

**Powergen's undertaking to the Secretary of
State for Trade and Industry not to purchase
Midland's Electricity plc**

A consultation paper

September 2002

Table of contents

1. Introduction.....	1
2. The Issues	2
3. Conclusion.....	4

1. Introduction

- 1.1. In 1996 the then Secretary of State for Trade and Industry decided that Powergen should not be allowed to purchase Midlands Electricity plc (MEB), because he took the view that the acquisition would have been detrimental to competition, given the then current state of the electricity market's development. As a result, Powergen gave an undertaking to the Secretary of State that it would not acquire or exercise material influence over MEB. Powergen has requested that it be released from its undertaking not to purchase MEB.
- 1.2. The Director General of Fair Trading has requested Ofgem's view, following the usual industry consultation, on whether the undertaking remains necessary, taking into account the changes that have taken place in the structure and regulation of the industry since 1996. The Director General of Fair Trading will then advise the Secretary of State as to whether Powergen should be released from its undertaking.
- 1.3. Ofgem is not aware, at this stage, of any bid for MEB having been made (or accepted). This consultation is not, therefore, seeking views on the issues that might be raised by a change in ownership of MEB. Any corporate transaction involving MEB, an electricity distribution business, would be subject to the merger control process in the normal way.
- 1.4. This paper describes Ofgem's initial view, on which interested parties are invited to comment. Comments must be received by 5 pm on Thursday 3 October 2002.

2. The Issues

- 2.1. At the time of the proposed acquisition of MEB by Powergen in 1996, the generation market was less competitive than is currently the case, and competition in retail supply markets was restricted to customers demanding more than 100kW.
- 2.2. Since 1996 important changes have taken place in the structure of the electricity industry. The generation market has become significantly less concentrated and more competitive, and the retail supply market is fully open to competition. Both of these changes are delivering considerable benefits to consumers. Reforms to the arrangements for wholesale electricity trading (NETA) have also increased the level of competition in the wholesale market, and have contributed to recent falls in wholesale prices.
- 2.3. At the time of Powergen's proposed purchase of MEB in 1996, MEB's main businesses were electricity distribution and retail electricity supply. In addition to these businesses, MEB also had interests in a number of generation assets. MEB's supply business was transferred to National Power (now Innogy) in 1998, and MEB's principal business is now that of electricity distribution. Since 1999 the holding company of the MEB distribution business has been owned by GPU and then FirstEnergy; 79.9% was sold to Aquila Inc in May 2002.
- 2.4. Since 1996, Powergen's position has also evolved. For example, its share of the electricity generation market has fallen considerably, in part as a result of an undertaking to divest generating plant given in the context of its acquisition of East Midlands Electricity in 1998.
- 2.5. Ofgem's view is that the present structure of the electricity industry is dramatically different from the structure in 1996, and that the position of both Powergen and MEB within the industry has considerably evolved since that time.
- 2.6. Any future corporate transaction involving MEB would be subject to merger control under either the Fair Trading Act 1973 or under the European Community Merger Regulation. Were any such transaction to be proposed, Ofgem would advise the Director General of Fair Trading on the possible

impacts of the transaction on regulation and competition in electricity and gas markets in Great Britain; this advice would be developed following consultation and would depend on the issues raised by the identities of the specific parties involved.

- 2.7. Ofgem is not aware of any other companies being subject to similar undertakings not to purchase MEB.
- 2.8. In light of the changes in industry structure that have taken place since 1996/7, Ofgem's initial conclusion is that there is no justification for the retention of an absolute prohibition on Powergen acquiring MEB, and that Powergen should, in future, be subject to exactly the same merger control process in respect of MEB as would any other party.

3. Conclusion

- 3.1. Ofgem is seeking comments from interested parties on whether Powergen's undertaking not to acquire or exercise material influence over MEB remains necessary, taking into account the changes that have taken place in the structure and regulation of the industry since 1996/7.
- 3.2. Ofgem's initial view is that Powergen should be released from its undertaking relating to MEB, and that Powergen should, in future, be subject to the same merger control process as any other potential purchaser. Were Powergen to be released from its undertaking and were it then subsequently to purchase MEB, the transaction would, in the first instance, be considered by the European Commission under the European Community Merger Regulation. In this case, Ofgem would, following consultation, advise the Director General of Fair Trading of any potentially adverse impacts on competition or on Ofgem's ability to regulate the gas and electricity sectors in Great Britain.
- 3.3. 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.
- 3.4. Comments should be sent, by 5pm on Thursday 3 October 2002, to:

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