. Centrica currently has an approximate 1.8% share in electricity generation, the PPL and APGL acquisitions would bring this share up to 2.9%.
- 5.10 Ofgem will have to consider whether Centrica's vertically integrated position is likely to result in a leveraging of market power. Large companies in the electricity market, such as Centrica, may use their market power in one activity to reduce competition in another to the potential detriment of consumers. Ofgem will have to consider whether such concerns can be dealt with effectively through its existing powers under the Electricity Act 1989, the Gas Act 1986 and the Competition Act 1998.

## 6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of PPL and APGL by Centrica 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. Consultees 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 Wednesday 19 September 2001 to:

Rachel Graham  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Fax: 020 7901 7197

E-mail: [rachel.graham@ofgem.gov.uk](mailto:rachel.graham@ofgem.gov.uk)