

***Case No IV/M.1606 -  
EDF / SOUTH  
WESTERN  
ELECTRICITY***

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**REGULATION (EEC) No 4064/89  
MERGER PROCEDURE**

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Article 6(1)(b) NON-OPPOSITION  
Date: 19/07/1999

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 19.07.1999

PUBLIC VERSION

MERGER PROCEDURE  
ARTICLE 6(1)(b) DECISION

TO THE NOTIFYING PARTY

Dear Sirs,

**Subject: Case No IV/M. 1606 – EDF / SOUTH WESTERN ELECTRICITY**

Notification of 17.06.1999 pursuant to Article 4 of Council Regulation No 4064/89

1. On 17.06.1999, 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 London Electricity plc ("LE") acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of the supply business of South Western Electricity plc ("SWEB").
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 AND THE OPERATION**

3. LE is one of the twelve Regional Electricity Companies ('RECs') operating in England and Wales, and its main activities are the distribution of electricity in the London area and the supply of electricity in England and Wales. It is controlled by Electricité de France ('EdF'), a French wholly state-owned group, whose principal activity is the generation, transmission, distribution and supply of electricity in France. EdF also has operations in Italy Portugal, Sweden and Spain, and supplies electricity to the United Kingdom through the France/UK interconnector cable.
4. South Western Electricity plc is also one of the twelve Regional Electricity Companies ('RECs') operating in England and Wales, and is mainly active in the distribution of electricity in South West of England and the supply of electricity in England and Wales. South Western Electricity plc is controlled by Southern Energy, Inc. ("Southern"), a United States energy company.

5. After a private auction arranged by Southern in April 1999, LE concluded a sale agreement with South Western Electricity plc for the purchase of South Western Electricity plc supply business. However, it will not be possible for the purchase to be accomplished by transferring South Western Electricity plc's supply business directly to LE. This is because, under the United Kingdom regulatory system, South Western Electricity plc is subject to a Public Electricity Supply ("PES") licence covering both its distribution and supply activities. Given that South Western Electricity plc will keep its distribution business, and that its licence cannot be split into a supply licence and a distribution licence, South Western Electricity plc's rights and obligations in relation to its supply business must remain with South Western Electricity plc. Consequently, in practice, LE will purchase the goodwill and certain assets of South Western Electricity plc's supply activities and will enter into an Agency Agreement with South Western Electricity plc ensuring that LE will be South Western Electricity plc's agent for the conduct of its supply business and that LE will fulfil South Western Electricity plc's licence supply obligations.
6. The notifying party has informed the Commission that it has accepted, in principle, certain licence modifications and conditions discussed with Ofgem, the regulator. These are as follows :
  - A condition that the LE and SWEB second tier supply licences (second tier licences allow suppliers to supply electricity outside their franchise areas) are terminated and replaced by a single second tier licence which will enable LE to supply all customers in England and Wales,
  - A condition that there will be adequate management and resources for the combines LE and SWEB supply business
  - A licence modification preventing internal trading between EdF/LE generation businesses and the SWEB public electricity supply business,
  - A licence modification preventing the transfer to EdF of any information relating to power purchase agreements,
  - A licence modification requiring the separation of the LE distribution business from the LE and SWEB supply businesses,
  - A licence modification requiring the provision of separate regulatory accounts for the SWEB first tier supply business and,
  - A licence modification requiring compliance by LE as South Western Electricity plc's agent with the first tier obligations of the SWEB supply business.

In addition the parties have given assurances about their behaviour in relation to designated customers in the SWEB and LE areas during the transitional period.

7. The commission considers that these matters fall within the scope of the regulatory provisions governing the industry in question. Accordingly they will be implemented and monitored by the United Kingdom authorities.

## **II. CONCENTRATION**

8. The system of regulation in the United Kingdom does not allow LE to simply acquire SWEB's supply business in a normal manner. SWEB is responsible under its Public Electricity Supply licence for both the distribution and the supply of electricity in its authorised area. The two activities cannot be separated so an agency agreement is necessary to effect the operation until the regulatory framework is modified, probably late in 1999. However the operation results in the acquisition of sole control by LE over SWEB's supply business and is therefore a concentration within the meaning of Article 3(1)b of the Merger Regulation.

## **III. COMMUNITY DIMENSION**

9. EdF and SWEB's supply business have a combined aggregate world-wide turnover in excess of EUR 5,000 million (EdF, EUR 28,025 million; and SWEB's supply business, EUR 1,043 million). Each of them has a Community-wide turnover in excess of EUR 250 million (EdF, EUR 27,330 million; and SWEB's supply business, EUR 1,043 million), and 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. It does not constitute a co-operation case under the EEA Agreement.

## **IV. COMPETITIVE ASSESSMENT**

### **A. Relevant product markets**

10. 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.
11. In the *EdF/London Electricity* decision<sup>1</sup>, the Commission concluded that each of these activities could be regarded 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.
12. In the same decision, the Commission also concluded that it was possible to distinguish at least two markets in relation to the supply of electricity, for customers whose demand exceeds 100kW, who have been free for a number of years to select their electricity suppliers, and for those whose demand is below this level. This was because, unlike larger customers, some of the customers with a demand below 100 kW still had to purchase their electricity from their local public electricity supply company.
13. The process of liberalisation of electricity supply was completed on 24 May 1999, when all the smallest customers became free to source electricity from any licensed supplier in England and Wales. It is therefore necessary to consider whether a distinction should be made between the supply of electricity to the smallest customers (i.e. those whose demand for electricity is below 100 kW) and other customers.

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<sup>1</sup> See case IV/M.1346-EdF/London Electricity

14. Even though the supply to smallest customers has now been completely liberalised, the competitive conditions of supply for these smallest consumers remain different from those for the larger customers, mainly because these smallest customers are and will continue to be, in the short-to-medium term at least, protected by the Director General of Electricity Supply (“DGES”) - who sets maximum prices for supply to them. Furthermore these customers are relatively unsophisticated and for them electricity is not a major item of expenditure so the potential savings do not constitute a significant incentive. It follows that the supply to the smallest customers would still appear to form a distinct product market.
15. However, for the purpose of this case, it is not necessary to decide whether there are 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**

16. In the *EdF/London Electricity* decision, the Commission left the exact definition of the geographic market for generation open. However, it suggested that this geographic market could be England and Wales, as i) 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, and ii) 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). In the present case the exact definition of the geographic market for generation can also be left open.
17. In the same decision, the Commission concluded that the geographic market for the supply of customers with a demand over 100 kW was England and Wales, as such customers have been free to choose their supplier for more than four years, and appear to regularly review their supply arrangements and change suppliers frequently.
18. Finally, the Commission found that the geographic markets for the supply of the smallest customers coincide with the twelve distribution areas established at the time of privatisation. Firstly, some of these customers still had no choice in their electricity suppliers, and were restricted to the public electricity supply company responsible for their geographic area. Secondly, in those areas, the price for the supply of the smallest customers was limited by at a maximum level (‘caps’) fixed by the DGES. Thirdly, it was thought likely to take some time before a significant number of these customers change their electricity supplier, as many small customers were found unlikely to be familiar with the process involved in changing suppliers, or knew how to compare the competing offers. The notifying party submits that the relevant geographic market for the supply of all customers should now be defined as England and Wales. They consider that, after the full liberalisation of supply as completed on 24 May 1999, the conditions of competition are identical in England and Wales. They also think that the smallest customers are well informed about competitors’ products and prices, as, in a survey conducted by Offer in February 1999, 89% of domestic customers indicated that they were aware of their ability to purchase electricity from more than one supplier. They finally submit that the process of changing supplier is uncomplicated, and that an increasing number of customers are reported to change suppliers.
19. However, the price for the supply of electricity to the smallest customers will remain capped at least in the short term. In addition, it is unclear whether these customers are well

informed about the identity of competitors, as more than 72% of the customers surveyed by Offer could not name more than three suppliers. Finally, no more than 5% of customers in LE's or SWEB's areas have already changed suppliers. This would suggest that the geographic market for the supply to the smallest customers would still remain limited to the distribution areas.

20. However, for the purpose of this case, it is not necessary to decide whether the relevant geographic market for the supply of electricity to the smallest customers is England and Wales or the individual REC areas as effective competition would not be significantly impeded in the EEA or any substantial part of it in either case.

### **C. Assessment**

#### Horizontal Aspects

21. The proposed concentration will only give rise to a horizontal overlap in the supply of electricity.
22. If there is only one market for the supply of electricity in England and Wales, there would be no horizontally-affected markets, as LE and SWEB's combined shares do not exceed 15%.
23. Alternatively, if there is a separate product market for the supply of electricity to the smallest customers (i.e. those with a demand below 100 kW), and if the geographic market coincides with the twelve distribution areas in England and Wales, then there would be two affected markets : the market for the supply of electricity to the smallest customers in LE's region, and the market for the supply of electricity to the smallest customers in SWEB's region, where both LE and SWEB operate.
24. In each of these markets, the incumbent supplier has a dominant position. Until 24 May 1999, the smallest customers had to source electricity from the incumbent supplier. Since that date, both LE and SWEB have retained market shares in excess of 95% in their respective areas.
25. However, there is no indication that the operation would strengthen these dominant positions. Firstly, the current situation will only lead to de minimis overlaps, as neither LE nor SWEB's market share currently exceeds 1% in each other's region. Secondly, in the longer term, neither LE nor SWEB would, in the absence of the concentration, appear to be among the other's main potential competitors (their main competitor being British Gas, which, in the survey conducted by Offer in February 1999, held just under 60% of domestic switchers nationally). And thirdly, these markets are heavily regulated and the DGES imposes maximum prices in both cases
26. Consequently, the horizontal aspects of the proposed concentration do not lead to the creation or the strengthening of a dominant position as a result of which effective competition in the EEA or any substantial part of that area.

#### Vertical Aspects

27. The concentration will also give rise to a vertical integration between EdF and LE's generation activities and SWEB's supply business.

28. If there is only one market for the supply of electricity in England and Wales, there are no vertically-affected markets, as neither LE and EdF's combined share of generation nor SWEB's share of supply exceed 10%.
29. Alternatively, if there is a separate product market for the supply of electricity to the smallest customers (i.e. those with a demand below 100 kW), and if the geographic market coincides with the twelve distribution areas in England and Wales, the vertical integration has to 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 SWEB area, and
  - the generation of electricity in England and Wales.
30. 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.
31. On the market for the supply of electricity to the smallest customer in the SWEB area, SWEB is dominant. However the proposed operation will not strengthen the dominant position of the SWEB business for these smallest customers as the fact that EdF is a generator will not, given the current market situation and market shares will not increase the SWEB business' scope for independent behaviour. Moreover this market has been fully liberalised since 24 May 1999, it is heavily regulated.
32. In addition, the current 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. In particular, generators cannot contract directly with suppliers for the physical delivery of electricity.
33. As all trading between supplies and generators has to be conducted through the Pool, where the price is set at national level, EdF or LE cannot contract directly with SWEB for the actual delivery of electricity. However, after the complete implementation of the operation, EdF or LE and SWEB would be able to enter into 'contracts for differences' with each other. Such contracts allow generators and suppliers to 'hedge' against fluctuations in the Pool price, which can be volatile. But theoretically EdF or LE would also, following the merger, be able either to enter into contracts with SWEB to supply at higher prices than the best available from third parties, and thereby increase prices to any 'captive' SWEB customers above the competitive level; or alternatively, it might contract for a lower price and thereby subsidise those SWEB customers it wished to dissuade from transferring to other suppliers.
34. SWEB'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 SWEB's previous owner, Southern, had, in theory, the same possibility of raising prices above the competitive level by entering into 'back to back'

contracts with SWEB 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 SWEB 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.

35. SWEB would not, of course, be prevented from contracting with EdF or LE 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 or LE. 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 LE (or generators) to contemplate.
36. For the above reasons, it would appear that the prospect of EdF or LE 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 or LE and SWEB following the completion of the operation does not significantly alter SWEB's position in the market and does not, therefore, threaten the creation or the strengthening of dominant positions.
37. An alternative possibility might be cross-subsidy to EdF by using SWEB's resources to finance other EdF activities. However, to the extent that SWEB's position might be affected, it would be likely to weaken SWEB's competitive position rather than strengthen it. Accordingly, it cannot be expected to lead to the creation or strengthening of dominant positions.
38. 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. ANCILLARY RESTRICTIONS**

### *Conduct of business prior to the completion of the transaction*

39. LE and SWEB have entered into a number of covenants relating to the period between signing the sale contract and completion of the transaction. These clauses essentially provide for SWEB to obtain LE's prior approval before carrying out major business transactions (such as substantial capital expenditures, merger or acquisition discussions, etc.).
40. These clauses do not appear to amount to restrictions of competition. However, in the event that the measures concerned lead to such restrictions, they can be considered directly related and necessary to the transaction.

### *Non competition*

41. The parties have agreed that :



- (1) For a period of 3 years, South Western Electricity plc will not be concerned in any business carrying on a supply business anywhere in the United Kingdom;
  - (2) South Western Electricity plc will not use any trading name, mark or style which may suggest a connection with the supply business;
  - (3) For a period of 1 year, South Western Electricity plc will not induce any employee to leave the employment of the supply business or any other member of the LE group;
  - (4) For a period of 1 year, LE will not induce any employee of the South Western Electricity plc to leave the employment of the South Western Electricity plc.
42. Clause (1) aims at the protection of LE's investment in SWEB's supply business. However, its scope exceeds what is necessary for the operation, as it applies to the whole of the United Kingdom while the business transferred is limited to the supply of electricity in England and Wales, and as it applies to even minor financial interests potentially to be held by South Western Electricity in a competing supply business. It follows that this clause is directly related and necessary to the operation only in respect of England and Wales, and only to the extent that South Western Electricity has a controlling interest in that business.
43. Clause (2) ensures the full transfer of the goodwill related to the SWEB's trademark and name in the supply business. Consequently, this clause appears to be an integral part of the operation and cannot be considered as an ancillary restriction.
44. Clause (3) again aims at the protection of LE's investment in SWEB's supply business. However, its scope exceeds what is necessary for the operation, as it applies to the whole of enlarged LE group and is not restricted to the business transferred. Consequently, the clause can only be considered as directly related and necessary to the operation in so far as it concerns the SWEB supply business.
45. Clause (4) protects SWEB from the competition of LE and is therefore intended protect the vendor. It is not considered to be necessary for the operation and cannot be covered by this decision.

#### *Agency agreement*

46. The parties have agreed that LE will be the sole and exclusive agent to manage, carry out and conduct SWEB's tariff supply business.
47. This provision aims to allow LE to carry on the SWEB supply business in South Western Electricity plc's area given that, as was explained in paragraph 5 above, under the current licensing structure in England and Wales, South Western Electricity plc must remain technically the Public Electricity Supplier licensee in its distribution area.
48. This provision therefore appears to be an integral part of the operation. Consequently, it cannot be considered as an ancillary restriction.

## **VI. CONCLUSION**

49. 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,