

Scottish Power plc's acquisition of Damhead Creek

Report to the Office of Fair Trading

Introduction

This note is written in accordance with the Concordat between our two offices to set out Ofgem's views on this transaction so that you may take them into account in deciding whether the merger may result in a substantial lessening of competition.

On 2 June 2004 Scottish Power plc (SP) acquired the entire share of capital of the 800MW CCGT Damhead Creek power plant and associated contracts, including a long-term gas supply agreement, from the creditor banks.

Consultation

On 11 June 2004, Ofgem placed an overview of the acquisition on its website, and invited views on the issues raised by the acquisition. Ofgem opted for this approach to consultation to give parties more time to respond and because Ofgem's initial view was that there were no obviously significant competition concerns stemming from the transaction.

No responses were received by the deadline of Friday 18 June 2004. Ofgem's views are set out below.

Ofgem's views

SP is a large vertically integrated energy group and has significant gas and electricity interests in Great Britain (GB). SP supplies gas and electricity to around 4.25 million customers¹ and is active in the generation, transmission and distribution of electricity. It also has interests in energy support services including metering, billing and call centre support.

Damhead Creek power station is a natural gas-fired plant located Southern England with a capacity of approximately 800MW. Therefore Ofgem considers the relevant market for analysis to be that of electricity generation.

Relevant market- electricity generation

The wholesale electricity market arrangements in Scotland are currently different from those operating in England and Wales, although the two systems are interconnected. From April 2005, subject to the commencement of the relevant provisions of the Energy Act 2004, a common system is to be implemented across the whole of Great Britain. The analysis that follows therefore considers competition both within an England and Wales market (including imports from Scotland) and on a Great Britain-wide basis.

Position pre-acquisition: Great Britain

SP's generating interests include coal-fired, hydro and pump storage power stations as well as wind farms in Scotland and two CCGT gas-fired plants in England. Market share in electricity generation can be measured either in terms of installed capacity owned or in terms of the metered volume of output from the generator. Ofgem generally includes plant capacity which has been mothballed in its calculation of capacity market shares if the plant is likely to be able to return to

¹ Data from www.scottishpower.com

service relatively quickly. In its calculation of market shares by output, Ofgem includes, where possible, output obtained from contracts in addition to that generated from owned assets. SP's total current capacity is 5,480². Ofgem also considered SP's share of output [based on commercially sensitive data for 2003-04] for the GB market.

Position- pre-acquisition: England and Wales

SP's generation assets in England and Wales (E&W) include the 715 MW CCGT plant at Rye house in Hertfordshire and the Shoreham 400 MW CCGT plant.³ In addition, Ofgem has included SP's share of the England–Scotland interconnector⁴ (1,488 MW), since it almost always flows into the E&W system.

Based on these figures SP's generation capacity pre-merger is 2,604 MW. Ofgem also considered SP's total output [based on commercially sensitive data for 2003-04] in E&W.

Impact of the acquisition

Damhead Creek is a CCGT plant with a capacity of approximately 800MW, which represents a small share of total capacity and output in both GB and E&W. Ofgem does not, therefore, consider the acquisition will lead to a significant increase in SP's market power in either capacity or output or give rise to competition concerns. Ofgem also notes that the HHI indices post-acquisition remain below the 1000 threshold, which denotes that the market is not concentrated.

Other issues

Ofgem does not consider that the fuel source of specific plants within the generation system is a relevant consideration. All generators are able to compete in the wholesale electricity market.

Damhead Creek is not contracted to NGC for services such as fast response, and it does not play a significant role in providing services through the balancing mechanism. Therefore, Ofgem does not consider the acquisition to raise concerns in relation to the provision of ancillary services to NGC.

Conclusion

Ofgem considers the electricity generation sector in GB to be competitive at present. Ofgem has noted previously⁵ in its advice to the OFT regarding the proposed arrangements between International Power and Drax that the market shares that may be likely to give rise to competition concerns in the electricity generation sector may be lower than in other markets, due to the inelastic nature of short-run supply and demand for electricity. Nevertheless Ofgem's view is that there are no competition concerns arising from this transaction.

² Data. From Electricity Supply Handbook 2004. Ofgem also considered capacity information provided by Scottish Power.

³ Based on the allocation of Shoreham's capacity and output to SP.

⁴ SP's share of the interconnector is calculated on the basis that SP owns 56% of the first 850MW of capacity and 75% of the remaining 1350 MW capacity.

⁵ Proposed arrangements between International Power plc and Drax Holdings Limited – Report to the Office of Fair Trading, October 2003.