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

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 9 (3)
Date: 27/01/1999

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 27.01.1999

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 9(3) DECISION

Decision Relating to the referral of the case No IV/M. 1346 – EDF/LONDON ELECTRICITY to the United Kingdom Competition Authorities, pursuant to article 9 of Regulation 4064/89

THE COMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No. 4064/89 of 21 December 1989, on the control of concentrations between undertakings, and in particular article 9(3) thereof,

Having regard to the notification filed by ELEX (UK) Ltd on 4 December 1998, pursuant to article 4 of the said Regulation,

Having regard to the request of the United Kingdom Authorities of 8 January 1999,

Whereas:

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 (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. On 8 January 1999, the United Kingdom authorities submitted a request under Article 9(2) of the Merger Regulation that the notified concentration be referred to its competent authorities with a view to the application of national competition law.

I THE PARTIES

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 cables ('the interconnector').

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 EEC Merger Regulation.

III CONCENTRATION

7. As EdF has acquired all the shares of LEHL it will acquire sole control of LEHL. The operation therefore constitutes a concentration within the meaning of Article 3(1)b of the Merger Regulation.

IV COMMUNITY DIMENSION

8. 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 State. 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.

V THE RELEVANT MARKETS

A. Relevant product markets

9. The activities of the electricity industry can be divided into four different types of operation:*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. In the UK, the electricity industry has for some years now 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 generation, transmission or supply of electricity without regulatory approval and a licence. In England and Wales, the process of liberalisation of the industry has moved at a different pace for different groups of customers, according to the size of their demand for electricity. The largest customers (i.e., those whose demand exceeds 1 MW) have been free to select their supplier for eight years and the medium sized customers (i.e., whose demand ranges between 100 kW and 1 MW) for four years. However, until very recently, 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 (PES), although by the beginning of June 1999 all of these customers, also, will be able to choose their supplier.

10. In their request to the Commission, the UK authorities submit that in view of these differences, the supply sector should be divided into three product markets on the above lines. By contrast, the notifying party, and most of the competitors who responded to the Commission's enquiry state that, given that the final stage of liberalisation of electricty supply is now in progress, the whole of the supply sector constitutes a single relevant product market. However, the Commission notes that supply to smallest customers has not yet been completely liberalised, and that 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 term at least, protected by the regulator, who sets maximum prices for supply to them. It is therefore possible to distinguish a product market for the supply of customers whose demand does not exceed 100kW.

11. It is not necessary to determine whether the supply of electricity to large and to medium sized customers should constitute one or two relevant product markets since, as discussed below, in either case effective competition would not be significantly impeded on a market within the United Kingdom which presents all the characteristics of a distinct market.

B. Relevant geographic markets

Generation

12. All electricity supplied in England and Wales, with the exception of that produced in the very smallest power stations, must be sold by generators 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 - in particular, France - on the other hand, the equipment permitting these exchanges (the 'interconnnector') is of limited capacity - less than 6% of total capacity. The relevant geographic market for *generation* therefore

appears to be 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

13. 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

14. In their request to the Commission, the UK authorities submit that the relevant geographic markets for distribution are the individual Authorised Areas as distribution is a natural monopoly in each Authorised Area.

15. When the electricity industry in England and Wales was privatised twelve Regional Electricity Companies ('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

16. The parties and a majority of the competitors who responded to the Commission's enquiry state 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 claim that it is necessary to examine the situation of each type of customer individually.

17. Larger customers, ie those whose demand exceeds 100kW,have been able to choose their suppliers for at least four years (eight years for those whose demand exceeds 1MW) and there is considerable evidence that they review their supply contracts and change suppliers frequently. For these customers, the relevant geographic market is England and Wales as they can select any of the public electricity supply companies operating there to supply their needs.

18. In their request to the Commission, the UK authorities submit that the relevant geographic markets for supply to medium customers are the individual Authorised Areas. They argue that, as LE currently has 58% of the medium sized customers in its distribution Authorised Area, this indicates this area constitutes a separate geographic market.

19. However, according to information provided by the parties, approximately 40% of LE's customers with a demand of between 100kW and 1MW will move from LE each year. They are replaced by approximately the same number of customers, which LE has won from other public electricity supply companies. This suggests that 'brand loyalty' (unlikely in any event in a commodity market such as electricity) and the difference in market shares between the different 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 competitng tariffs. The number of customers in this class currently supplied by LE is relatively small (c.5,000). Consequently other suppliers face no significant barriers in seeking to obatin their custom. In this situation, the conditions of competition in the LE Authorised Area are no different from those elsewhere in England and Wales, and 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 therefore also appears to be England and Wales.

20. In their request to the Commission, the UK authorities also submit that the relevant geographic markets for supply to small customers are the individual Authorised Areas.

21. Until very recently these customers have had no choice in their electricity suppliers. They were restricted to the public electricty supply company responsible for their geographic area – in the case of most of London, to LE. Their interests were 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 1 April 2000. Moreover, the regulator expects to continue the cap after this date, though this is not certain. It is likely to be some time before a significant number of these customers change their electricity supplier. The process has only just begun, so that many customers are unlikely to be familiar with the process involved in changing suppliers, or how to compare what they offer. The potential savings involved may, at present price levels, be quite small. Consequently, the ability of these customers to change suppliers may not of itself, for the time being at least, suffice to constrain LE's prices. The relevant market for these customers therefore is LE's Authorised Area.

VI ASSESSMENT UNDER ARTICLE 9(2)A

22. Article 9(2)a of the EEC Merger regulation states that the Commission may refer a concentration to the competent authorities of a Member State when this concentration threatens to create or strengthen a dominant position as a result of which effective competition will be significantly impeded on a market within that Member State, which presents all the characteristics of a distinct market. If, however, the Commission consider s that such a distinct market or threat does not exist it shall adopt a decision to that effect.

23. Taking as the relevant markets the distribution of electricity in the LE Authorised Area, the supply of electricity to small (< 100kW) customers in the LE Authorised Area and the supply of electricity to medium (100kW-1MW) customers in the LE Authorised Area, the UK authorities submit that these markets are distinct markets within the UK, that LE has a dominant position on these markets, and that these dominant positions will be strengthened by the proposed concentration.

A. Distinct markets

24. The Commission recognises that the markets for the distribution of electricity in the LE Authorised Area and the supply of electricity to small customers in the LE Authorised Area are regional markets which present all the characteristics of distinct markets within the UK.

25. If there is a product market for the supply of electricity to customers whose maximum demand is between 100kW and 1MW, then in the view of the Commission this market has, as explained above, a geographical dimension of England and Wales.

B. Threat of Dominance

26. The UK authorities' opinion that LE has a dominant position on the markets for markets for the distribution of electricity in the LE Authorised Area and the supply of electricity to small customers in the LE Authorised Area appears well - founded.

27. LE owns and operates the only distribution network in its Authorised Area, and thereby has a dominant position on the market for distribution of electricity in this area .

28. Until recently, customers in LE's Authorised Area with a maximum demand of less than 100kW had to source their electricity from LE. Therefore, LE still has a considerable share of this market. Although past evidence suggests that these market shares will erode after the complete liberalisation of the supply sector, there are also indications that small consumers might not change suppliers in the same manner as medium or large customers do, and that therefore LE will keep significant market power for some time. As a result, LE also has a dominant position on the market for the supply of electricity to small customers in LE's Authorised Area.

29. In relation to the customers whose maximum demand is between 100kW and 1MW the relevant geographic market is England and Wales. On this market there would be no threat of dominance as LE's market share is less than 15%.

C. Strengthening of a dominant position

30. In their request to the Commission, the UK authorities submit that the notified operation threatens to strengthen LE's dominant positions by vertical integration with EdF's generation operations. The UK authorities identify three possible adverse effects which constitute this threat:

- 'Internal trading' between the generation and supply business would make it difficult for the DGES to detect or prevent discriminatory or predatory pricing by LE;
- LE would have an incentive to discriminate in favour of EdF as regards direct generator connections to the LE distribution system ('embedded generation');
- LE's resources might be used to finance EdF's activities ('cross-subsidisation').

It is important for the effectiveness of the regulatory system that the DGES can clearly identify the assets, costs, turnover etc attributable to each of the different functions (generation, supply etc) so that relevant matters such as profitability, prices, security of supply etc, can be properly monitored and action taken where necessary. Vertical integration potentially makes that separation less clear.

31. Each of these possible concerns is examined further below. There are, however, also a number of general factors which may be considered to reduce the likelihood of these adverse effects arising in practice. The structure of the electricity industry in England and Wales, which separates generation from both distribution and supply, reduces the opportunities for 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.

32. It should also be borne in mind that LE is heavily regulated: in particular, LE's distribution network is open to all suppliers under the same terms and conditions, and the regulator imposes maximum prices in both distribution and the supply of electricity to small customers.

Internal trading

33. Due to the organisation of the electricity sector, EdF cannot enter into direct contracts with LE for the actual delivery of electricity: all trading is achieved through the Pool, where the price of electricity is set at national level.

34. 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 both generators and PESs to hedge against fluctuations in the Pool price. Theoretically this could enable EdF either to contract for higher prices and to exploit any captive customers, or alternatively to contract for lower prices and subsidiseany LE customers who might otherwise change supplier.

35. 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..

36. 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 through cross-subsidy seems likely to be far too costly for EdF or any other generator to contemplate.

37. For the above reasons, it would appear that the prospect of EdF being able to raise prices above the competitive level, or otherwise behave anti-competitively (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, in the view of the Commission the possibility of internal trading following the completion of the operation does not threaten the creation or the strengthening of dominant positions.

Embedded Capacity

38. Another possible adverse effect of the vertical integration between a generator and an REC would 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). With 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 another international utility company, LE had similar incentives. In this respect, there is no change in the situation and the operation does not threaten the creation or the strengthening of dominant positions.

Cross-Subsidy

39. The UK authorities are concerned that LE resources might be used to finance EdF activities, and more specifically EdF generation projects. However, such conduct would arguably not affect competition on the markets where LE is active. EdF itself has no interests in the UK in supply and distribution and its presence in generation (indirect, via the interconnector) is small. Moreover cross-subsidy would be more likely to weaken rather than strengthen LE's competitive position. In this respect, the operation does not threaten to lead to the creation or the strengthening of dominant positions.

40. In view of the above, it appears that the notified operation does not threaten to create or strengthen a dominant position.

D. Conclusion

41. From the above, it follows that the proposed concentration does not threaten to create or strengthen a dominant position as a result of which effective competition will be significantly impeded on a market within that Member State, which presents all the characteristics of a distinct market.

42. It follows that the conditions for a referral under article 9(2)a are not met.

VII ASSESSMENT UNDER ARTICLE 9(2)B

43. Under Article 9(2)(b), a Member State may request the Commission to refer a notified concentration if a concentration affects competition on a market within the Member State , which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.

44. In this case the United Kingdom authorities have claimed that the market for the distribution of electricity in the LE Authorised Area and the supply of electricity to customers with a maximum demand of less than 1MW meet the criteria set out in Article 9(2)(b).

45. The Commission considers that the market for the distribution of electricity in the LE Authorised Area is a relevant market. Furthermore it considers that the supply of electricity to customers with a maximum demand of less than 100kW in the LE Authorised Area constitutes a relevant market. The Commission's view differs from that of the United Kingdom authorities because it believes that the customers whose maximum demand is between 100kW and 1MW form part a different relevant market including those customers whose maximum demand exceeds 1 MW and whose principal distinguishing feature is the free choice of suppliers. This difference in appreciation does not however affect the analysis under Article 9(2)(b).

46. It is therefore clear that these two markets are distinct markets in the sense of Article 9. It is next necessary to examine whether competition on these markets is affected by the concentration. The Commission's analysis (section VI) above has shown that the position of London Electricity vis a vis its customers and competitors is not altered in any significant manner by the present operation. It follows thet there is no measurable effect on competition in either of these markets

47. Finally the question arises as to whether these markets constitute a substantial part of the common market. In this respect it should be remembered that London Electricity has some two million small customers, which probably represents some four million people. Although the proportion of electricity concerned only represents about 2% of total Community consumption (according to the United Kingdom authorities), this should not be regarded as decisive. Electricity is a commodity used by every inhabitant of the common market and it is an essential input for business and industry. Account should also be taken of the number of inhabitants and the importance of London as an economic, business, financial, cultural and administrative centre. By way of comparison LE's sales of electricity (which are approximately the same as those made in the LE Authorised Area) exceed the total supply of electricity in Ireland and Luxembourg and are about two thirds of the supply in Portugal and Greece. For these reasons it appears likely that the London Electricity Authorised Area could be regarded as a substantial part of the common market. However in the absence of any effect on competition in the market concerned it is not necessary to decide that issue.

48. From the above, it follows that the proposed concentration does not affect competition on a market within the Member State, which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.

49. It follows that the conditions for a referral under article 9(2)b are not met.

VIII CONCLUSION

50. In the light of the above, the conditions to request a referral under either article 9(2)a or article 9(2)b are not met in this case. Accordingly, the Commission has adopted this decision :

Article 1

The request made, pursuant to articles 9(2)a and 9(2)b of Council Regulation (EC) N° 4064/89, by the United Kingdom authorities for the referral of the notified concentration concerning the acquisition of sole control of LEHL by EdF is rejected.

Article 2

This decision is addressed to the United Kingdom.

For the Commission,