



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 27.01.1999

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sirs,

Subject: Case No IV/M. 1346 – EDF / LONDON ELECTRICITY

Notification of 4 December 1998 pursuant to Article 4 of Council Regulation No 4064/89

1. On 4 December 1998, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 4064/89 ('the Merger Regulation') by which the undertaking ELEX (UK) Limited, controlled by Electricité de France ('EdF'), acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of the whole of London Electricity Holdings No 1 Limited ('LEHL'), controlled by Entergy Corporation, by way of purchase of shares.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EEC) No 4064/89 and does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

I. THE PARTIES' ACTIVITIES

3. EdF is a French wholly state-owned group, whose principal activity is the generation, transmission, distribution and supply of electricity in France. It also has operations in Italy Portugal, Sweden and Spain, and supplies electricity to the United Kingdom through the France/UK interconnector cable.
4. LEHL mainly distributes and supplies electricity in England and Wales through its wholly owned subsidiary, London Electricity ('LE'). LE is one of the twelve Regional Electricity Companies ('RECs') operating in England and Wales.

II. THE OPERATION

5. After a private auction arranged by Entergy Corporation in September 1998, EdF concluded on 27 November 1998 a Share Purchase Agreement with a subsidiary of Entergy Corporation for the purchase of all the shares of LEHL.
6. On 4 December 1998, EdF acquired the shares of LEHL, thereby completing the transaction. This acquisition was made in accordance with a derogation from the obligations imposed in paragraphs 1, 2 and 3 of Article 7 of the Merger Regulation, which was granted by a Commission decision adopted on 30 October 1998 in accordance with Article 7(4) of the Merger Regulation.
7. On 8 January 1999, the United Kingdom authorities submitted a request that the case be referred to them with a view to the application of national competition law, in accordance with Article 9 of the Merger Regulation, on the grounds that the concentration threatened to create or to strengthen a dominant position as a result of which effective competition would be significantly impeded on a distinct market within the United Kingdom, and/or that the proposed concentration affected competition on a distinct market within the United Kingdom which did not constitute a substantial part of the common market. After examining this request, the Commission concluded that the conditions laid down in the Merger Regulation for referral under Article 9 were not met. Accordingly, on 27 January 1999, the Commission adopted a decision pursuant to Article 9(3) of the Merger Regulation, not to refer the concentration to the United Kingdom authorities.
8. Also on 8 January 1999, the United Kingdom authorities submitted a request under Article 21(3) of the Merger Regulation for the recognition of certain public interests as legitimate interests other than those taken into consideration by the Regulation. After examining the request, the Commission concluded that the measures described in the request were being taken pursuant to the existing system within that Member State for the ongoing regulation of the electricity industry and were not aimed at the concentration itself. Such ongoing regulatory activity was not precluded by the Regulation. It was therefore not necessary for the Commission to recognise a legitimate interest to which they related before the United Kingdom authorities could take the measures concerned. On 27 January 1999, and pursuant to Article 21(3) of the EEC Merger Regulation, the Commission adopted a decision informing the United Kingdom authorities of this conclusion.
9. The notifying party has informed the Commission that it has reached agreement with the DGES on certain licence modifications and conditions. These are similar to those applied by the UK authorities in previous cases of this type and would, broadly:
 - prevent internal trading between the generation and supply businesses involved;
 - prevent the construction or acquisition of ‘embedded’ generation plant without prior consent of the DGES;
 - secure a regulatory ‘ring fence’ around the electricity supply business of LE and the placing of generation outside it.
10. The Commission takes note of these matters. As already mentioned, it has concluded that they fall within the scope of the regulatory provisions governing the industry in question. Accordingly, although they will be implemented and monitored by the United Kingdom authorities, they constitute neither an application of a national legislation on competition to

a concentration that has a community dimension, nor measures to protect legitimate interests other than those taken in consideration by the Merger Regulation.

II. COMMUNITY DIMENSION

11. EdF and LEHL have a combined aggregate worldwide turnover in excess of EUR 5,000 million (EdF, EUR 28,207 million; and LEHL, EUR 1,626 million). Each of them has a Community-wide turnover in excess of EUR 250 million (EdF, EUR 27,570 million; and LEHL, EUR 1,626 million), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State¹. The notified operation therefore has a Community dimension, but does not constitute a cooperation case under the EEA Agreement, pursuant to Article 57 of that Agreement

III. COMPETITIVE ASSESSMENT

A. Relevant product markets

12. The activities of the electricity industry can be divided into four different types of operations, *generation*, the production of electricity in power stations; *transmission*, its transport over high tension cables; *distribution*, the transport of the electricity over the low tension local cables and *supply*, the delivery of the electricity to the final consumer. Each of these activities can be regarded for the present purpose as constituting a separate product market, as they require different assets and resources, and the market structures and conditions of competition are different for each.
13. In the United Kingdom, the electricity industry has for some years been privatised and liberalised. The legislation bringing this about also subjected the industry to regulation by the Secretary of State for Trade and Industry ('SoS') and a sectoral regulator, the Director General of Electricity Supply ('DGES') – in order, *inter alia*, to secure supplies and protect the interests of consumers. The DGES has various powers. In particular, no company can engage in the generation, transmission or supply of electricity without regulatory approval and a licence. In England and Wales there was also, originally, a separation between the large generators, and the RECs. However in recent years a number of vertical integrations between generators and RECs have been allowed to take place; none of them giving rise to a concentration with a Community dimension.
14. In England and Wales, the process of liberalisation of the industry has proceeded at a different pace for different classes of customer. The largest customers (i.e., those whose demand exceeds 1 MW) have been free to select their supplier for eight years and medium-sized customers (i.e., whose demand ranges between 100 kW and 1 MW) for four years. The smallest customers (i.e., those whose demand does not exceed 100 kW) have been obliged to purchase their electricity from their local public electricity supply company. However, by the beginning of June 1999 these customers too will be able to choose their supplier. It is therefore necessary to consider whether this difference leads to the creation of separate product markets for different classes of customer.

¹ Figures calculated on the basis of average ECU exchange rates to the extent that they include turnover for the period before 1.1.1999 in accordance with Article 5.1 abid with the notice on the calculation of turnover; and translated into EUR on a one-for-one basis.

15. The notifying party and most of the competitors who responded to the Commission's enquiries state that, given that the final stage of liberalisation of electricity supply is now in progress, electricity supply constitutes a single relevant product market. However, the supply to smallest customers has not yet been completely liberalised. As a result, the competitive conditions of supply for these smallest consumers remain different from those for the larger customers though not essentially different to those of similar customers supplied by other public electricity supply companies. These smallest customers are and will continue to be, in the short-to-medium term at least, protected by the DGES - who sets maximum prices for supply to them.
16. It is therefore possible to distinguish at least two markets in relation to the supply of electricity, for customers whose demand exceeds 100kW and for those whose demand is below this level.
17. It is also necessary to consider whether a distinction should be made between the supply of electricity to large and to medium sized customers. However, it is not necessary to determine whether these constitute one or two relevant product markets as in either case effective competition would not be significantly impeded in the EEA or any substantial part of it.

B. Relevant geographic markets

Generation

18. Generators must sell all electricity supplied in England and Wales, with the exception of that produced in the very smallest power stations, to suppliers through a wholesale trading arrangement called the Pool. Under this system, generators bid prices to the National Grid Company, which selects the offers securing that the quantity requirements and the transmission constraints are satisfied at the lowest possible price, and accordingly sets the price for electricity for the corresponding period. All generators located in England and Wales, and the external members of the Pool, EdF and the Scottish producers, operate under similar conditions. They bid into the Pool and are paid the price fixed by the Pool for all their output. However, this arrangement is limited to England and Wales. Furthermore, although some electricity can be exchanged between England and Wales on the one hand, and neighbouring countries on the other hand, the equipment permitting these exchanges is of limited capacity (less than 6% of total capacity). The relevant geographic market for *generation* may therefore be no wider than England and Wales. However, it is not necessary to define this geographic market, as in all alternative market definitions considered, the operation will not give rise to any competition problems.

Transmission

19. As neither EdF nor LE is engaged in the transmission of electricity it is not necessary to consider the geographical market for this operation.

Distribution

20. When the electricity industry in England and Wales was privatised, twelve RECs were established. Each REC inherited the low-tension distribution network in its defined geographic area (the 'Authorised Area'). This remains the situation so that each REC retains sole ownership of its distribution network. However access to these networks is available to any other electricity supplier selling electricity to customers located in the geographic area covered by a given REC's distribution network. Access is available on a fair and non-discriminatory basis and is furthermore subject to price control by the DGES.

The relevant geographic markets for distribution therefore appear to coincide with the twelve distribution areas.

Supply

21. With regard to the *supply* of electricity, the parties and a majority of the competitors who responded to the Commission's enquiry state that the relevant geographic market is England and Wales, on the basis that the conditions of competition are the same everywhere within this area. A minority of those contacted during the Commission's investigation, and the United Kingdom authorities, suggest that it is necessary to examine the situation of each type of customer individually.
22. For the larger customers, those whose demand exceeds 100kW and who have been able to choose their suppliers for at least four years (eight years for those whose demand exceeds 1MW) there is considerable evidence that these customers review their supply contracts and change suppliers frequently. This would suggest that the relevant geographic market for both groups is England and Wales as they can select any of the public electricity supply companies operating in this area to supply their needs.
23. The UK authorities, in particular, consider that the relevant geographic markets for supply to medium customers (demand between 100kW and 1MW) are the individual Authorised Areas, pointing out that LE currently has 58% of the medium sized customers in its distribution Authorised Area.
24. However, according to information provided by the parties, approximately 40% of LE's customers with a demand of between 100kW and 1MW will transfer away from LE each year. They are replaced by approximately the same number of customers which LE attracts from other suppliers. This suggests that 'brand loyalty' (unlikely in any event in a commodity market such as electricity), advertising costs and the difference in market shares between the competing suppliers in the LE area do not appear to have deterred customers from switching and therefore are not significant barriers to entry. Furthermore, LE bids annually to supply all customers with maximum demand between 100kW and 1MW. In the Commission's view, customers with demand of this order can be expected to be aware of the possibility of changing suppliers and of how to compare competing tariffs. Also, the number of customers in this class currently supplied by LE is relatively small (c.5,000), suggesting that competing suppliers could seek their custom without major additional investment. In view of these factors, the conditions of competition in the LE Authorised Area do not appear to be substantially different from those elsewhere in England and Wales, and medium-sized customers have been free to choose amongst all the public electricity supply companies for a significant period (over four years). Accordingly, the relevant geographic market for this group of customers also appears to be England and Wales.
25. The situation in relation to the smallest customers is more complex. Until very recently these customers had no choice in their electricity suppliers. They were restricted to the public electricity supply company responsible for their geographic area. Their interests are however protected by the DGES who establishes maximum prices ('caps'). In practice the supply companies, including LE, have charged these customers prices extremely close to the capped price (99%). Although the smallest customers have or will have shortly the possibility of selecting any supplier for their requirements, the price caps will remain in force until at least 1 April 2000. The regulator expects to continue the cap after this date, though this is not certain. It is thought likely to take some time before a significant

number of these customers change their electricity supplier. Many small customers are unlikely, for the time being at least, to be familiar with the process involved in changing suppliers, or know how to compare the competing offers. Consequently the ability of these customers to change supplier may not, for the time being, be sufficient by itself to constrain LE's prices. The relevant geographic market for these customers therefore is LE's Authorised Area.

C. Assessment

Horizontal Aspects

26. The proposed concentration will not give rise to any horizontal overlapping activity other than in generation. There, LE's interests are minimal, accounting for less than 0.5% of consumption in England and Wales. EdF has no generation interests in the UK itself, and supplies less than 6% of UK demand via the interconnector. Several other generators have substantially larger shares (eg National Power, Powergen and British Energy). Accordingly it is not necessary to examine this aspect of the operation any further.

Vertical Aspects

27. The concentration will also, however, give rise to a vertical integration between EdF's generation activities and LE's distribution and supply. This vertical integration must be examined in relation to three different relevant markets, as follows:
- the supply of electricity to customers with a maximum demand exceeding 100kW in the England and Wales,
 - the supply of electricity to customers with a maximum demand of less than 100kW in the LE area, and
 - the distribution of electricity in the LE area.
28. The parties' share of the market for the supply of electricity to customers with a maximum demand exceeding 100kW in the England and Wales is less than 15% and their share in the upstream market for the generation of electricity is less than 10%. The operation therefore will not create or strengthen a dominant position on this market.
29. On the other two markets LE is dominant because customers with a maximum demand of less than 100kW had until recently to source their electricity from LE and because it owns the only distribution network. These two markets are however heavily regulated and the DGES imposes maximum prices in both cases.
30. The structure of the electricity industry in England and Wales, which separates generation from both distribution and supply, reduces the opportunities for adverse vertical effects very significantly. There is no market link between generators and distributors and generators cannot contract directly with suppliers for the physical delivery of electricity.
31. As all trading between supplies and generators has to be conducted through the Pool, where the price is set at national level, EdF cannot contract directly with LE for the actual delivery of electricity. However, after the complete implementation of the operation LE and EdF would be able to enter into 'contracts for differences' with each other. Such contracts allow generators and suppliers to 'hedge' themselves against fluctuations in the Pool price, which can be volatile. But theoretically EdF would also, following the merger, be able either to enter into contracts with LE to supply at higher prices than the best

available from third parties, and thereby increase prices to any 'captive' LE customers above the competitive level; or alternatively, it might contract for a lower price and thereby subsidise those LE customers it wished to dissuade from transferring to other suppliers.

32. LE's licence requires it to purchase electricity at the best reasonably obtainable price. Acceptance of a contract which led to higher prices would therefore give rise to a breach of the licence conditions, which the DGES would have the power to remedy. . Moreover, it should be noted that LE's previous owner, Entergy Corporation (Entergy) had, in theory, the same possibility of raising prices above the competitive level by entering into 'back to back' contracts with LE on the one hand and third-party generators on the other. But in any event, it must be doubted whether such a strategy would be rational or successful. The existence of regulatory price caps for the smallest customers means that LE cannot raise its prices to them materially - as mentioned above, suppliers already charge these customers a price that is very close to the permitted maximum.. An attempt to raise prices to larger customers above the competitive level would be unlikely to succeed either. As explained above, significant numbers of customers could be expected to rapidly change their supplier.
33. LE would not, of course, be prevented from contracting with EdF at substantially lower prices than those offered through the Pool. But it is unclear why and in what circumstances (if any) such conduct would lead to anti-competitive effects or be rational for EdF. Given the number and the identity of actual and potential competitors, an attempt to eliminate competitors by predation or other anti-competitive conduct seems likely to be too costly for EdF (or generators) to contemplate.
34. For the above reasons, it would appear that the prospect of EdF being able to use internal trading to raise prices above the competitive level, or otherwise behave anticompetitively (eg by predation) as a result of the merger, and at the same time conceal this from regulatory scrutiny and control, is, though not inconceivable, at least remote. Accordingly, the possibility of internal trading between EdF and LE following the completion of the operation does not significantly alter LE's position in the market and does not, therefore, threaten the creation or the strengthening of dominant positions.
35. Another possible adverse effect arising from the vertical integration between a generator and an REC might be the use of the generator's expertise in the construction and operation of power stations to add to the REC's embedded generation (small scale generation plants connected directly to the REC's local distribution network). Within the merged entity LE might have incentives to favour schemes by its parent to construct and operate such embedded plant. However under the ownership of Entergy LE had similar incentives. The operation does not change this situation, which accordingly cannot lead to the operation creating or strengthening dominant positions.
36. A third possibility might be cross-subsidy to EdF by using LE's resources to finance other EdF activities, in particular, its own generation projects. However, such conduct would not, arguably, affect competition on the markets where LE is active. EdF itself has no other interests in the UK supply or distribution sectors, and its presence in generation in the UK (indirectly, via the interconnector) is small. Moreover to the extent that LE's position might be affected, it would be likely to weaken LE's competitive position rather than strengthen it. Accordingly, it cannot be expected to lead to the creation or strengthening of dominant positions.

37. In view of the above, it appears that the notified operation does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or any substantial part of that area.

V. CONCLUSION

38. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission,