

Text of the CC's remedies statement published in May 2003

The Competition Commission (the Commission) has sent a remedies letter, on a hypothetical basis, to the main party, Centrica plc, in its inquiry into Centrica's acquisition of Dynegy Storage Ltd and Dynegy Onshore Processing UK Ltd.

The Commission has not yet reached conclusions on any aspect of the inquiry, in particular as to whether the acquisition operates, or may be expected to operate, against the public interest. If it does reach an adverse finding on the merger, however, the Commission will wish to make recommendations to the Secretary of State as to measures which would remedy the adverse effects. This statement concerning possible remedies is being made public in order to enable interested parties to comment on the likely effectiveness and practicality of the measures envisaged. Any such comments should be sent to the Commission by Thursday 15 May (see details at the end of the statement).

The possible remedies are put forward on the hypothesis that the Commission might conclude that the merger is against the public interest because of possible adverse effects on competition of a horizontal and/or vertical nature, as postulated in the issues statement published on 4 April.

Behavioural remedies

Provision of flexibility to the market

1. On the hypothesis that the merger, by giving Centrica control of the Rough gas storage facility and the Easington terminal, has given Centrica market power (or enhanced previously existing market power) in the market for flexible gas and that its control of other sources of flexible gas may lead to an incentive to withhold flexibility from the market, either by not supplying existing capacity or by not developing capacity at Rough where this would be value-enhancing for the asset alone, the Commission wishes to explore the following possible remedies:

- (a) That Centrica would give an undertaking on the following lines:
 - (i) That the current nominal capacity of Rough (ie 455 GWh/day deliverability, 30,300 GWh space, 160 GWh/day injectibility) would continue to be sold as 455 million SBUs.
 - (ii) That a specified minimum percentage (perhaps 80 per cent) of nominal capacity would be made available to third parties. Centrica would be able to reserve the remainder for its own use—the level would be set somewhat below Centrica's normal usage of Rough in order to give it an incentive to expand Rough's capacity. Centrica would not participate in any primary sales processes but would be able to purchase any additional requirements in the secondary market.
 - (iii) The nominal capacity could be reviewed after some time—perhaps five years—in order to ensure that additional capacity was made available to the market after a reasonable period. In the meantime any such increases in capacity could be reserved for Centrica's use.
- (b) That Centrica would undertake to operate robust 'use it or lose it' provisions in relation to all Rough capacity.
- (c) That Centrica would undertake not to withhold flexibility from the market through its control of the output of the Morecambe and Sean fields and under its other depletion contracts with other UKCS producers—this may be achieved by a commitment to nominate maximum take from certain fields on particular days according to the demand or forward price in the market. The Group would also like to examine the possibility of a commitment on Centrica's use of its own capacity on the Bacton interconnector.

Non-discrimination between customers

2. On the hypothesis that the merger might enable Centrica to discriminate between customers of Centrica Storage Limited (CSL), which operates the Rough facility, in order to gain a competitive advantage in the downstream market, the Commission wishes to explore the following possible remedies:

- (a) That Centrica would undertake to sell capacity on non-discriminatory terms, perhaps by reference to the standard bundled units defined in paragraph 1(a)(i).
- (b) That Centrica would undertake to sell capacity in a particular manner. The method of sale would need to ensure that Centrica could not manipulate the prices for Rough. The Commission wishes to explore a variety of approaches, including combinations of:
 - annual or quarterly auctions;
 - auctions of the whole or a percentage of capacity;
 - different procedures for auctions; and
 - freedom to sell bilaterally, backed by an auction (with no reserve price) of any remaining capacity 30 days before the start of the storage year.
- (c) As an alternative to (b), that Centrica would control the method of sale, but publish up-to-date prices on offer and the prices agreed for individual sales.
- (d) That CSL should retain the standard Storage Services Contract (SSC), and alter its terms only with the agreement of a majority of users.
- (e) As an alternative to (d), CSL would regularly review with all users the terms of services offered, with a view to agreeing amendments to the SSC; and/or developing a choice of contracts available to all; and/or formulating proposals relating to other aspects of these undertakings.

Information available to the market

3. On the hypothesis that Centrica might gain an unfair advantage from the use of operational and/or customer information concerning Rough and Easington, and/or that Centrica might limit the information available to other companies that would enable them to operate efficiently within the flexibility and downstream markets, the Commission wishes to explore possible remedies that might involve:

- (a) a strict legal, financial and physical separation between Centrica's storage operations and all other parts of its business, perhaps up to main Board level;
- (b) an undertaking from Centrica to ensure that no privileged information was passed from the storage operation to other parts of the group, including a code of conduct for staff that highlighted that breach of the code was a disciplinary matter that could affect employment;
- (c) in addition to (a) and (b), that there should be reports to Centrica's Audit Committee, which in turn would submit a regular report to OFT and Ofgem on:
 - the arrangements for ensuring separation and protection of privileged information;
 - the operating plan for CSL; and
 - compliance with the full set of remedies.
- (d) publication of the annual audited financial results of CSL, with disclosure of how Centrica paid for its own capacity use at Rough;
- (e) an undertaking from Centrica that CSL would obtain its own shipper's licence (or that CSL would use a shipper independent of Centrica) to conduct trades necessary for operational

purposes associated with the management of the storage facility—but would be prohibited from engaging in any other trades; this would replace the present situation under which CSL engages the trading arms of the Centrica group to conduct trades on its behalf;

- (f) an undertaking from Centrica to make any disclosure relating to the operation of Rough to all market players simultaneously;
- (g) an undertaking that Centrica would disclose more information on the operation of Rough, such as:
 - daily level of gas in store;
 - within-day, perhaps hourly, injection/withdrawal quantities; and
 - operational limitations;
- (h) an undertaking that Centrica would disclose the level of capacity at Rough held by it for each storage year.

Certainty provided to competitors and potential entrants

4. On the hypothesis that Centrica's competitors and potential entrants to the market may face additional risks and uncertainty stemming from Centrica's enhanced position in the market for gas flexibility, the Commission wishes to explore the following possible remedies (in addition to 1(a) and (b)):

- (a) an undertaking from Centrica that a specified minimum proportion of capacity should be offered on staggered long-term contracts and a specified minimum to be offered on annual contracts. For example, Centrica would offer at least 50 per cent of capacity for terms of between 3 and 7 years, and reserve at least 20 per cent for annual contracts. The purpose of such an undertaking would be to offer customer choice, ensure that new entrants were not excluded and facilitate traders' involvement in the market, and to ensure that control of a significant proportion of long-term Rough flexibility was controlled by parties other than Centrica. The Commission has provisionally decided that prohibiting indexed contracts would not be appropriate as this would reduce customer choice, but it would like to explore the possibility of an undertaking from Centrica to offer both fixed and indexed long-term contracts.
- (b) an undertaking from Centrica to facilitate the efficient operation and development of a secondary market in Rough capacity, perhaps by:
 - (i) ensuring injectability, space and deliverability rights are defined in ways to allow them to be traded separately;
 - (ii) maintaining arrangements that allow for the transfer (not unreasonably restricted) of all or part of the rights purchased in the primary market; and
 - (iii) publishing regularly updated information on prices offered and attained in the primary market.

5. The Commission is inclined to the view that it would not be appropriate to prohibit Centrica from buying capacity in the secondary market, although some measure to provide reassurance for competitors may be appropriate—see 3(h).

Duration of any undertakings

6. The Commission's provisional view is that the duration of any package of undertakings should not be limited to a specified period but that Centrica could request that they be reviewed if it could demonstrate that there has been a material change in the circumstances which had led to the undertakings being put in place.

Structural remedy

7. The Commission also wishes to explore whether complete divestment of the assets acquired would be a more appropriate response to any combination of the hypothetical adverse effects that the Commission has identified, particularly if it appeared that the extent of the undertakings needed to address any adverse effects would itself have a negative effect on the market.

8. The Commission has provisionally decided that partial divestment, so that the assets were operated as a joint venture, would not be a suitable remedy because of the complexity and intrusiveness of the provisions that would be needed to ensure that such a remedy was effective in addressing the possible adverse effects of the merger.

Responses

9. Comments should be sent to the Inquiry Secretary (Room 613), Competition Commission, New Court, 48 Carey Street, London WC2A 2JT (telephone 020-7271-0282, fax 020-7271-0367), e-mail centrica@competition-commission.gsi.gov.uk by Thursday 15 May.