

Anticipated acquisition by RWE AG of a 16.67% minority stake in E.On SE

Decision on relevant merger situation and substantial lessening of competition

ME/6800/19

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 5 April 2019. Full text of the decision published on 16 April 2019.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

SUMMARY

1. RWE AG (**RWE**) has agreed to acquire a 16.67% stake in E.On SE (**E.On**) (the **Merger**). RWE and E.On are together referred to as the **Parties**.
2. The Merger is part of a complex asset and share swap transaction between the Parties during which:
 - E.On will acquire RWE's energy distribution network and retail business in the form of innogy SE (**Innogy**) (the **Innogy Acquisition**); and
 - RWE will acquire almost all of E.On's assets for the generation of energy from mainly renewable sources¹ (the **Generation Assets Acquisition**).

¹ This includes the generation assets currently held by Innogy that will initially be sold to E.On and will then be re-acquired by RWE.

3. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of RWE and E.On is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the turnover test is met. Accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
4. The CMA found that the Innogy Acquisition, the Generation Assets Acquisition and the Merger are interconditional, in a way that the Merger cannot proceed without the Innogy Acquisition and the Generation Assets Acquisition and vice versa. Given that the Merger will not proceed if the Innogy Acquisition and the Generation Assets Acquisition do not proceed, the CMA has only assessed a scenario in which both the Innogy Acquisition (currently subject to the European Commission's review under the European Union Merger Regulation²) and the Generation Assets Acquisition proceed simultaneously or immediately after the Merger.
5. After the Merger, the Parties will have a small overlap in wholesale energy in Great Britain (**GB**),³ ie in electricity generation and in the wholesale trading of electricity and gas. Apart from this horizontal overlap, the Parties will be active at different levels of the supply chain with RWE focusing on electricity generation and E.On focusing on retail energy supply.⁴
6. In line with previous decisions of the CMA⁵, the CMA has assessed the impact of the Merger in the following frames of reference:
 - (a) the retail supply of electricity to domestic customers in GB;
 - (b) the retail supply of gas to domestic customers in GB;
 - (c) the retail supply of electricity to small and medium enterprises (**SME**) in GB;
 - (d) the retail supply of electricity to industrial and commercial (**I&C**) customers in GB;
 - (e) the retail supply of gas to SME customers in GB;
 - (f) the retail supply of gas to I&C customers in GB;

² Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L 24, 29.01.2004, p. 1-22.

³ The Parties have [X] in Northern Ireland, which has separate gas and electricity arrangements from GB.

⁴ Outside the UK, E.On will also operate energy distribution networks.

⁵ [CMA, Final report of the Energy Market Investigation 2014 - 2016](#), 24 June 2016, and the precedents cited therein.

- (g) the wholesale supply of electricity in GB (including generation and trading); and
 - (h) the wholesale supply of gas in GB (including production and trading).
- 7. The CMA, for the purposes of this decision, did not have to conclude on the exact product and geographic scope of the relevant frames of reference, because, as explained below, the CMA found that no concerns arise on any plausible frame of reference.
- 8. The CMA has considered whether the Merger would give rise to:
 - (a) unilateral horizontal effects in the wholesale supply of electricity and gas in GB; and
 - (b) vertical effects as a result of the vertical relationship between the activities of E.On in the retail supply of electricity and RWE in the electricity and gas generation and trading operations in GB.⁶
- 9. With regard to the horizontal effects of the Merger, the CMA found that the combined shares of supply of the Parties after the Merger will be lower than 20% in GB generation, with a very small increment of less than [0-5]% resulting from the Merger. Post-Merger, both entities will continue to be constrained by a sufficient number of credible competitors in both the wholesale supply of gas and electricity in GB.
- 10. The CMA also believes that the Merger does not raise vertical competition concerns. After the Merger, RWE would not have the ability to foreclose its competitors, either upstream in the wholesale supply of electricity and gas (input foreclosure) or downstream (customer foreclosure), mainly because:
 - (a) With regard to input foreclosure, post-Merger RWE's share in the wholesale supply of electricity and gas in GB will be relatively small, with only a small increment brought by the Merger, and it will have limited (if any) opportunities to exercise unilateral market power in generation.⁷ Furthermore, a unilateral strategy by the RWE would not have significant effects on other market participants' ability to trade wholesale energy

⁶ In relation to the wholesale supply of gas, the Parties do not overlap in the production of gas in GB and only have a very small overlap in gas trading (following the Transactions, RWE will no longer need to trade gas to supply a retail arm in GB).

⁷ Opportunities may arise if a generator is 'pivotal', ie if it is not possible to meet GB's electricity demand without using any of that generator's capacity. In such a situation, a generator might strategically reduce the output of one or more of its power stations in order to increase the wholesale price, and therefore the profitability of its other power stations. These opportunities arise very rarely, as discussed below.

effectively, in particular because the volume of trading is several times the overall demand downstream for gas and electricity.

(b) With regard to customer foreclosure, post-Merger, E.On will have retail shares in the supply of electricity and gas, by volume, lower than [20-30]%. Furthermore, wholesale markets have sufficient alternative buyers and sellers that the Parties will not be able to engage in foreclosing behaviour.

11. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) within a market or markets in the UK resulting from horizontal or vertical effects.
12. The Merger will therefore not be referred under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

13. RWE is a DAX-listed German energy company. Its Europe-wide activities are focused on two business areas, (i) electricity generation from mainly conventional sources (lignite, gas, nuclear), and (ii) energy trading (for which it has introduced its own platform). Via its subsidiary Innogy, RWE also controls Npower plc (**Npower**), a British retail energy supplier.
14. In the financial year ending 2017 RWE had revenues of £[~~XX~~] in the UK.
15. In 2017, Innogy announced a proposed merger between Npower and the domestic supply business of SSE plc. After the CMA had investigated and cleared this merger,⁸ this transaction was abandoned by the Parties in November 2018.
16. E.On is a DAX-listed German energy company. Its Europe-wide activities are focused on three business areas: (i) electricity generation from renewable sources, (ii) energy distribution networks, and (iii) retail supply.
17. In the financial year ending 2017 E.On had revenues of £[~~XX~~] in the UK.
18. E.On previously held a 46.65% stake in Uniper SE, to which it had spun off its conventional electricity generation business and its global commodities

⁸ CMA, [SSE Retail and Npower](#), A report on the anticipated merger between the domestic retail energy business of SSE plc and Npower Group Limited, 10 October 2018.

trading business. In January 2018, E.On sold its shares in Uniper SE to Fortum Oyi, a Finnish energy company with its seat in Espoo, Finland. The transaction was completed on 26 June 2018 following an investigation by the European Commission.⁹

Transaction

19. Under the “*Share Purchase and Transaction Agreement relating to the sale and purchase of all shares (indirectly) held by RWE AG in innogy SE*”, E.On will execute a capital increase from authorised capital with the additional shares being provided to RWE against a contribution in kind comprising of all of its shares in Innogy and an additional cash payment of 1.5 billion. As a result, RWE will hold a 16.67% stake in E.On.
20. As explained in more detail below, the Merger is part of a complex asset and share swap transaction of the Parties that also comprises the Generation Assets Acquisition and the Innogy Acquisition.
21. The Parties submitted that the rationale of the Merger is to provide RWE with shares in E.On as part of the consideration for the acquisition by E.On of the shares in Innogy and thus enable E.On to finance the acquisition of RWE’s 76.8% stake in Innogy via a non-cash capital increase. The Parties further submitted that the 16.67% stake in Innogy is also intended to provide a reliable cover of RWE’s nuclear and lignite provisions and to support covering long-term liabilities, all via stable and attractive dividend payments.
22. The Parties further submitted that the rationale for both the Innogy Acquisition (including the Merger) and the Generation Assets Acquisition is for the Parties to specialise in different levels of the energy supply chain, with RWE focusing on energy generation and E.On focusing on energy distribution networks, retail supply of energy and customer solutions.¹⁰

Jurisdiction

23. In the context of an anticipated transaction, a relevant merger situation exists where there are arrangements in progress or in contemplation which, if carried into effect, will lead to enterprises ceasing to be distinct and either:

⁹ The European Commission decision on [M.8660 - Fortum/UNIPER](#), 15 June 2018.

¹⁰ The Parties’ submission about the rationale of the Merger is confirmed by internal documents produced by the Parties, namely minutes of the meetings of the supervisory board of both RWE and E.On.

- (a) the value of the target enterprise's UK turnover exceeded £70 million in its last fiscal year (the turnover test); or
- (b) the enterprises ceasing to be distinct have a share of supply in the UK, or in a substantial part of the UK, of 25% or more in relation to goods or services of any description (the share of supply test).¹¹

Two or more enterprises ceasing to be distinct

- 24. Each of RWE and E.On is an enterprise. The CMA considered whether the acquisition will lead to RWE and E.On ceasing to be distinct.
- 25. Two or more enterprises will cease to be distinct if they are brought under common ownership or control.¹² The ability to exercise material influence constitutes the lowest level of control that may give rise to two or more enterprises ceasing to be distinct. Although there is no presumption of material influence below 25%, the CMA may examine any shareholding of 15% or more in order to see whether the holder might be able materially to influence the company's policy.¹³
- 26. In this case, given the level of shareholding acquired by RWE, the CMA considered whether RWE will acquire the lowest level of control, that is the ability, directly or indirectly, to materially influence the policy of E. On.

The Parties' Views

- 27. The Parties have submitted that the 16.67% stake that RWE will acquire in E.On will not give RWE the ability to exercise material influence over E.On for a number of reasons.
- 28. First, the Parties submitted that the minority stake is intended to be a purely financial investment. In particular, the Parties submitted that, via dividends from its shareholding, RWE's commercial aim is to bolster its existing financial portfolio and counter its exposure to the energy transition in Germany with an investment that will provide stable and attractive dividends.
- 29. Second, the Parties submitted that they have entered into an Investor Relationship Agreement which limits RWE's ability to exercise material

¹¹ Section 23 of the Act.

¹² Section 26(1) of the Act.

¹³ [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), paragraph 4.20.

influence on E.On. In particular, the Parties submitted that the Investor Relationship Agreement:

(a) [REDACTED];¹⁴

(b) [REDACTED];¹⁵

(c) [REDACTED];¹⁶

(d) [REDACTED]¹⁷ [REDACTED]¹⁸ and

(e) [REDACTED].¹⁹

30. Third, [REDACTED].

31. Fourth, the Parties have submitted that RWE's expertise and status will not lead to RWE having a degree of "soft" influence over other shareholders to such an extent that RWE effectively has a blocking stake because:

(a) RWE will cease to have any material activities at the same level of the supply chain as E.On and therefore will not have any unique or special business knowledge or insights;

(b) E.On's remaining shareholders are mostly institutional investors who typically have experience of investing in the utilities sector with a view to securing stable returns; and

(c) [REDACTED].

32. Fifth, the Parties have submitted that the Investor Relationship Agreement will [REDACTED], between RWE and E.On that will continue to apply in the long term.

The CMA's assessment

33. The CMA's assessment of whether the acquisition of a minority shareholding gives the ability to exercise material influence requires a case-by-case analysis of the overall relationship between the acquirer and the target and depends on the facts and circumstances of each case.²⁰

¹⁴ [REDACTED].

¹⁵ [REDACTED].

¹⁶ [REDACTED].

¹⁷ The Parties submitted That E.On's supervisory board will comprise 14 members (of which seven members are determined by the shareholders and seven members are determined by employee representatives).

¹⁸ [REDACTED].

¹⁹ [REDACTED].

²⁰ [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, paragraph 4.15.

34. In considering whether material influence may be present in a particular case, the CMA will consider not only whether the acquiring party has the right to block special resolutions but also whether, given other factors, it is able to do so as a practical matter. This gives effect to the general principle that the purpose of UK merger control is to enable the CMA to consider the commercial realities and results of transactions and that the focus should be on substance rather than legal form.²¹
35. In this case, the CMA notes that at 16.67%, RWE's shareholding is at the low end of the levels of holding which have, in the past, been found to confer material influence. The CMA also notes the Parties' submission that the 16.67% stake is purely a financial investment and the existence of the Investor Relationship Agreement between the Parties. Regardless of the weight the CMA places on the Investor Relationship Agreement,²² the CMA considers that, post-Merger, RWE may have the ability to exercise material influence on E.On, at least at shareholder level and on the basis of two factors which are not addressed by the Investor Relationship Agreement, namely:
- (a) RWE's level of shareholding compared with other shareholders; and
 - (b) RWE's ability, given its status and industry expertise, to influence other shareholders and/or affect policy formulation.
36. As set out in the CMA's Guidance, one of the factors relevant to the assessment of a minority shareholding is "*the distribution and holders of the remaining shares, for example whether the entity's shareholding makes it the largest shareholder*".²³ In this case, the evidence indicates that, at present, 78% of E.On's shareholders are institutional investors. RWE's 16.67% stake makes it the largest shareholder post-Merger by some margin as RWE's stake was more than twice that of the next largest shareholder, BlackRock. BlackRock has a stake of 7% and [REDACTED]. The CMA therefore considers that the size of RWE's voting rights combined with its status and industry expertise (see below) may facilitate the adoption of decisions (including special resolutions) at shareholders' meetings.
37. The CMA may also have regard to "*the status and expertise of the acquirer, and its corresponding influence with other shareholders*" and may consider "*whether, given the identity and corporate policy of the target company, the*

²¹ *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), paragraphs 4.20 and 4.21.

²² The CMA notes that it would not be unreasonable to perceive some risk associated with relying on the Investor Relationship Agreement, including its application to unknown future events, and [REDACTED] ([REDACTED]) and enforceability.

²³ *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), paragraph 4.21.

acquirer may be able to materially influence policy formulation at an earlier stage through, for example, meetings with other shareholders".²⁴ In this case, RWE is a consolidated and well respected player with significant expertise in the energy sector. The CMA considers that RWE may be able to use this status and expertise to influence other shareholders and, therefore, to materially affect a policy that may be expected to require a special resolution at an early stage through, for instance, meetings and discussions with other shareholders. When RWE has a view in relation to any decision favoured by E.On's board, it may have the ability to influence the voting of other shareholders due to the size of its shareholding combined with its industry knowledge and standing.

38. The CMA acknowledges that post-Merger RWE will cease to be active at the same level of the supply chain as E.On. This, however, does not mean that post-Merger RWE will lose all of its expertise and operational knowledge acquired over time in the markets E.On is active in. For a certain period, RWE's acquired expertise and experience will continue to be of relevance and up to date. Further, RWE's financial interest in E.On combined with the size of its stake suggest that RWE will, at least, continue to monitor E.On's areas of activities with a view to monitoring the financial attractiveness of its investment in E.On. Finally, the Parties have submitted that RWE is active in a multitude of energy sector related activities, associations and conferences so that it will continue to update its knowledge on the markets E.On is active in.
39. The CMA notes that other E.On's shareholders are sophisticated institutional investors with investments in utility firms. However, they do not have the same level of expertise and active involvement in the industry as a former competitor such as RWE. Therefore, RWE's views may be of particular interest to shareholders who do not avail of the knowledge and expertise as RWE does.
40. Finally, the fact that RWE has undertaken, under the Investor Relationship Agreement, [X], does not prevent RWE from using its industry knowledge and standing to influence the voting of other shareholders, and/or to affect early policy formulation, for instance, through meetings and discussions with other shareholders.
41. In light of the reasons set out above, and on the facts and circumstances of this case, the CMA considers that the 16.67% stake in E.On will give RWE the

²⁴ [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), paragraph 4.22.

ability to exercise material influence over E.On and, as a result of the Merger, the enterprises of RWE and E.On will cease to be distinct.

Turnover test

42. In the year ending 2017 E.On had a turnover exceeding £70 million in the UK. Therefore, the CMA considers that the turnover test in section 23(1)(b) of the Act is satisfied.

Conclusion

43. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

Industry Background

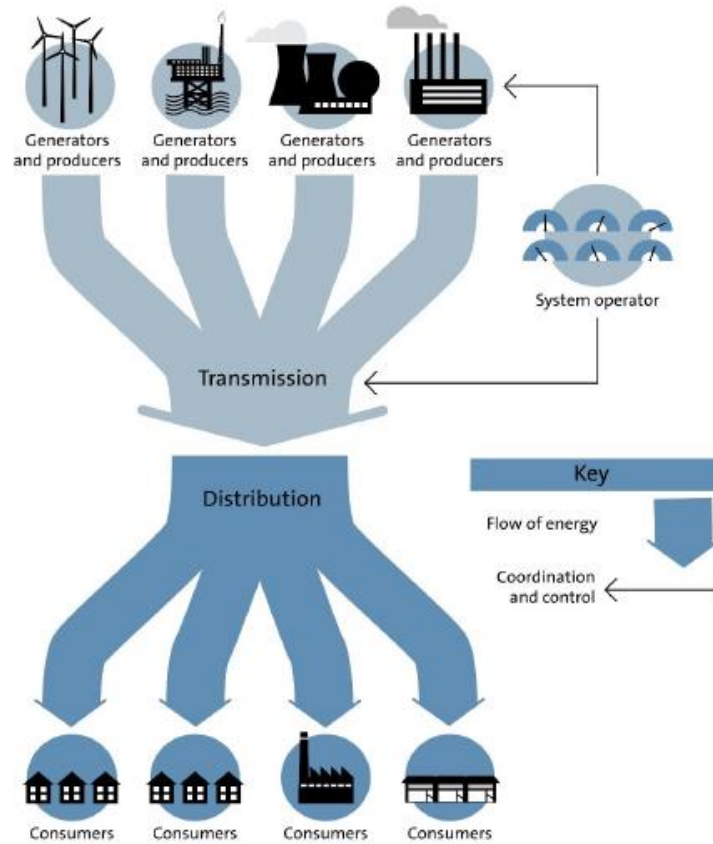
The supply chain in the energy sector

44. The energy sector consists of electricity generators and gas producers, grid operators and distribution network operators (who transport the electricity and gas to end users), wholesale traders (who trade energy for half-hour periods at various moments in the future), a system operator (National Grid) and retail supply companies (who sell electricity and gas to end users).
45. Wholesale activities in the energy sector in GB broadly encompass the following:
- (a) upstream production and importation of gas, as well as generation and importation of electricity, for sale into the wholesale trading market; and
 - (b) bilateral and exchange trading between producers, generators, suppliers, and financial traders in the wholesale trading market.
46. At a high level, there are some strong similarities between the supply chains for electricity and gas:
- (a) In the electricity sector, different types of generation technology (eg coal, gas, nuclear or renewable) generate electricity, which is transported to customers via high-voltage transmission lines and low-voltage distribution lines.
 - (b) In the gas sector, gas from different sources (eg from offshore fields in the North Sea, imports via interconnectors from other countries or imports in

the form of liquified natural gas) is transported to customers via high-pressure transmission pipes and low-pressure distribution pipes.

47. Figure 1 illustrates, at a high level, the basic flow of energy to customers in both the electricity and gas sectors.

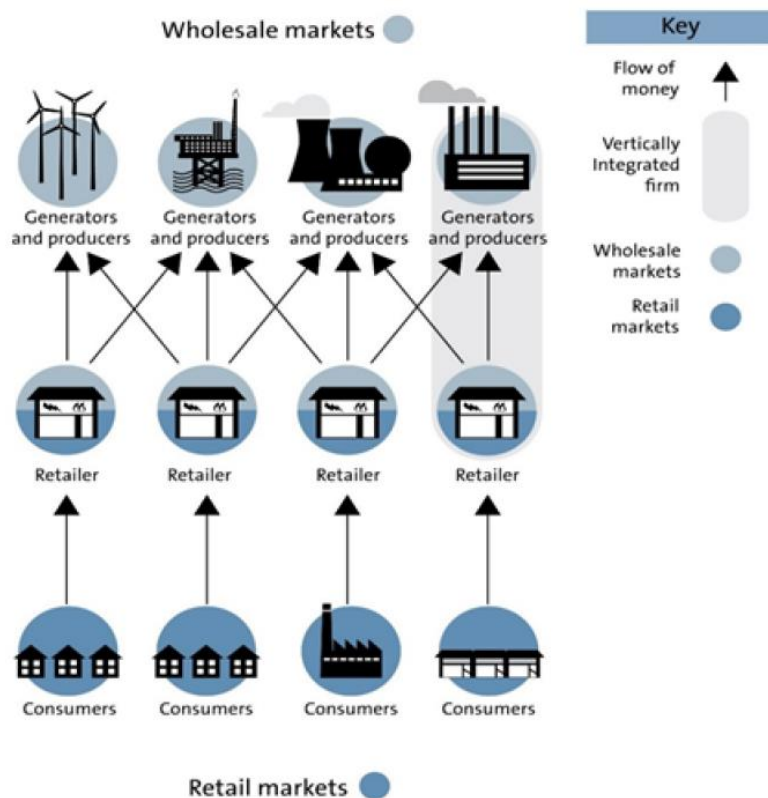
Figure1: Physical supply chain in electricity and gas



Source: EMI final report (24 June 2016), Figure 2.1.

48. Figure 2 below demonstrates the financial flows and market arrangements between the generators and producers (upstream) and energy retailers (downstream).

Figure 2: Financial flows and market arrangements between generators and producers and energy retailers



Source: EMI final report (24 June 2016), Figure 2.2.

49. The trading for electricity and gas in wholesale markets can take place bilaterally or through exchanges. Contracts can be struck over multiple timescales, from several years ahead to on-the-day trading. Gas is financially settled and balanced on a daily basis as it can be stored, while electricity is financially settled on a half-hourly basis.
50. Retail activities in the energy sector encompass the purchasing of gas and electricity in wholesale markets and selling it onto final customers.
51. Most energy retailers are active both in the retail supply of electricity and gas. Gas and electricity are often sold together by energy retailers through a bundled tariff called a 'dual fuel' tariff. Moreover, the regulatory regime applying to retail functions applies equally to electricity and gas.
52. In its energy market investigation (2014-2016) (EMI),²⁵ the CMA found several features of domestic retail energy supply giving rise to adverse effects on

²⁵ CMA, Final report of the Energy Market Investigation 2014 - 2016 (24 June 2016).

competition, including an overarching feature of weak customer response and lack of engagement. This gives suppliers the ability to exploit their position through their pricing policies, eg through price discrimination by charging their Standard Variable Tariffs materially above a level that could be justified by cost differences.²⁶ Since the conclusion of the EMI, a series of remedies were implemented to deal with some of the competition concerns raised, in particular in the areas of domestic weak customer response, prepayment and restricted meters.²⁷

53. Most households continue to be served by one of the ‘six large energy firms’ (**SLEFs**) – British Gas, who previously supplied gas to the whole of GB, and the five firms who are the successor companies to the former incumbent electricity suppliers in the 14 ‘Public Electricity Suppliers’ (**PES**)²⁸ regions (SSE, EDF, Scottish Power, E.On and Npower).
54. As stated in Ofgem’s 2018 State of the Energy Market Report, the retail markets are still concentrated, but concentration is declining.²⁹ The SLEFs’ combined share of supply of domestic energy in GB has declined from approximately 95% in 2013 to around 75% in 2018. In June 2018, there were 73 active licensed suppliers in the domestic retail market, of which 64 were dual fuel, seven gas-only and two electricity-only. These suppliers form a heterogeneous group with a variety of business models.

Parallel transactions between the Parties

55. The Merger is part of a larger set of transactions involving both the Innogy Acquisition and the Generation Assets Acquisition. Innogy Acquisition and Generation Assets Acquisition were notified to the European Commission.
56. Under the Innogy Acquisition, E.On will acquire RWE’s 76.8% stake in Innogy, while also making a public bid for the remainder of Innogy. Most of the generation assets of Innogy will then be transferred back to RWE as part of the Generation Assets Acquisition.

²⁶ The Standard Variable Tariff is the most commonly used default tariff for domestic customers, ie the tariff that domestic customers pay unless they have actively chosen a different tariff.

²⁷ [CMA, Final report on the anticipated merger between the domestic retail energy business of SSE plc and Npower Group Limited](#) (10 October 2018), paragraph 2.53.

²⁸ Public electricity suppliers (**PES**) were the 14 electricity companies created in GB when the electricity market was privatised. In relation to electricity distribution, there are 14 licensed distribution network operators in GB which are owned by six different groups.

²⁹ [Ofgem’s 2018 State of the energy market report](#), page 18.

57. The Innogy Acquisition was notified to the European Commission on 31 January 2019.³⁰ On 7 March 2019, the European Commission decided to initiate a Phase II review under Article 6(1)(c) of Council Regulation 139/2004 with respect to the Innogy Acquisition.³¹ [✂].
58. Under the Generation Assets Acquisition, RWE will acquire most of E.On's electricity generation business mainly from renewable energy sources and minority participations in two nuclear power plants in Germany. In the UK, E.On will retain a proportion of its participation in the Rampion offshore windfarm, as well as its [✂].
59. The Generation Assets Acquisition was notified to the European Commission on 22 January 2019.³² On 26 February 2019 it was unconditionally cleared by the European Commission.³³
60. The Merger was also notified to and unconditionally cleared by the German Federal Cartel Office.³⁴ It found that the Merger would not lead to RWE becoming dominant in the German wholesale market, nor would it create incentives for the Parties to engage in foreclosure in Germany.³⁵

Previous CMA merger investigation and market investigation in the energy sector

61. The CMA recently reviewed an anticipated acquisition by SSE plc (**SSE**) of Npower, which is active in the retail supply of domestic and non-domestic gas and electricity gas and electricity and energy related services in GB. On 8 May 2018 the CMA referred this transaction for an in-depth investigation.³⁶ After clearance at the end of phase II investigations the parties decided to abandon the transaction.
62. From 2014 to 2016, the CMA conducted an in-depth investigation into the energy market in the UK, including both the wholesale and retail markets

³⁰ Case page [M.8870](#).

³¹ [Press release of the European Commission](#).

³² Case page [M.8871](#).

³³ [Press release of the European Commission](#), 26 February 2019.

³⁴ [Press release of the German Federal Cartel Office](#).

³⁵ [FAQ document published by the German Federal Cartel Office](#). The full decision is not yet available.

³⁶ [CMA, Final report on the anticipated merger between the domestic retail energy business of SSE plc and Npower Group Limited](#), 10 October 2018. In its final report the CMA noted that it had found that the Parties are not particularly important constraints on each other in acquisition tariffs due to a relatively low level of customer switching between the Parties and a large number of additional alternative suppliers, SLEFs and small and medium-sized suppliers (**SAMS**). The CMA further found that suppliers would have continued to face fierce competition in default tariffs. This was based on a large number of customers being disengaged on standard variable tariffs. The CMA found that any increase in Standard Variable Tariffs would have prompted customers to re-engage and that re-engaged customers usually aim for acquisition tariffs.

(including the supply to households and microbusinesses). As explained above in paragraph 52, the CMA found several features of retail energy supply giving rise to adverse effects on competition in the EMI. On 24 June 2016 the CMA published its final report on its EMI.³⁷

Counterfactual

63. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.³⁸
64. The Parties have submitted that the CMA should adopt pre-merger conditions of competition as the counterfactual against which to assess the impact of the Merger.
65. At phase 1, the CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction). The CMA is likely to consider whether the statutory test for reference would be met whether or not the parallel transaction proceeds (unless the parallel transaction can clearly be ruled out as too speculative).³⁹
66. As stated in paragraphs 57 and 59 above, the Parties have notified the Innogy Acquisition and the Generation Assets Acquisition to the European Commission. While the latter was cleared unconditionally, the former was referred to an in-depth investigation.
67. The CMA found that the Innogy Acquisition, the Generation Assets Acquisition and the Merger are interconditional in a way that the Merger cannot proceed without the Innogy Acquisition and the Generation Assets Acquisition and *vice versa*. This is supported by three key factors.

³⁷ CMA, [Energy market investigation, Final Report](#), 24 June 2016.

³⁸ [Mergers Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Mergers Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D).

³⁹ [Mergers Assessment Guidelines](#), paragraphs 4.3.5, 4.3.25, 4.3.26 et seq.

68. First, based on the contractual arrangements the CMA is satisfied that the Innogy Acquisition will not proceed if the Merger does not go ahead and vice versa. The share purchase agreement for the Innogy Acquisition provides that a number of relevant closing actions are to be undertaken simultaneously to the completion of the Merger, including: (i) the delivery by RWE of a duly executed subscription certificate in relation to the additional shares in E.On (16,6%); and (ii) the conclusion of a contribution agreement with respect to the Innogy shares by RWE as contribution in kind for the acquisition by RWE of E.On's shares.
69. Second, the CMA is satisfied that the Generation Assets Acquisition is also dependent on prior completion of both the Innogy Acquisition and the Merger. [X].⁴⁰
70. Third, the Merger is also commercially conditional on the Generation Assets Acquisition. This is because the Innogy Acquisition (including the Merger) is commercially tied to the Generation Assets Acquisition as the Parties transaction goal of specialising on different levels of the value chain would be unattainable without completion of the Generation Assets Acquisition.
71. Given the interconditionality between the three transactions, the CMA considers that there is no realistic prospect that the Merger will take place without the Innogy Acquisition and the Generation Assets Acquisition and it is not necessary to assess the Merger in a scenario in which the Innogy Acquisition and the Generation Assets Acquisition do not proceed. Therefore, the CMA has only assessed the Merger in a scenario in which both the Innogy Acquisition and the Generation Assets Acquisition take place simultaneously or immediately after the Merger.
72. For the avoidance of doubt, the CMA has not assessed the effects on competition of either the Innogy Acquisition or the Generation Assets Acquisition as standalone transactions.

Frame of Reference

73. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the

⁴⁰ Such closing actions include: (i) the filing of a capital increase in E.On with the responsible court registry in Germany; (ii) the delivery by RWE of a duly executed subscription certificate in relation to the additional shares in E.On; (iii) the conclusion of a contribution agreement with respect to the contribution of the Innogy shares by RWE as contribution in kind; (iv) the assignment of all of RWE's shares in Innogy to E.On; and (v) the conclusion of an Investor Relationship Agreement [X].

market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.⁴¹

Overlaps and vertical relationships between the Parties

74. Pre-Merger, the Parties overlap in both wholesale and retail in GB. Moreover, they frequently trade with one another in the wholesale market.⁴² The Parties have an overlap in the wholesale supply of electricity (both generation and trading). The Parties do not overlap in the production of gas. In relation to the wholesale supply of gas, the Parties do not overlap in the production of gas in GB and will have only a very small overlap in gas trading (following the Transactions, RWE will no longer have a retail arm in GB and will therefore not need to trade gas for hedging purposes).

Product Scope

Wholesale supply of energy (electricity and gas)

75. In line with previous decisions, particularly its final report in the EMI, the CMA has considered the frame of reference separately for the wholesale and retail supply of energy.⁴³
76. In the EMI, the CMA found the wholesale supply of electricity and gas to be two separate markets comprising different segments including generation of electricity (both the production of electricity at power stations and imports through interconnectors) and production of gas (including imports), as well as trading of electricity and gas.⁴⁴
77. With regard to the wholesale supply of energy, the Parties submitted that the appropriate frame of reference is a single product market for generation and trading of electricity, and a second wholesale market for the production and trading of gas.⁴⁵

⁴¹ [Mergers Assessment Guidelines](#), paragraph 5.2.2.

⁴² In the UK, all of the E.On Transfer Assets are located in GB. [X].

⁴³ Neither Party is present in the UK markets for distribution or transmission.

⁴⁴ EMI report, pages 139 and 140.

⁴⁵ Merger Notice, paragraphs 102-104.

78. This is in line with the approach of the European Commission.⁴⁶
79. The CMA has received no evidence to suggest that it would be appropriate to deviate from these precedents and has therefore assessed the Merger using two separate frames of reference for the wholesale supply of electricity and the wholesale supply of gas. In both cases, the frame of reference includes trading.

Retail supply of energy

80. With regard to retail markets, the Parties submitted that the CMA should define separate markets for gas and electricity, as it has done in previous decisions.⁴⁷
81. Moreover, the Parties submitted that the CMA should distinguish three customer types:
- (a) domestic customers;
 - (b) SME customers; and
 - (c) I&C customers.
82. The Parties submitted that the CMA should not distinguish customers based on their meter type, tariff type, or payment method.
83. The CMA has received no evidence to suggest that it would be appropriate to depart from previous decisions. The CMA has not received any evidence to indicate that the approach previously adopted by the CMA in relation to the distinction between the supply of gas and electricity as separate frames of reference is not appropriate in the present case. Therefore, the CMA has assessed the effects of the Merger in relation to the retail supply of gas and electricity separately and has not considered dual fuel tariffs as a distinct frame of reference.⁴⁸

⁴⁶ European Commission decision on [M.8871 - RWE/E.On Assets](#), 26 February 2019.

⁴⁷ [CMA, final report on its energy markets investigation 2014-2016](#) (24 June 2016); [SSE Retail and Npower, A report on the anticipated merger between the domestic retail energy business of SSE plc and Npower Group Limited](#), 10 October 2018.

⁴⁸ Dual fuel tariffs are tariffs for a combined contract for electricity and gas. Because electricity and gas are not demand-side substitutes, the CMA and its predecessor authorities have generally not found it appropriate to define a dual fuel market. [SSE Retail and Npower, A report on the anticipated merger between the domestic retail energy business of SSE plc and Npower Group Limited](#), 10 October 2018, paragraphs 7.5-7.15.

84. The CMA may sometimes define separate relevant frames of reference for separate customer groups if the effects of the merger on competition with regard to the supply varies between different groups of customers.
85. In line with previous decisions, the CMA distinguished between domestic and non-domestic customers.⁴⁹ Domestic customers are defined in the supply licence as those who use electricity wholly or mainly for domestic purposes. Within non-domestic customers, the CMA and the OFT distinguished between the supply of electricity and gas to I&C customers and the supply of electricity and gas to SMEs. This was due to different needs and profiles on the demand side and different services and technologies offered on the supply side. In the supply of electricity, SME and I&C customers can be distinguished by the type of contract which sets out whether customers will be charged at half-hourly tariffs or not. For the supply of gas, the distinction is more difficult and may depend on the size of the customer.
86. While the CMA has found it difficult to establish a clear distinction between the characteristics of SMEs, including microbusinesses, and I&C customers (industrial and commercial customers), particularly in the supply of gas, it was not necessary to conclude on this point, since no competition concerns arise on any plausible frame of reference.
87. Similarly, the CMA has not found it necessary to decide whether customers on a Standard Variable Tariff or domestic customers with a restricted meter constitute a separate frame of reference since no competition concerns arise on any plausible frame of reference.

Geographic Scope

88. The Parties proposed a geographic frame of reference encompassing all of GB for all product frames of reference. This is consistent with past decisional practice of the CMA.⁵⁰
89. With regard to the wholesale supply of gas and energy, in the EMI the CMA found that wholesale suppliers of each fuel compete in separate GB markets regulated by Ofgem and that there are certain times when markets may be more localised or regionalised by transmission constraints that cause isolated

⁴⁹ See, for instance, the OFT decisions on: (i) the *anticipated acquisition by Telecom Plus plc of Electricity Plus Supply Limited and Gas Plus Supply Limited from Npower Limited* (ME/6289/13), 16 December 2013; and (ii) the *anticipated acquisition of Economy Power Limited by E.On UK plc* (ME/1667/05), 9 June 2005.

⁵⁰ The relevant market does not include Northern Ireland because of the limited interconnector capacity between Northern Ireland and GB, because of the different regulatory framework in Northern Ireland, and because of the fact that the Parties and most of their competitors in the GB market have limited or no presence in Northern Ireland.

markets. However, the CMA in the EMI did not need to take a definitive view and considered that the appropriate scope to assess the wholesale geographic markets for both gas and electricity to be GB. The European Commission, in previous decisions, considered that the relevant geographic scope for the wholesale supply of gas and electricity comprised the whole of GB, as this area was subject to the same regulatory framework and therefore similar conditions of competition applied.⁵¹

90. At retail level, the CMA has considered whether retail energy suppliers in GB compete nationally or whether they compete in individual regions. The CMA found that the opportunities for regional variation in competition have increased significantly since the EMI, as the prior regulatory limits on the suppliers' ability to offer tariffs and promotions adapted to local competitive conditions have been removed. However, the CMA considers that a GB-wide frame of reference is still appropriate, because of demand-side and supply-side considerations, such as uniform product characteristics and the prevalence of suppliers operating across the whole of GB. The CMA notes, however, that individual PES regions can play a prominent role in how suppliers think about competition and that regional pricing is becoming increasingly prevalent.
91. The CMA assessed the effects of Merger in GB, but it did not have to conclude on the exact scope of the geographic frame of reference both at retail and wholesale level, because no competition concerns arise on any plausible geographic frame of reference.

Conclusion

92. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:
 - (a) the wholesale supply of electricity in GB, including trading in GB;
 - (b) the wholesale supply of gas in GB, including trading in GB;
 - (c) the retail supply of electricity to SMEs in GB;
 - (d) the retail supply of electricity to I&C customers in GB;
 - (e) the retail supply of gas to SMEs in GB;

⁵¹ European Commission decision on [M.5224](#) – EDF/British Energy, 22 December 2008.

- (f) the retail supply of gas to I&C customers in GB;
- (g) the retail supply of electricity to domestic customers in GB; and
- (h) the retail supply of gas to domestic customers in GB.

Competitive assessment

93. Focusing on areas in which the parties overlap the CMA assessed the Merger focusing on whether the transaction gives rise to
- (a) unilateral horizontal effects in the market for the wholesale of gas or electricity (including trading); and
 - (b) vertical effects created by the vertical integration of the Parties.

Unilateral Horizontal Effects

94. As discussed above in paragraphs 55 to 60, the Merger is part of a deal that also includes the Innogy Acquisition and the Generation Assets Acquisition. The European Commission has already cleared the Generation Assets Acquisition and has referred the Innogy Acquisition to Phase 2 without identifying competition concerns in the UK markets that it investigated.⁵²
95. As explained in the Counterfactual section, the analysis below assumes that RWE's assets in the UK that are part of the Generation Assets Acquisition have already been transferred to E.On and that the Parties are no longer competitors in the retail supply of energy in GB, as a result of the Innogy Acquisition.
96. Moreover, the CMA found that the Parties' shares of supply in the wholesale supply of electricity in GB do not raise *prima facie* competition concerns. After completion of the Merger and the Generation Assets Acquisition, RWE will have a share of [10-20]% in the generation of electricity (by volume supplied), in GB, while E.On will retain a share of less than [0-5]%. Therefore, the combined share of RWE post-Merger will be lower than 20%, with a very small increment of less than [0-5]% resulting from the Merger.
97. In the EMI, the CMA found that the eight largest owners of generating capacity have very different portfolios of technologies, with EDF Energy being currently the largest generator with a share of around 26% of generation

⁵² European Commission cases [M.8870](#) and [M.8871](#).

output. The CMA also found, following a review of the period between 2012 and 2013, that no single generator had the incentive to increase the wholesale price by a significant amount in a significant number of half-hour periods.⁵³

98. Ofgem uses pivotality analysis, which looks at past generation and trading data, to assess whether power stations that are owned by a company are required to meet demand in a given period. If this were the case, the generator would be pivotal and could potentially influence wholesale prices in that period. However, Ofgem's most recent modelling suggested that there would not be significant opportunities to exert pivotality.⁵⁴ Given the scale and nature of the assets acquired in this Merger, Ofgem's conclusion on this point is unlikely to change.
99. With regard to the trading of electricity and gas, there is a high level of trading of electricity and gas in GB. For example, EMI found a level of "churn" (the electricity traded compared to the amount delivered to consumers) of over 3.5 times, and significantly higher in gas. Each of the SLEFs traded multiples of the size of their final consumption and generation of electricity, and many other generators and suppliers, as well as financial investors, traded significant volumes as well. In relation to the trading of gas, in particular, the GB gas market is a hub with a range of external supply sources which attracts participants across Europe. Therefore, although exact figures are not available, the Parties are responsible for a relatively small share of trading.
100. No third party raised concerns with the horizontal effects of the Merger. Ofgem has also not expressed concerns with the horizontal effects of the Merger.
101. For the reasons set out above, the CMA believes that the firm post-Merger will continue to be constrained by a sufficient number of credible competitors and that the overall change in market structure brought about by the Merger is limited (in particular because the increment in the share of supply is small).
102. Accordingly, the CMA has found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the wholesale supply of electricity and gas in GB.

⁵³ CMA, [Final report on its energy markets investigation 2014-2016](#) (24 June 2016), paragraph 4.85.

⁵⁴ [Ofgem's 2019 State of Energy Market report](#), page 50.

Vertical effects

103. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer.
104. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in the foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC in the foreclosed market(s), not merely where it disadvantages one or more competitors.⁵⁵ In the present case, the CMA has considered whether the Merger is likely to give the Parties the ability to engage in input or customer foreclosure.
105. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) the incentive of it to do so, and (c) the overall effect of the strategy on competition.⁵⁶ This is discussed below.
106. The CMA notes that pre-Merger both Parties are vertically integrated.⁵⁷ This raised two issues which were considered in the EMI. First, the CMA analysed the scope for input or customer foreclosure in the GB electricity sector and found that foreclosure was unlikely to be an issue.⁵⁸ The CMA found that: (i) the lack of unilateral market power in the wholesale supply of energy make it implausible that vertically integrated generators would be able to foreclose non-vertically integrated ('independent') retail suppliers; and (ii) there was no evidence of vertically integrated energy suppliers refusing to buy from independent generators, as suggested by continued investment in generation by these generators.
107. Second, vertical integration could raise barriers to entry and growth by new suppliers if they were unable to secure sufficient wholesale electricity. However, the EMI's analysis of wholesale market liquidity⁵⁹ suggests that vertically integrated firms carry out extensive external trading, and liquidity in the products that vertically integrated firms use to hedge their exposure to

⁵⁵ In relation to this theory of harm 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.

⁵⁶ [Mergers Assessment Guidelines](#), paragraph 5.6.6.

⁵⁷ Although E.On is only active in generation to a limited extent, following the transfer of its conventional generation assets to Uniper.

⁵⁸ EMI, [Appendix 2](#). There, the CMA also analysed various partial foreclosure strategies in greater detail.

⁵⁹ Liquidity is a measure of the availability of products that market participants wish to trade; the EMI said that a product can be considered to be liquid if it is possible to buy or sell it without causing a significant change in its price. Poor liquidity could distort competition.

wholesale market risk is sufficient for independent firms to hedge in a similar way.

108. Ofgem has not expressed concerns with the vertical effects of the Merger.

Input foreclosure

109. When assessing the scope for input foreclosure, the CMA assessed whether either firm post-Merger could increase wholesale electricity prices by (a) withholding generation capacity at times of particular scarcity (ie when the firm is pivotal), or (b) changing its trading activity to sell less to particular suppliers or reduce liquidity in general, in order to increase independent suppliers' costs.
110. With regard to withholding capacity at particular times, the CMA found that neither party has significant ability to engage in such a strategy, and that the Merger would not change this. As set out above in paragraph 96, RWE will have a post-Merger share in electricity generation by output of [10-20]%, with less than [0-5]% increment resulting from the Merger, while there is no overlap in the production of gas. Furthermore, as set out above, RWE will not have significant opportunities (if any) to exert pivotality.
111. With regard to changing its trading activity, the CMA found in EMI that a firm could not target specific suppliers, because a large majority of trading is anonymised.⁶⁰ The CMA also found that a unilateral strategy by any firm would not have significant effects on overall liquidity. Finally, the CMA found that there is a considerable amount of generation output outside the SLEFs that generators sell on the wholesale market. This includes output from both independent generators and other vertically integrated firms that are 'long' in generation, ie that generate more electricity than they sell to their own retail customers.
112. Since the CMA has concluded that the Merger will not provide RWE with the ability to foreclose competitors downstream, the CMA has not assessed in detail the impact of the Merger on its incentive to foreclose or the effect of a foreclosure strategy on competition. However, the CMA notes, on incentive, that given that RWE will only acquire a minority share in E.On (16.67% share), in order for RWE to have the incentive to profitably engage in a foreclosure strategy, the gains downstream would have to exceed the upstream costs by a factor of 6.

⁶⁰ EMI, [Appendix 2](#), paragraph 84.

Customer foreclosure

113. When assessing the scope for customer foreclosure, the CMA assessed whether E.On may reduce its purchases of electricity from RWE's competitors in the wholesale supply of electricity in order to harm their ability to compete in the upstream wholesale supply of electricity. In particular, the CMA considered the extent to which rival upstream firms can supply to other electricity retailers in the UK.
114. In the EMI, the CMA did not identify a plausible mechanism that would permit a single vertically integrated supplier to foreclose one or more independent generators. This conclusion did not rely on factors that will be affected by the Merger. In particular, the points made above in paragraph 111 about trading, ie the fact that a large share of trading is anonymous, and that many generators have a 'long' position, apply equally to both sides of the market. It is unlikely that any firm, even post-Merger, would be able to significantly influence liquidity.⁶¹
115. In relation to the supply of electricity in GB, E.On will have a share of supply of [20-30]% in relation to domestic customers, [20-30]% in relation to SME, and [20-30]% in relation to I&C. In the retail supply of electricity overall, this amounts to a [20-30]% share. With regard to the retail supply of gas in GB, E.On will have a share of supply of [10-20]% in relation to domestic customers, [10-20]% in relation to SMEs; and [5-10]% in relation to I&C.
116. While E.On will be the largest electricity supplier in GB, it is unlikely that its scale downstream will create any ability to foreclose rival electricity generators.
117. First, given that electricity is a homogeneous good, it is unlikely that E.On's share of supply of less than [20-30]% is enough to make it an essential route to market.⁶²
118. Second, E.On will need to supply to end users much more electricity than RWE will have the capacity to generate, meaning that E.On will in any event have to do business with other wholesale suppliers.

⁶¹ EMI, [Appendix 7.2](#).

⁶² For comparison, when examining non-horizontal mergers, the European Commission uses a 30% market share threshold, below which problems are unlikely. European Commission (2008), [Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings](#), page 16.

119. Third, large amounts of wholesale electricity trading take place in venues where the identities of the buyer and seller are not known at the time that trading takes place, meaning that it would be difficult to target any particular generator(s). Given the various trading mechanisms that exist and the large number of participants in the market, the CMA believes that E.On would not have the ability to influence the prevailing level of wholesale prices or to reduce wholesale market liquidity.⁶³
120. Therefore, the CMA considers that the Merger will not give rise to the ability to engage in customer foreclosure.
121. Since the CMA has concluded that the Merger will not provide E.On with the ability to foreclose its rivals upstream, the CMA has not assessed the impact of the Merger on its incentive to foreclose or the effect of a foreclosure strategy on competition.

Conclusion on vertical effects

122. For the reasons set out above, the CMA believes that, post-Merger, the firms will not have the ability to engage in input or customers foreclosure, because its shares of supply upstream and downstream are below 30%. The wholesale supply of electricity and gas is sufficiently liquid, with many alternative buyers and sellers, so that the Parties will not be able to engage in foreclosing behaviour upstream or downstream.
123. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in relation to the supply of wholesale electricity and gas (customer foreclosure) and the retail supply of electricity and gas to customers (to both domestic, SME and I&C customers) (input foreclosure) in GB.

Barriers to entry and expansion

124. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.⁶⁴ In terms of timeliness, the CMA's guidelines indicate that the CMA

⁶³ [EMI final report, appendix 7.1.](#); [Ofgem's 2018 State of the energy market report](#), pages 51 et. seq.

⁶⁴ [Merger Assessment Guidelines](#), from paragraph 5.8.1.

will look for entry to have a significant impact on competition within two years.⁶⁵

125. However, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

126. The CMA contacted the Parties' main upstream and downstream competitors. None of them raised specific concerns regarding the Merger. No other third parties raised concerns about the Merger.

127. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

128. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom.

129. The Merger will therefore **not be referred** under section 33(1) of the Act.

Eleni Gouliou

Director, Mergers

Competition and Markets Authority

8 April 2019

⁶⁵[Merger Assessment Guidelines](#), paragraph 5.8.11