

April 2002

**RWE Group's proposed acquisition
of Innogy Holdings plc**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- gives details of the proposed acquisition of Innogy Holdings plc (Innogy) by RWE Aktiengesellschaft, the ultimate parent company of the RWE Group (RWE);
- explains the merger control process for the proposed transaction; and
- invites comments on any issues arising from the proposed transaction.

1.2 Ofgem will make recommendations to the Director General of Fair Trading (DGFT) in relation to the proposed acquisition. The DGFT may make recommendations to the European Commission. In order to allow comments to be considered, Ofgem must receive all comments no later than **2pm on Monday 22 April 2002**.

2. Details of the acquisition

- 2.1 RWE is a German based multi-utility whose areas of activity include energy, water and waste management and environmental services. In the UK, RWE owns Thames Water plc, the appointed water and sewerage undertaker for an area comprising most of metropolitan London and the Home Counties, and is currently in the process of acquiring other water and energy businesses outside Germany. RWE is currently active in the GB gas shipping industry and holds non-domestic electricity and gas supply licences for GB.
- 2.2 Innogy is one of the largest electricity generators in GB and through its npower brand is one of the largest gas and electricity suppliers in GB, supplying both domestic and non-domestic customers. Innogy is also active in gas shipping, electricity and gas trading and in the development of electricity storage technology.
- 2.3 On 22 March 2002, RWE announced a public offer for the acquisition of Innogy for an overall value of over £5 billion (including over £2 billion net debt). The proposed transaction, was notified to the European Commission on 12 April 2002.

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 European Commission with a view to establishing whether or not it is compatible with the common market. Because of the parties' combined world-wide and EC turnover, the proposed acquisition of Innogy 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.
- 3.5 The European Commission, in considering the proposed acquisition, will consult with the national competition authorities. The relevant authorities for the UK are the Secretary of State for Trade and Industry and the DGFT. The DGFT will inform the European Commission of any competition concerns that the proposed acquisition may raise for the UK and in preparing his advice in relation to proposed acquisitions within the energy sector will consult with Ofgem.

4. Details of the parties

Innogy

4.1 Innogy was established to hold the GB assets of the former National Power plc, from which it was demerged in 2000. Its principal businesses are:

- ◆ **electricity generation** - the operation of seven wholly owned major power stations (and 3 minor ones) in the UK, with total generation capacity of 8,703MW;
- ◆ **electricity supply** - a national electricity supply business supplying, through wholly owned subsidiaries including Npower Yorkshire Limited and Npower Limited, approximately 4.3 million domestic electricity customers and almost 400,000 non-domestic customers (by number of meter points). Innogy's supply business includes the ex-PES supply businesses of the Midlands, Yorkshire and Northern areas and the former second-tier supply business of Independent Energy plc;
- ◆ **electricity and gas trading** – Innogy is involved in the sale and purchase of electricity and gas in the wholesale and forward markets and is one of the largest players in the sector;
- ◆ **gas supply** – Innogy has a national gas supply business which includes the former gas supply businesses of Calortex Limited and Independent Energy (principally York Gas). Innogy supplies, through wholly owned subsidiaries including Npower Gas Limited, Npower Yorkshire Limited and Npower Direct Limited approximately 1.8 million domestic gas customers and 30,000 non-domestic gas customers (by number of meter points);
- ◆ **gas shipper** - Innogy holds a number of gas shipper licences, through wholly owned subsidiaries, including Npower Gas Limited, Yorkshire Energy Limited and Npower Northern Limited. In 2001/02 Innogy accounted for around 5.2% of total gas shipped through the system; and
- ◆ **metering services** – electricity metering services business, providing data aggregation, data processing, data collection and meter operation services

in the ex-PES areas of Yorkshire and Northern¹. Innogy also provides metering services for gas and water businesses².

- 4.2 Innogy's total generation capacity in GB for 2001 was 8,703MW (the same figure applies for England and Wales as Innogy has no generation plant in Scotland), which represents 11.1% of total installed GB capacity (12.8% of total England and Wales capacity). In 2001/02, Innogy's generation output was around 24.7TWh which represents 7% of total GB output for the period (8% of total England and Wales output);
- 4.3 As at January 2002, Innogy's electricity supply business supplied 16.9% of domestic electricity customers (by number of meter points) and 17.9% of non-domestic electricity customers (by number of meter points). In relation to volumes of electricity supplied to customers, in 2000/01 Innogy accounted for around 16.7% of electricity supplied to domestic customers.
- 4.4 In relation to gas supply, Innogy supplied, as at April 2002, 8.8% of domestic gas customers (by number of meter points) and 8.2% of non-domestic gas customers (by number of meter points). In relation to volumes of gas supplied to customers, in 2000 Innogy accounted for 8.9% of gas supplied to domestic gas customers and 8.2% of gas supplied to non-domestic customers.

RWE

- 4.5 RWE is a German based energy company involved primarily in energy, water and waste management and environmental services. RWE's energy business is extensive and includes numerous interests in continental Europe and further interests in the United States (US).
- 4.6 RWE is active in electricity distribution, electricity supply, electricity generation, electricity transmission, gas supply, gas transportation and gas exploration and production. RWE is one of the largest electricity and gas suppliers in continental Europe and is also involved in electricity and gas trading on the wholesale and forward markets.

¹ The physical meters remain the assets of the ex-PES distribution businesses.

² Innogy currently provides metering services to one water company. This company is not Thames Water.

4.7 In addition RWE, which is one of the largest water and wastewater utilities in the world, owns Thames Water in GB and is in the process of acquiring American Water in the US.

4.8 In the GB energy sector RWE's activities are as follows:

- **electricity generation** – through its ownership of Thames Water, RWE holds 59.3MW of generation assets. It supplies electricity to Thames Water and sells electricity on the wholesale market. Thames Water's total generation output for 2001/02 was 0.17TWh which represents 0.06% of England and Wales total output during the period. Thames Water is an exempt generator³;
- **electricity supply** – through its wholly owned subsidiary RWE Trading Direct Limited which holds a non-domestic electricity supply licence. RWE Trading Direct Limited has only recently begun to supply electricity to customers;
- **gas trading** – RWE is involved in the sale and purchase of gas in the wholesale and forward markets;
- **gas supply** – through its wholly owned subsidiary RWE Trading GmbH, RWE holds a non-domestic gas supply licence. RWE Trading GmbH does not currently supply gas to customers within GB;
- **gas shipper** – through its wholly owned subsidiary RWE Trading GmbH. In 2001/02 RWE accounted for less than 0.001% of total gas shipped through the system.

4.9 At present, RWE is not active in the supply of gas in GB (although it does hold a non-domestic gas supply licence) and has only recently begun to supply electricity to non-domestic customers. The combined position of RWE and Innogy would be equivalent to Innogy's current position.

4.10 In 2001/02, RWE's GB gas shipping activity accounted for only 0.001% of total throughput and Innogy accounted for 5.2%. The combined position of RWE and Innogy would also account for 5.2% of total GB throughput.

5. Issues arising from the acquisition

Competition within the GB energy sector

- 5.1 Competition within the GB energy sector has generally developed well and is continuing to develop. The gas and electricity supply sectors were fully opened up to competition in 1998 and 1999 respectively and there are currently 10 suppliers active in the domestic electricity supply sector (20 non-domestic suppliers) and 11 active suppliers in the domestic gas supply sector (14 non-domestic suppliers). The National Audit Office (NAO) stated in 1999 in relation to gas and 2000 in relation to electricity⁴ that the introduction of competition in electricity and gas supply has brought estimated annual savings for customers of £1 billion in gas and £300 million in electricity. Competition within the electricity generation sector has also developed well in general with 36 generators currently active within the electricity generation sector.
- 5.2 In examining proposed mergers, acquisitions or other comparable transactions it is important to consider what effect the proposed transaction may have on the level of competition present within any relevant part of the GB energy sector.
- 5.3 In particular a merger or acquisition might raise concerns for Ofgem when the purchaser and the companies that it is acquiring have overlapping activities within GB as the overall level of competition within a particular sector may be reduced if two companies combine.
- 5.4 RWE's proposed acquisition does not appear to raise any concerns in any of the relevant sectors, being those sectors in which some overlap occurs:
- electricity generation – Thames Water's total generation output for 2001/02 was 0.17TWh, representing less than 0.06% of GB total generation output during the period. Innogy's total installed generation capacity is 8703MW and in 2001/02 Innogy's output of 24.7TWh accounted for 7% of total GB output for the period;

³ The Electricity (Class Exemptions from the Requirement for a Licence) Order 2001.

⁴ 'Office of Gas and Electricity Markets: Giving Customers a Choice – the Introduction of Competition within the Domestic Gas Market' NAO publication May 1999 and 'Office of Gas and Electricity Markets: Giving Customers a Choice of Electricity Supplier' NAO publication January 2001.

- electricity supply - RWE has only recently begun to supply electricity to non-domestic customers. The combined position of RWE and Innogy would be equivalent to Innogy's current position, supplying 16.9% of domestic electricity customers and 17.9% of non-domestic electricity customers (by number of meter points);
- gas supply - at present RWE is not active in the supply of gas (although it does hold a non-domestic gas supply licence). As such the combined position of RWE and Innogy would be equivalent to Innogy's current position, supplying 8.8% of domestic gas customers and 8.2% of non-domestic gas customers (by number of meter points); and
- gas shipping - in 2001/02, RWE's gas shipping activity accounted for only 0.001% of total throughput. Innogy accounted for 5.2% within the same period. The combined position of RWE and Innogy would be equivalent to Innogy's current position, accounting for 5.2% of total throughput.

5.5 Ofgem considers that competition in electricity generation, electricity supply, gas supply and gas shipping is generally well developed and that it is continuing to develop⁵. RWE's activity within each of these areas of activity is very small, and in relation to gas supply does not actually exist at this time (although as a gas supply licence holder RWE does have the potential to become active within the sector). The small consolidation that will arise from combining RWE and Innogy's GB operations does not appear to alter the position in any of the above sectors to any notable extent.

5.6 In both the gas and electricity sectors there are increasingly close links between the British and continental European markets. There is active price arbitrage and increasing interactions between British and continental European gas and electricity markets as a result of the physical links between the markets through the Bacton-Zeebrugge gas interconnector and the England-France electricity interconnector.

⁵ 'A review of the development of competition in the Industrial and Commercial gas supply market' Ofgem August 2002; 'A review of the development of competition in the Industrial and Commercial electricity supply market' Ofgem December 2000; and 'Review of domestic gas and electricity competition and supply price regulation: initial proposals' Ofgem November 2001.

- 5.7 Ofgem would welcome views on whether the proposed acquisition raises issues with respect to competition in the GB and European energy markets.

Vertical Integration

- 5.8 Innogy is a vertically integrated business that is active in both electricity generation and electricity supply, accounting for 7% of total GB output in 2001/02. RWE, through its ownership of Thames Water, accounted for less than 0.06% of total GB generation output in 2001/02. Given RWE's existing generation assets within GB (through Thames Water) the proposed acquisition of Innogy represents a small increase in the vertically integrated position of RWE as a result of the proposed acquisition.
- 5.9 RWE has some gas exploration and production interests, including some North Sea interests. RWE's activities are estimated to account for less than 0.5% of EEA (European Economic Area) natural gas production. Innogy's generation assets include gas fired plant and in addition Innogy supplies gas to domestic and non-domestic customers in GB. As such RWE will have a vertically integrated position in gas as a result of the proposed acquisition.
- 5.10 Ofgem would welcome views on any vertical integration issues arising from the proposed transaction.

Metering services

- 5.11 In relation to electricity metering services, Innogy provides a full range of metering services – data processing; data aggregation, data collection and meter operation services in relation to the ex-PES supply businesses of the Northern and Yorkshire areas. Innogy also provides metering services for gas and water businesses⁶.
- 5.12 RWE owns Thames Water, the appointed water and sewerage undertaker for most of metropolitan London and the Home Counties. Thames Water provides metering services in relation to water customers within its appointed area.

⁶ As mentioned above Innogy currently provides metering services to one water company. That company is not Thames Water.

5.13 Ofgem would welcome any views on whether the proposed acquisition raises any issues in relation to the provision of metering services.

Views

5.14 Ofgem would welcome any comments on the issues raised in this paper, in particular in relation to competition within the GB and European energy sectors, vertical integration and metering services. Comments are also welcome on any other issues affecting whether or not the proposed transaction should be allowed to proceed.

6. Conclusion

- 6.1 In this document Ofgem is seeking the views of interested parties on the acquisition of Innogy by RWE, so that it may inform any submissions made by the DGFT to the European Commission.
- 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 In order for Ofgem to meet the timetable laid down in the European Merger Regulations, comments on the acquisition should be sent, to arrive no later than **2pm on Monday 22 April 2002**, to:

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