

October 2001

**AEP Energy Services UK Generation
Limited's proposed acquisition of Edison
First Power Limited's Ferrybridge and
Fiddler's Ferry power stations**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the proposed acquisition of Edison First Power Limited's Ferrybridge and Fiddler's Ferry power stations by AEP Energy Services UK Generation Limited;
- ◆ explains the merger control process for this transaction; and
- ◆ requests comments on the regulatory issues arising from the proposed transaction.

1.2 Ofgem¹ will make recommendations to the Director General of Fair Trading (DGFT) in relation to this acquisition. In order to allow comments to be considered, Ofgem needs to receive these not later than 5pm on Wednesday October 31 2001.

¹ With the commencement of the relevant provisions of the Utilities Act in December 2000, the duties and functions of the Director Generals of Electricity and Gas Supply were transferred to the new Gas and Electricity Markets Authority. However, this document refers to the Office of Gas and Electricity Markets (Ofgem) throughout.

2. Details of the proposed acquisition

- 2.1 At present, Edison First Power Limited (Edison) owns, and operates under licence, both coal and gas fired power station businesses at Ferrybridge and Fiddler's Ferry. Edison is proposing to sell the business and assets of Ferrybridge and Fiddler's Ferry power stations to AEP Energy Services UK Generation Limited (AEP). The proposed transaction will also include the plants' fuel supply contracts.
- 2.2 AEP announced the proposed acquisition on 8 October 2001. The parties have notified the 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 the assets involved 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 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 AEP and whether any assurances and, or, undertakings are necessary should the transaction proceed.

4. Details of the Parties

AEP Energy Services UK Generation Limited

4.1 AEP Energy Services UK Generation Limited is a wholly owned subsidiary of American Electric Power Company Inc., which is a major energy services company serving 4.8 million customers in the United States and 4 million customers elsewhere, notably Australia, Brazil, China, Mexico, and the United Kingdom (UK).

4.2 Having sold its 50 per cent interest in Yorkshire Power Group Limited in June 2001, American Electric Power Company Inc's energy businesses comprise its wholly owned subsidiary Seeboard and shareholdings in two generation companies. Its interests are broken down across generation, distribution and supply as follows:

- ◆ electricity generation: AEP Energy Services UK Generation Limited (AEP) has a 37.5 per cent shareholding in Medway Power Limited, which owns and operates a 700 MW combined cycle gas turbine plant on the Isle of Grain in Kent. AEP also owns 50 per cent of South Coast Power Limited, which is a joint venture between Seeboard and Scottish Power plc. Earlier this year South Coast Power commissioned a 400 MW combined cycle gas turbine plant at Shoreham in West Sussex. Taken together this would give AEP a capacity of 463 MW;
- ◆ trading: Seeboard is involved in the trading of electricity in Great Britain and is a participant in the electricity balancing mechanism;
- ◆ electricity distribution: through Seeboard distribution subsidiary, Power Networks Limited, operates and maintains an electricity distribution system in Kent, Sussex and Surrey, to which 2.15 million customers are connected. Power Networks Limited also has an 80 per cent share of Seeboard Powerlink, the consortium that manages power supplies for the London Underground; and
- ◆ electricity and gas supply: through Seeboard's supply subsidiary, Seeboard Energy Limited, supplies energy to 1.96 million customers nationwide. (The great majority of its customers are in Seeboard's former Public Electricity Supply authorised area in the south east of England.) Seeboard has 1.61 million retail electricity customers in Great Britain, giving it a 5.6 per cent share; and 0.35 million retail gas customers in Great Britain, giving it a 1.7 per cent share.

4.3 Seeboard also operates an electrical contracting business called Seeboard Contracting Services.

Edison First Power Limited

- 4.4 Edison First Power Limited is wholly owned by Edison Mission Energy Limited, which is itself wholly owned by Edison International Corporation. Edison International Corporation is an electric power generator, distributor, and structured finance provider operating in the United States and in nine other countries.
- 4.5 Edison Mission Energy Limited is involved in the following activities in the UK energy markets:
- ◆ electricity generation: through its wholly-owned subsidiaries, First Hydro Company, Edison First Power Limited and Lakeland Power Limited, as well as a shareholding in Derwent Cogeneration Power Limited, Edison either owns or has an interest in six generation stations in the UK with a total capacity of 6379 MW. In the event that the proposed transaction proceeds, Edison's share of total generating capacity in the England and Wales market would fall from 9.5 per cent to 3.6 per cent²; and
- 4.6 Edison Mission Energy Limited is also involved in the trading of electricity in Great Britain and is a participant in the electricity balancing mechanism

Ferrybridge power station

- 4.7 Ferrybridge power station is a 1989 MW combined coal fired power station operated by Edison First Power Limited, based in West Yorkshire. It was commissioned in 1966. The power station's capacity represents 2.9 per cent of total generation capacity available in England and Wales. In 2000, the actual output of the power station was 7.6 TWh, representing 2.5 per cent of total generation output in England and Wales³.

Fiddler's Ferry power station

- 4.8 Fiddler's Ferry power station is a 1995 MW combined coal fired power station operated by Edison First Power Limited, based in Cheshire. It was commissioned in 1971. The power station's capacity represents approximately 3.0 per cent of total generation capacity available in England and Wales. In 2000, the actual output of the power station was 7.3 TWh, representing 2.4 per cent of total generating output in England and Wales⁴.
- 4.9 Both Ferrybridge and Fiddler's Ferry are flexible mid-merit coal stations

² Edison's Great Britain market share of generation capacity will fall from around 8.4 per cent to around 3.2 per cent.

³ In 2000/01, Ferrybridge's share of Great Britain total generating output was around 2.1 per cent.

⁴ In 2000/01, Fiddler's Ferry's share of Great Britain total generating output was around 2.2 per cent.

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. 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 regarding companies with relatively low market shares 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 Ferrybridge and Fiddler's Ferry power stations by AEP Energy Services UK Generation Limited represents a concentration in the generation market of Great Britain, which would have detrimental effects on the development of competition in the generation market.
- 5.5 As noted above, AEP Energy Services UK Generation Limited currently has a 37.5 per cent shareholding in Medway Power Limited, which owns and operates a 700 MW combined cycle gas turbine plant on the Isle of Grain in Kent. It also owns 50 per cent of South Coast Power Limited, a joint venture with Scottish Power plc, which has commissioned a 400 MW combined cycle gas turbine plant at Shoreham in West Sussex. On the assumption that the Shoreham project is completed, AEP Energy Services UK Generation Limited would have a total capacity of 463 MW. Given that total installed capacity in England and Wales is 67.4 GW, this would represent 0.7 per cent of the market. If AEP Energy Services UK Generation Limited were to acquire Ferrybridge and Fiddler's Ferry (with a combined capacity of 3984 MW), its total capacity would rise to 4447 MW, or about 6.6 per cent of total installed capacity in England and Wales⁵.

⁵ AEP's Great Britain market share of total generation capacity will rise from around 0.6 per cent to around 5.9 per cent.

- 5.6 Ofgem would welcome comments on whether the change in ownership of Ferrybridge and Fiddler's Ferry raises any concerns about the development of competition in generation and, if so, what if any action is needed to address such concerns.

Vertical integration

- 5.7 AEP, through its UK subsidiaries, is already a vertically integrated participant in the electricity market. AEP Energy Services UK Generation Limited, as noted above, has 0.7 per cent of the England and Wales generation market, while Seeboard Energy Limited has approximately 5.6 per cent of the Great Britain market for the retail supply of electricity customers.
- 5.8 Ofgem will have to consider whether AEP's vertically integrated position is likely to result in a leveraging of market power. Vertically integrated companies with market power may use that market power in one activity to reduce competition in another, to the potential detriment of consumers.
- 5.9 The acquisition will result in around 6 per cent of total England and Wales generation capacity moving from a company without supply interests to a company with nearly 6 per cent of the Great Britain supply market. This may raise concerns about reduced liquidity in electricity trading. In the supply licences of the former Public Electricity Suppliers (PES) with significant generation capacity, there is a 'self-supply' condition that prohibits them from supplying customers in their former designated area using their own generation interests. Subject to responses to this consultation, Ofgem intends to seek an assurance from AEP that it will accept the same condition in Seeboard's supply licence, covering supply to those customers who would have been designated customers within its authorised area prior to 1 October 2001⁶. Ofgem would then undertake a formal consultation proposing the inclusion of the condition in Seeboard's electricity suppliers' licence.
- 5.10 Ofgem would welcome comments on the proposal to seek an assurance from AEP that it will accept the self supply condition in Seeboard's licence and whether any additional regulatory measures are needed to address any concerns about vertical integration following this acquisition.

Fuel supply contracts

- 5.11 The proposed transaction will also include the fuel supply contracts to the power stations. Ofgem will need to consider whether these agreements give rise to any competition concerns,

⁶ The concept of the 'designated' customer was removed from licences as of 1 October 2001, and customers are now classed as either domestic or non-domestic.

or whether they should be viewed as ancillary to the transaction. Our initial view is that, as with similar transactions, such agreements are not ancillary to the acquisition and that Ofgem should retain the ability to take appropriate action under the Competition Act 1998 if any or all of the agreements were to have any anti-competitive effects. Views are welcome on this issue.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of Ferrybridge and Fiddler's Ferry by AEP Energy Services UK Generation Limited so that we 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 31 October 2001 to:

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