

January 2002

**British Gas Trading Limited's
acquisition of the gas and
electricity supply businesses of
Enron Direct Limited**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the acquisition by British Gas Trading Limited (BGT) of Enron Direct Limited's (EDL) gas and electricity customers and certain of its assets;
- ◆ explains the merger control process for this transaction; and
- ◆ invites comments on the regulatory issues arising from the 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 Friday 1 February 2002.

2. Details of the acquisition

- 2.1 EDL is a subsidiary of Enron Europe Limited (Enron Europe) which is itself a subsidiary of Enron Corporation, the US parent company. EDL holds an electricity supply licence, a gas supply licence and a gas shipper licence and is licensed to supply electricity and gas to domestic and non-domestic (I&C) customers¹. In addition, EDL has a number of agreements with third party selling agents for the supply of electricity to customers. These agents are Cambridge Gas Company Limited, Crown Oil Limited, Telecom Plus plc, Energy Supplies (UK) Limited and North Wales Energy. The customers supplied under these agreements are predominantly domestic customers.
- 2.2 Enron Europe and other Enron subsidiaries went into administration on 29 November 2001 and PricewaterhouseCoopers (PwC) were appointed as administrators for the company. On 4 December 2001, shortly after EDL went into administration², BGT, a wholly owned subsidiary of Centrica plc (Centrica), entered into an agreement with PwC and EDL to acquire EDL's gas and electricity supply customers and certain of its assets, including its agency contracts with Cambridge Gas Company, Crown Oil Limited, Telecom Plus plc, Energy Supplies UK Limited and North Wales Energy³. The transaction was completed on 4 December 2001.
- 2.3 On 16 January 2002, BGT 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.

¹ A domestic customer is defined in Standard Licence Condition 1 (Interpretation) of the standard licence conditions for electricity suppliers and the standard licence conditions for gas suppliers which were introduced on 1 October 2001 under the Utilities Act 2000. Non-domestic customers are those customers that do not fall within the definition of 'domestic customer'.

² EDL went into administration on 4 December 2001, prior to this transaction.

³ BGT did not acquire EDL itself which remained a wholly owned subsidiary of Enron Europe.

3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the value of the EDL supply business 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. 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 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 advise that in lieu of such a reference 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 will operate, or is likely to operate, against the public interest. If the Competition Commission concludes that the transaction is not expected to operate against the public interest, the Secretary of State has no power to prevent the transaction. 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 exercise these powers.
- 3.4 In advising the OFT, Ofgem considers what modifications might be needed to the licences held by the parties and whether any assurances might be necessary should the merger proceed.

4. Details of the parties

*EDL*⁴

4.1 EDL began trading in 1996 and at the time of this acquisition EDL's principal businesses were:

- ◆ **electricity supply** - a national electricity supply business supplying approximately 149,000 non-domestic sites⁵. These customers appear mainly to be smaller scale I&C customers rather than large scale industrial users and the average contract duration for these I&C customers is 5 years. In addition, Cambridge Gas Company Limited, Crown Oil Limited, Telecom Plus plc, Energy Supplies (UK) Limited and North Wales Energy have contracts with EDL to act as third party selling agents for EDL for the supply of electricity to customers. The agents have responsibility for all customer facing activity, including the setting of retail prices and billing. These agents supply approximately 34,000 domestic customers and 2,000 I&C customers;
- ◆ **electricity and gas trading** – electricity trading through NETA;
- ◆ **gas supply** – a national gas supply business, supplying approximately 12,000 I&C gas sites. EDL did not, as a rule, supply gas to domestic customers. However, it is Ofgem's understanding that a small number of EDL's gas supply sites are domestic sites which are being supplied through multi-site contracts as provided for by standard condition 35 (Supply to chains of business premises) of the gas supply standard licence conditions that were in force prior to 1 October 2001. From 1 October 2001 domestic sites cannot be supplied on a I&C contract in this way. However, Standard Licence Condition 22 (Domestic Premises) of the standard licence conditions for gas suppliers which came into effect on 1 October 2001 puts in place transitional arrangements for multi-site contracts which were in

⁴ The customer numbers and data on the domestic and I&C gas and electricity sectors set out in this document has been provided by BGT and is based upon meter points.

⁵ Some I&C customers may have multi-site contracts and so reference is made to sites as it would not be correct to refer to each of these sites as a customer. This is the case in both electricity and gas and this approach is adopted throughout this paper.

effect prior to 1 October 2001. It is Ofgem's understanding that any domestic gas customers supplied by EDL are supplied on this basis; and

- ◆ **shipper** - EDL holds a gas shipper licence. EDL did not ship gas for any other gas supplier.

4.2 EDL's supply business has approximately 2.5%⁶ of the supply of electricity to I&C sites in Great Britain (GB) by volume (3.8% by number of sites). EDL supplies, through the agency contracts referred to at paragraph 4.1 above, 0.14% of the total domestic electricity customers in GB (by customer number) and 0.09% of the total I&C electricity sites in GB (by number of sites).

4.3 EDL has a much smaller share of the gas market, supplying 0.87%⁷ of gas to I&C sites in GB by volume (1.6% by number of sites). EDL does not supply gas to domestic customers, other than a small number supplied under multi-site contracts (please see paragraph 4.1).

BGT

4.4 BGT is a wholly owned subsidiary of Centrica which was formed in 1997 by the demerger of British Gas plc. Centrica is a customer services company with significant energy interests (both GB and international) and is also involved in telecoms. Centrica owns the AA and provides various financial services through its brand Goldfish. Centrica's principal energy businesses (excluding BGT) 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. For 2000, Centrica was the sixth largest holder of gas production assets by recoverable reserves (3000bn

⁶ As explained previously the data used in preparing this document was supplied by BGT. Alternative calculations by Ofgem based upon Meter Point Administration Numbers (MPANs) in electricity suggest that these percentage figures may in some cases overstate EDL's position.

⁷ As explained previously the data used in preparing this document was supplied by BGT. Alternative calculations by Ofgem based upon Meter Point Reference Numbers (Meter Points) in gas suggest that these percentage figures may in some cases overstate EDL's position.

cubic feet) on the UKCS, and with 12% (436 bn cubic feet) of production it was the third largest producer. 91% of Centrica's production comes from the Morecombe Bay gas fields. 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 its wholly owned subsidiary Accord Energy, which is involved in the sale and purchase of electricity and gas in the wholesale and forward markets;
- ◆ **gas shipping** - Accord Energy Ltd and BGT flow about 40% of all gas going through the National Transmission System;
- ◆ **electricity supply** - through Accord Energy Ltd, which holds an I&C electricity supply licence;
- ◆ **electricity generation** – ownership of: Kings Lynn power station, a 350MW combined coal and gas turbine power station; Peterborough power station, a 405MW combined coal and gas turbine power station; and a 60% share in Humber Power Limited, which has 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; and
- ◆ **retailing of central heating equipment and maintenance services** – offering a range of central heating products and a maintenance service for domestic central heating systems and appliances.

4.5 BGT's⁸ principal activities include:

- ◆ **electricity supply** – a national electricity supply business supplying approximately 155,000 I&C sites and 5.4 million domestic electricity customers;

⁸ The customer numbers and data on the supply of customers to the domestic and I&C electricity sector and the non-domestic gas sector set out in this document was provided by BGT following its acquisition of EDL and is based upon meter points.

- ◆ **electricity and gas trading** – BGT is involved in the sale and purchase of electricity and gas in the wholesale and forward markets
- ◆ **gas supply** – a national gas supply business, supplying approximately 316,000 I&C sites and 13.8 million domestic gas customers. BGT also supplies gas to combined cycle gas turbine plants, its share of this market is approximately 20%; and
- ◆ **gas shipper** – BGT holds a gas shipper licence.

4.6 BGT supplies 1.06%⁹ of electricity to I&C sites in GB by volume (and 3.9% by number of sites). Following its acquisition of EDL, BGT supplies 3.5% of electricity to I&C sites in GB by volume (and 7.7% by number of sites). BGT has also acquired agency contracts whereby it supplies electricity to around 34,000 domestic customers and 2,000 I&C sites through third parties. These third parties are responsible for all customer facing activity including the setting of retail prices and billing. Traditionally these customers have been counted as customers of EDL's rather than customers of the agent and as such should be considered in assessing how BGT's position is altered by this acquisition.

4.7 BGT supplies 12.2%¹⁰ of gas to I&C sites in GB by volume (42.1% by customer number). BGT's share of the I&C sector increases to 13.07% by volume and 43.5% by customer number as a result of this acquisition. BGT supplies around 67% of domestic gas customers in GB. EDL did not supply domestic gas customers. However, some domestic customers are supplied under multi-site contracts in accordance with Standard Licence Conditions 22 (Domestic Premises) of the standard licence conditions for gas suppliers (as discussed in paragraph 4.1). As these customers are removed from such multi-site contracts (on the expiration or termination of the contract) in accordance with SLC 22 they will need to be classed as domestic gas customers and counted accordingly. This may result in some increase in BGT's customer base, if these customers choose to remain with BGT on the expiration/termination of their contract.

⁹ As explained previously the data used in preparing this document was supplied by BGT. Alternative calculations by Ofgem based upon MPANs in electricity suggest that these percentage figures may in some cases overstate EDL's position.

¹⁰ As explained previously the data used in preparing this document was supplied by BGT. Alternative calculations by Ofgem based upon Meter Points in gas suggest that these percentage figures may in some cases overstate EDL's position.

5. Issues arising from the acquisition

Competition in supply

- 5.1 In November 2001 Ofgem published its review of domestic gas and electricity competition¹¹. Ofgem considered a range of factors: customers' experiences; customer switching behaviour; market shares; price and non-price offers; entry and exit of suppliers; and barriers to entry. The review indicated¹² that domestic competition is well established and is continuing to develop well.
- 5.2 In its December 2000 review of competition in the domestic gas and electricity supply market¹³ Ofgem explained how it would evaluate the effect of mergers and acquisitions on supply competition. Ofgem explained that it seeks to balance the prospect that consolidations will reduce costs per customer, through increased scale and the joint provision of related products, against the possibility that these benefits will not reach customers in the form of lower prices and/or innovation, because of reduced rivalry following the consolidation. Ofgem explained that it would seek to balance these considerations.
- 5.3 Ofgem most recent assessments of the state of competition within the I&C electricity and gas sectors took place in December 2000 and August 2000 respectively¹⁴. In those assessments Ofgem considered a range of factors in considering the state of competition in the I&C electricity and gas sectors: the extent of entry and exit by suppliers; suppliers' performance, including their market shares; price offers, customer switching behaviour and how customer choices reflect changes in suppliers' offers; and barriers to entry. Following these assessments Ofgem concluded¹⁵ that competition in the I&C supply sectors is developing well.

¹¹ "Review of domestic gas and electricity competition and supply price regulation: Evidence and initial proposals" November 2001.

¹² For a full account of Ofgem's review and its conclusions on domestic electricity and gas competition please see the document cited at footnote 11 which is available on the Ofgem website.

¹³ "A review of the development of competition in domestic gas and electricity supply", Ofgem, December 2000.

¹⁴ "A review of the development of competition in the Industrial and Commercial electricity supply", Ofgem, December 2000; and " A review of the development of competition in the industrial and commercial gas supply market", Ofgem, August 2000.

¹⁵ For a full account of Ofgem's review and its conclusions on the I&C electricity and gas sectors please see the documents cited at footnote 14 which are available on the Ofgem website.

- 5.4 As a result of this transaction BGT has increased its share in the I&C electricity supply sector and in the I&C gas supply sector, with a total share of the I&C electricity sector of 3.5% by volume and a total share of the I&C gas sector of 13% by volume. EDL's I&C electricity customers appear mainly to be smaller scale I&C customers rather than large scale industrial users and the average contract duration for I&C customers is 5 years
- 5.5 There are currently 40 active I&C electricity suppliers and 12 active domestic electricity suppliers. There are 80 suppliers active in the I&C gas supply sector and 14 active domestic gas suppliers.
- 5.6 The acquisition has had relatively little impact on BGT's share of gas supplied to I&C sites, increasing it by just under 1% to 13% in terms of volume. The increase in terms of the number of sites represents a rise of about 1.5% to 44%.
- 5.7 The transaction on the I&C electricity sector increases BGT's share of electricity supplied to the I&C sector by 2.5% to 3.5% in terms of volume. In relation to the number of sites supplied this represents around a 4% increase in BGT's share of the I&C electricity sector from 4% to just under 8%. This represents a market share comparable with other suppliers in this sector.
- 5.8 In relation to the domestic electricity sector, BGT currently supplies 22% of domestic electricity customers. Cambridge Gas Company Limited, Crown Oil Limited, Telecom Plus plc, Energy Supplies UK Limited and North Wales Energy together account for 0.14% of the domestic electricity sector (by customer number), which represents a nominal increase in BGT's position from 22% to 22.15%.
- 5.9 One result of this acquisition is to remove an active supplier from the I&C electricity supply sector and the I&C gas supply sector. It is not necessarily the case that such a reduction will reduce competitive pressures in either market, although it will be a factor to consider. EDL's wish to expedite the sale would most likely have been achieved (in this instance) through sale to an existing electricity or gas supplier. Such an expeditious sale could help to safeguard directly the interests of EDL's customer base.

- 5.10 The increase in the size of BGT's supply business following the acquisition may, although the numbers concerned are relatively small, assist BGT in allowing it to achieve economies of scale in its operations, although it is likely that any cost savings resulting from the merger will only be passed on to customers if competitive pressures are strong enough.
- 5.11 Ofgem would welcome views on the impact of BGT's acquisition of EDL's supply business on competition in gas and electricity supply and in particular on I&C supply. Ofgem's initial view is that looking at BGT's position as a result of this acquisition combined with the level of competition present in the electricity and gas supply sectors, this acquisition does not appear to raise any significant competition concerns.

Vertical Integration

- 5.12 Ofgem recognises the benefits of integration but believes that the market must be sufficiently competitive to mitigate against the possible negative effects associated with integration. Companies with market power in one or more activities may seek to leverage market power in one activity to distort competition in another. The extent to which this can be achieved depends upon the levels of competition in the areas in which they operate. Ofgem would welcome views on any vertical integration issues arising from this transaction, including whether any safeguards through licence modifications or assurances might be necessary.

6. Conclusion

- 6.1 In this document Ofgem is seeking the views of interested parties on the acquisition of EDL's supply business by BGT, so that it may make recommendations to the DGFT.
- 6.2 Responses will normally be made available in the Ofgem library and on the Ofgem website unless respondents request that they should remain confidential. Respondents should mark any part of their response (or the 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 acquisition should be sent, by 5pm on Friday 1 February 2002, to:

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