

November 2001

**Utilicorp United Inc.'s and Deutsche
Bank AG's proposed acquisition of
FirstEnergy Corp.'s Avon Energy
Partners Holdings**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of Utilicorp United Inc.'s and Deutsche Bank AG's proposed acquisition of FirstEnergy Corp.'s Avon Energy Partners Holdings;
- ◆ 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 Office 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 6 December 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 Utilicorp United Inc ('Utilicorp') and Deutsche Bank AG ('DB') propose to acquire joint control of FirstEnergy Corp.'s ('First Energy') Avon Energy Partners Holdings ('AEPH').
- 2.2 AEPH is the holding company of Midlands Electricity plc ('Midlands'), which owns the electricity distribution network in western central England, and has an interest in the 1,875 MW Teesside power station. Amongst other interests, Midlands also has a metering services business and an electrical contracting business. Midlands trades under the name GPU Power UK.
- 2.3 On 18 October 2001 Utilicorp made an offer to FirstEnergy to purchase the entire issued share capital of AEPH from EI UK Holdings Inc., a subsidiary of GPU Inc. The offer was not capable of acceptance until FirstEnergy completed its merger with GPU Inc. On 25 October 2001 Utilicorp and DB entered into a binding arrangement in which DB agreed to purchase from Utilicorp a 50 per cent interest in UCU-UK, a specially created purchase vehicle which will hold the shares in AEPH. On 7 November 2001, following completion of the merger between First Energy and GPU Inc., FirstEnergy accepted the offer made by Utilicorp on 18 October 2001.
- 2.4 On 22 November 2001 Utilicorp and Deutsche Australia Limited (a subsidiary of DB) 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.

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. Because of the parties' combined world-wide and EC turnover, the proposed acquisition 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

Utilicorp

- 4.1 Utilicorp is an international energy and services company based in the United States (US). It owns seven utility distribution networks in the US and has interests in a number of other utility distribution businesses in Canada, Australia and New Zealand. Utilicorp also has a wholesale energy trading and marketing arm, Aquila Inc., which is active in the US, Canada, the United Kingdom (UK), Germany and Norway. The great majority of Utilicorp's European turnover is derived from wholesale gas trading, virtually of all of which occurs in the UK. Utilicorp also has interests relating to the building and support of broadband and telecommunications networks.
- 4.2 In the UK, Aquila is involved in the trading of gas and electricity in Great Britain. It also has a gas storage business that operates a salt cavern storage facility at Hole House, Cheshire, England. Hole House has a space capacity of 821 GWh and a current maximum daily deliverability capacity of 29.3 GWh/d.
- 4.3 Aquila also has three subsidiaries that are licensed both to ship and supply gas (Aquila Energy Limited, Aquila Energy Power and Light Limited, and Aquila Energy Trading Limited). In addition, Aquila Energy Storage Limited and Aquila Energy Supplies Limited are licensed to ship gas and Saracen Gas Limited is licensed to supply gas.

DB

- 4.4 Deutsche Australia Limited is a wholly owned indirect subsidiary of DB, which is a commercial bank with worldwide operations. DB will acquire joint control over AEPH through a non-bank subsidiary of Deutsche Australia Limited.
- 4.5 DB does not have any overlapping activities with either Utilicorp or Midlands within the UK.

AEPH

- 4.6 As stated above, AEPH is the holding company for Midlands. AEPH is a subsidiary of GPU Power UK, which is a wholly owned subsidiary of GPU

International. GPU Inc, which wholly owns GPU International, is a US-based company that, amongst other things, owns three electric utility subsidiaries in the US, owns electricity distribution networks in Argentina, and has electricity generation interests in Bolivia, Colombia, Pakistan, Turkey and the UK. GPU Inc recently merged with FirstEnergy. FirstEnergy is a US-based company that owns seven electric utility operating companies in the US, serving 4.3 million customers within 36,100 square miles of Ohio, Pennsylvania and New Jersey.

4.7 Midlands' principal activities in the UK are as follows:

- ◆ electricity distribution - GPU Power Networks (UK) plc is the licensed electricity distribution arm of Midlands, and operates the distribution network in the western central region of England to which 2.4 million customers are connected;
- ◆ electricity generation - Midlands Power International (MPI), a subsidiary of Midlands, manages investments in independent power projects in the UK and abroad. In May 2001 MPI disposed of its interests in the Humber power station to Centrica plc and TotalFinaElf. However, MPI still holds Midlands' 19.2 per cent direct interest in Teesside Power Limited, which operates the 1,875 MW Teesside gas-fired power station, and it also holds a further 7.5 per cent indirect holding in this power station through Teesside Power Holdings Limited. MPI's share of the generation market in England and Wales is 0.74 per cent in terms of capacity and 0.99 per cent in terms of output in the financial year 2000/2001². (MPI also has interests in a 480 MW CCGT power plant in Turkey and a 586 MW CCGT plant in Pakistan.)
- ◆ gas supply – through Midlands Sales Limited, Midlands supplies gas to around 480 industrial and commercial users in Great Britain (a market share of around 0.13 per cent as at September 2001³), and around 200 domestic customers.

² Midland's overall 26.7 per cent share of Teesside accounts for just over 500 MW, which constitutes around 0.66 per cent of capacity in Great Britain. Midlands' output in the financial year 2000/2001 was 2.97 TWh or around 0.88 per cent of output in Great Britain.

³ The industrial and commercial gas supply market comprises customers whose annual consumption of gas exceeds 73,268 kWh.

- 4.8 In addition to its gas supply business, Midlands also undertakes some wholesale gas trading, although the majority of its gas trading business was sold to Cinergy in 1999.
- 4.9 A subsidiary, Metering Services, installs, maintains and reads meters for electricity, gas and water companies across the UK, as well as for large end-users.
- 4.10 Midlands' other subsidiaries include MEB Contracting, which provides electrical contracting services; Energy Services (UK) Limited, which advises businesses and public sector organisations on energy management strategies; and Geophysical Mapping Services, which provides a mapping service that determines the exact location of underground pipes, cables and ducts.

5. Issues arising from the proposed acquisition

Regulation of distribution businesses

- 5.1 Utilicorp does not currently have a presence in the distribution sector in Great Britain. As a result of the proposed transaction, Utilicorp will acquire Midlands' distribution business, GPU Power Networks (UK) plc. As the transaction will not reduce the number of independent management teams operating within the electricity distribution sector, Ofgem considers that the transaction will have no effect on its ability effectively to set price controls and performance standards applicable to GPU Power Networks (UK) plc. Views are invited on this issue.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition by Utilicorp and DB of AEPH, so that we may make recommendations to the Office 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 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 6 December 2001. Comments should be sent to:

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