

**November 2001**

**London Power Company plc's  
acquisition of TXU Europe (Hood  
No. 2) Limited - West Burton power  
station from TXU Europe Group plc**

**A consultation paper**

# 1. Introduction

## *Purpose of this document*

1.1 This document:

- ◆ gives details of the proposed acquisition of TXU Europe (Hood No.2) Limited - West Burton power station by London Power Company plc;
- ◆ explains the merger control process for this transaction; and
- ◆ requests comments on the regulatory issues arising from the proposed transaction.

1.2 Ofgem<sup>1</sup> 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 28 November 2001.

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<sup>1</sup> 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 London Power Company plc, a wholly owned subsidiary of London Electricity Group plc (LEG), is proposing to acquire TXU Europe (Hood No.2) Limited ("Hood 2") from TXU Europe Group plc.
- 2.2 Hood 2 is a wholly owned subsidiary of TXU Europe Group plc. Hood 2 has two subsidiaries, TXU Europe (Hood) Limited ("Hood 1"), which owns the property and fixed assets of West Burton power station, and TXU Europe (West Burton) Limited ("Hood WB"), which holds a licence to operate West Burton power station. West Burton power station is a 2012 MW coal-fired station near Retford in Nottinghamshire, England.
- 2.3 On 19 November 2001 LEG notified the proposed transaction to the Merger Task Force at the European Commission for a decision to clear the transaction or to refer it to Phase II of the European Community Merger Regulation.
- 2.4 On 19 November 2001 LEG separately notified the Merger Task Force at the European Commission of a proposal for it to acquire TXU Europe Group plc's Eastern Electricity Limited and its 50 per cent shareholding in 24Seven, a joint venture between LEG and TXU Europe Group plc. Ofgem has published a separate consultation paper on the issues raised by that transaction.

### 3. Merger Control Process

- 3.1 Under the European Community Merger Regulation (Council Regulation 4064/89 as amended by Council Regulation 1310/97) ("the Regulation"), a merger having a Community dimension should be appraised by the Commission of the European Union ("the Commission") with a view to establishing whether or not it is compatible with the common market. The proposed acquisition of West Burton appears to meet the relevant criteria for a merger having a Community dimension. The Commission has one month from the date of receipt of a complete notification to decide whether the merger raises serious doubts as to the acquisition's compatibility with the common market and whether to initiate an in-depth investigation under Phase II of the Regulation.
- 3.2 Article 9 of the Regulation provides for the Commission to refer a merger to the competent authorities of a Member State where on application of that Member State:
- ◆ a concentration threatens to create or to strengthen a dominant position as a result of which effective competition would be significantly impeded in a market within that Member State, which presents all the characteristics of a distinct market; or
  - ◆ a concentration affects competition in a market within that Member State which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.
- 3.3 If a merger is referred back to the Member State under Article 9, the Member State may only take measures strictly necessary to safeguard or restore effective competition in the market concerned. Unless the Commission decides to refer the merger to the UK, the UK will be precluded from applying its national legislation on competition to the merger. The EU Commission then has exclusive jurisdiction to determine whether the proposed acquisition, with or without conditions, does or does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or a substantial part of it and accordingly whether it is, or is not compatible with the common market.

3.4 Article 21 of the Regulation provides for a Member State to take appropriate measures to protect legitimate interests other than those taken into consideration by the Regulation.

## 4. Details of the Parties

### *LEG*

- 4.1 As stated above, London Power Company plc is a wholly owned subsidiary of LEG. LEG is wholly owned by London Electricity Holding Group, a subsidiary of EdF UK Limited<sup>2</sup>. EdF UK Limited is wholly owned by EdF International SA, which itself is a wholly owned subsidiary of EdF. The French State wholly owns EdF.
- 4.2 The principal business of EdF is the generation, transmission, distribution and supply of electricity in France. In 1999, its output was 469 TWh out of a total of 500 TWh in France. It exports electricity from France to neighbouring countries, including to England and Wales through the 1998 MW France/England interconnector. EdF and National Grid Company each hold a 50 per share of the physical assets of the interconnector, and EdF carries out the auctions of 100 per cent of the capacity. EdF generates, transmits, distributes and supplies electricity elsewhere in the world. It is active in electricity trading other than in France through a joint venture with Louis Dreyfus called EdF Trading Limited, which is based in England. EdF also designs, builds and acts as a technical consultant in relation to the construction, operation and maintenance of electrical plants and power networks and, through specialised subsidiaries, provides waste recycling and street lighting services.
- 4.3 LEG's principal business interests are:
- ◆ electricity generation – through its subsidiary London Power Company plc, LEG has interests in three UK businesses involved in power generation (Sutton Bridge Power Limited, Jade Power Generation Limited and a 13.475 per cent stake in Barking Power Limited). LEG currently has a 4.4 per cent share of capacity in the England and Wales generation market<sup>3</sup>. LEG's share of output in 2000/2001 was about 4.52 per cent<sup>4</sup>.

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<sup>2</sup> EdF acquired control of EdF UK Limited following a decision of the European Commission in 1999 to grant merger clearance.

<sup>3</sup> The market share, capacity and output figures in this document exclude the French interconnector. However, in assessing whether the proposed transaction is likely to raise any competition concerns, Ofgem intends to take into account capacity that may be available to EdF through the French interconnector.

In the event that this acquisition is completed, LEG's share of generation in England and Wales would increase to around 7.4 per cent of capacity and around 5.9 per cent of output<sup>5</sup>.

- ◆ electricity distribution - through its subsidiary London Power Networks plc (LPN), LEG owns the principal electricity distribution network in the London metropolitan area, to which 2.3 million customers are connected. With TXU Europe Group plc, LEG has a 50:50 joint venture, 24Seven Utility Services Limited (24Seven), which provides utility network asset management services to a number of distribution network owners, including London Power Networks plc and Eastern Electricity Limited, in the UK<sup>6</sup>. The European Commission cleared the formation of the joint venture in February 2000. However, as stated above, LEG has recently agreed, subject to clearance by the European Commission, to acquire from TXU Europe Group plc both Eastern Electricity Limited and its 50 per cent share of 24Seven. LEG also operates a number of private distribution networks;
- ◆ electricity and gas supply – LEG also owns London Electricity plc (LE), which is an electricity and gas supplier operating principally in England and Wales, and which owns SWEB Limited, the electricity supply business acquired from South Western Electricity plc in September 1999, following a decision of the European Commission in July 1999 to grant merger clearance. LEG also has a 75 per cent interest in Virgin Energy Limited, the other 25 per cent of which is owned by the Virgin Group. LE supplies energy to 3.3 million customers in Great Britain. LE has 3.0 million retail electricity customers in Great Britain, giving it a 10.4 per

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<sup>4</sup> Or approximately a 3.9 per cent share of capacity and approximately a 3.8 per cent share of output in the Great Britain market.

<sup>5</sup> This would represent approximately a 6.6 per cent share of capacity and approximately a 5.3 per cent share of output in the Great Britain market.

<sup>6</sup> 24Seven is managed by a board comprising two directors from each parent company and an independent Chairman. 24Seven controls the assets previously employed by each distribution company in maintaining, managing and operating its distribution networks, including equipment, IT systems, staff and leases of property and vehicles. 24Seven provides the security and safety of supply enquiry service and new connections for both distribution companies. There are separate, different fixed term contracts between each distribution company and 24Seven.

cent share of the market, and 0.3 million retail gas customers in Great Britain, giving it a 1.6 per cent market share.

- 4.4 EdF Trading Limited, EdF's joint venture with Louis Dreyfus, is involved in the trading of electricity in Great Britain and is a participant in the electricity balancing mechanism.
- 4.5 LEG, through ECS Metering Services Limited, carries out the majority of metering and meter reading work in the London area. LEG's proposed acquisition of Eastern Electricity Limited includes the acquisition of meters belonging to the Eastern distribution business, but not the acquisition of any metering or meter reading business.
- 4.6 24Seven also carries out electricity connections work and has a market share of around 17 per cent in Great Britain. 24Seven carried out the vast majority of connections undertaken across the distribution areas of LPN and Eastern in 2000/2001.

#### ***TXU Europe Group plc***

- 4.7 As stated above, Hood 2 is a wholly owned subsidiary of TXU Europe Group plc (TXU Europe). Hood 2 has two subsidiaries, TXU Europe (Hood) Limited ("Hood 1"), which owns the property and fixed assets of West Burton power station, and TXU Europe (West Burton) Limited ("Hood WB"), which holds a licence to operate West Burton power station.
- 4.8 TXU Europe is a wholly owned subsidiary of TXU Corporation, an investor-owned holding company headquartered in Dallas, Texas. The principal activities of the TXU Corporation are the provision of services in the gas and electricity sectors, energy trading, energy marketing and telecommunications. These activities are carried by subsidiaries primarily in the United States, Europe and Australia.
- 4.9 TXU Europe, whose principal business is the generation and distribution of electricity, energy trading and gas marketing, carries out TXU Corporation's European activities. TXU Europe operates primarily in the UK, where it has interests in power stations and two electricity supply businesses, but is also active in continental Europe, where it has generation plant, holdings in energy



supply and retail companies, energy trading licences and trading and retail joint ventures.

#### 4.10 TXU Europe's principal businesses in Great Britain include

- ◆ electricity generation, through TXU Europe Power, which owns (either outright or in part) five<sup>7</sup> 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 Europe Power has a total capacity of 5,061 MW. Following the recent sale of King's Lynn and Peterborough power stations to Centrica, TXU Europe Power's share of the England and Wales generation market is approximately 7.5 per cent by capacity and 5.1 per cent by output for the financial year 2000/2001<sup>8</sup>. If the proposed sale of West Burton power station is completed, TXU Europe Power's market share will fall to 4.5 per cent of capacity, with an adjusted output share of 3.4 per cent for the financial year 2000/2001<sup>9</sup>;
- ◆ gas shipping, through its subsidiary TXU Europe Energy Ltd;
- ◆ electricity distribution - Eastern holds a licence to distribute electricity in Great Britain. Its distribution service area comprises Norfolk, Suffolk and Hertfordshire, most of Bedfordshire, Essex and Cambridgeshire, parts of Oxfordshire and Buckinghamshire and the northern suburbs of Greater London. 3.4 million customers are connected to this network. As stated above, TXU Europe also has a 50 per cent share in 24Seven;
- ◆ gas shipping, through its subsidiary TXU Europe Energy Ltd;
- ◆ electricity supply, through TXU Energi (previously Eastern Energy and Norweb Energi), currently supplying about 4.4 million electricity customers in total (which represents 15.4 per cent of the market); and

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<sup>7</sup> A sixth station, the 1046 MW coal plant, Rugeley B, is currently in the final stages of divestment to International Power plc.

<sup>8</sup> Or approximately a 6.7 per cent share of capacity and approximately a 4.5 per cent share of output in the Great Britain market.

<sup>9</sup> This would represent around a 4.0 per cent share of capacity and around a 3.1 per cent share of output in the Great Britain market.

- ◆ gas supply, through wholly owned subsidiaries including Norweb Gas and Eastern Natural Gas (Retail) Ltd, currently supplying 1.2 million gas customers in total (which represents 5.6 per cent of the market).

4.11 TXU Europe also has a subsidiary, TXU Europe Energy Trading, which is involved in the sale and purchase of electricity and gas in the wholesale and forward markets. TXU Europe Energy Trading is one of the largest energy traders in the UK. In 2000 it traded 308TWh of electricity and 1,489TWh of gas in the UK.

### ***West Burton power station***

4.12 West Burton is a coal-fired power station near Retford in Nottinghamshire, England, which was commissioned in 1967. West Burton has a generation capacity of 2012 MW.

4.13 During the financial year 2000/01 (up to and including 26 March 2001), West Burton produced 4.84 TWh of electricity<sup>10</sup>, representing 1.6 per cent of generation output in England and Wales<sup>11</sup>.

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<sup>10</sup> The corresponding figure for the financial year 1999/2000 was 6.87 TWh, or 2.3 per cent of total system output.

<sup>11</sup> Or around 1.5 per cent of generation output in Great Britain.

## 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 Hood 2 (ie. West Burton power station) by LEG 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 LEG, through LPC, has interests in three UK businesses involved in power generation with a total capacity of 2,946 MW. This represents 4.4 per cent of the England and Wales market. Given that total installed capacity in England and Wales is 67.4 GW, West Burton accounts for about 2.13 per cent of total capacity<sup>12</sup>.
- 5.6 In the event that the proposed transaction is completed, LEG's total generation capacity would rise to 4,958 MW, or around 7.4 per cent of the England and

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<sup>12</sup> Or around 2.7 per cent of generation capacity in Great Britain.

Wales generation market, and TXU Europe's share would fall from 7.5 per cent to 4.5 per cent<sup>13</sup>.

- 5.7 Ofgem would welcome views on whether any competition concerns are raised by the proposed transaction.

***Vertical integration (restriction on use of own generation capacity)***

- 5.8 Under the proposed transaction, ownership of generation plant is effectively being transferred from one vertically integrated company to another. 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 This may raise concerns about reduced liquidity in electricity trading. In the supply licences of the former Public Electricity Suppliers 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.
- 5.10 The self-supply condition is present in the licences of London Energy Company Limited and of SWEB Limited, and it applies to the sale of electricity only to former designated<sup>14</sup> customers in the supply service areas of those licensees. The condition would apply to the generation output of West Burton power station if the transaction were cleared.

***Sulphur oxide (SOx) emissions limits***

- 5.11 Ofgem is concerned to ensure that after the transfer of ownership, any arrangements with regard to sulphur emissions limits for the LEG and TXU Europe coal generation portfolios do not have a significant adverse effect on competition in the wholesale electricity market. Ofgem may need to discuss with LEG, TXU Europe and the Environment Agency the extent to which the

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<sup>13</sup> Or, respectively, around 6.7 per cent and 4.0 per cent of generation capacity in Great Britain.

<sup>14</sup> 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.

arrangements that the parties are considering applying to the Environment Agency to enter into, are consistent with this objective.

***Fuel supply contract***

- 5.12 The proposed transaction will also include a coal supply contract to the power station. 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. Our initial view is that, as with similar transactions, such an agreement is not ancillary to the acquisition and that Ofgem should retain the ability to take appropriate action under the Competition Act 1998 if the agreement were to have any anti-competitive effects. Views are welcome on this issue.

## 6. Conclusion

- 6.1 Ofgem is seeking views of interested parties on the proposed acquisition 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. 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 In order to meet the timetable laid down in the Merger Regulations, Ofgem requires comments (preferably by email) from interested parties not later than 5pm on 28 November. Comments should be sent to:

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