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Energy and Infrastructure

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A "special merger control regime" for Energy Network Enterprises

What has changed?

The Energy Act 2023 introduces a new UK merger control regime under which all mergers between energy network companies active in the UK can be assessed for their impact on Ofgem's ability to make comparisons between energy networks. Transactions can be blocked/unwound where such impact is found to be prejudicial.

This new requirement sits alongside both the current UK merger control regime essentially scrutinising whether transactions result in a "substantial lessening of competition" and the government's power to review transactions in the energy sector under the National Security and Investment Act 2021.

Whilst the new regime came into force in October 2023, the Competition and Markets Authority ("CMA") and Ofgem only issued guidance on their respective role, approach and intended methodologies in April 2024.

A similar "special merger regime" already exists in respect of mergers between water companies. The CMA makes reference to this regime in its guidance stating that its experience in administering the water regime will be relevant to its approach to reviewing relevant transactions in the energy network sector.

In this update we give an overview of the new regime, how it fits with the existing UK regulatory framework as it relates to the energy sector, along with its likely impact on deal opportunities, structures and timetables for parties impacted by the new regime.

Why is this relevant to you?

This new regime adds an additional regulatory layer when considering potential transactions in the UK energy network sector. The relevant test is framed around a preservation of Ofgem's ability to compare data from independently run entities meaning the assessment cuts across the commercial rationale of the benefit and synergies that can flow from owning two businesses in the same space.

Although the new regime is voluntary, parties will need to consider whether to notify the CMA depending on the nature of the arrangements. The CMA has the power to call any transaction for review to determine whether it is in scope, and the lack of any share of supply test indicates that transactions which have relatively limited impact on competition may still be reviewable.

The likelihood that an assessment of a transaction will be taken through to phase II will have the probable impact of elongating deal timetables. Parties should seek competition (and FDI advice) as early as possible in any transaction to address these timing and regulatory consequences.

Deeper Dive

The scope of the special energy network merger regime

The new regime applies to transactions involving two "energy network enterprises" of the same type[1]. The jurisdictional threshold for the new regime is based on turnover only (as opposed to the UK's general merger regime which also has an alternative share of supply test).

Similarities with the existing special merger regime for water companies

The special merger regime for water companies is well established, and should provide a degree of comfort around the new regime in that it is simply moving energy networks into line with the regulatory approach already taken in the water industry. However, the differences in the structures of these markets does suggest that the impact will be felt in different ways. Whereas the water industry framework could be described as "mature" consisting of a small number of large players, and meaning that consolidation is unlikely, energy network enterprises are actually four distinct types of businesses[1], vary in size from large to small "last mile" operators, and so likely to be more "dynamic" in nature in terms of acquisition and consolidation opportunities.

The Process

The new regime is administered and enforced by the CMA and the process is similar to the general UK merger control regime insofar as:

- Voluntary – no legal requirement to notify even if a transaction meets the jurisdictional threshold; however the CMA monitors the markets and can investigate on its own initiative if a transaction has not been notified
- Pre notification – parties are strongly encouraged to engage with the CMA and Ofgem as early as possible to discuss the application of the new regime to any proposed transaction
- Initial phase I investigation – 40 working days, to either clear or refer for an in depth phase II investigation. Undertakings in lieu of a phase II investigation can be accepted
- In depth phase II investigation – 24 weeks (can be extended by a further 8 weeks)
- Deals can be investigated and potentially "blocked" (or unwound) even after completion

The CMA will work closely with Ofgem in any review of a relevant transaction. Where a transaction is referred for an in-depth phase II investigation, the final decision-making authority will be an independent group of experts selected from a panel appointed by the Secretary of State.

[1] *Energy network enterprises are the companies that hold licences to operate the networks that carry electricity and gas around Great Britain (and are funded by consumers through their energy bills) - split into four types: electricity transmission, gas transmission, electricity distribution and gas distribution*

The test: Impact on Ofgem's ability to make comparisons between energy network enterprises

The tests for phase I and phase II under the new regime are slightly different.

The question for the CMA at phase I is whether there is a "realistic prospect" that a transaction would substantially prejudice Ofgem's ability to make comparisons between energy network enterprises. At phase II this becomes "on a balance of probabilities" threshold test.

The CMA may decide not to make a phase II reference where, "this prejudice is outweighed by relevant customer benefits relating to the merger." The CMA can also accept undertakings in lieu of a phase II reference.

In its "statement of methods" Ofgem highlights the different ways in which an energy network transaction could have detrimental impacts on its ability to make comparisons. These include:

- Potential reduction in the quality of information on costs and performance
- Potential reduction in the diversity of management approaches and practices
- Potential reduction in the extent of rivalry between network licensees

The CMA, in its final guidance, sets out examples of the types of factors that it may consider when assessing the impact of a transaction under the new regime. These include:

- Any reduction to the number of independent observations available to Ofgem to facilitate their comparison of costs, outputs, and service quality
- The loss of an independent comparator
- The extent to which the transaction will change benchmarks
- The loss of a company with important similarities, or important differences
- Whether it would be possible for Ofgem to change its approach to offset these potential impacts

In reaching a decision at phase I, the CMA has stated that it will place significant weight on Ofgem's opinion on whether the transaction is likely to prejudice its ability to make comparisons between energy network enterprises. The CMA has also explained that in order not to refer a transaction to phase II, the CMA will need to be able to make a decision that the transaction is not likely to cause this prejudice "within the constraints of the phase I timetable" Citing likelihood that the issues to be assessed may be complex the CMA have said that, even where there is agreement in principle between Ofgem and the parties that the merger is not likely to lead to prejudice, a phase II referral may be "necessary to come to a conclusion." Such an approach will have an impact on deal timetabling, and parties may need to prepare for a significant period between signing and closing a transaction subject to CMA review.

Interplay with pre-existing merger control regime

The existing general UK merger control regime will continue to apply to transactions involving energy network enterprises. This means that where the businesses of both (or more) transacting parties involve energy network companies of the same type but where there's other activities involved , the CMA will consider:
the parts of the transaction relating to the overlapping energy network companies under the special energy network merger provisions; and
the parts of the transaction relating to the parties' other activities under the general merger control provisions.

Where both regimes apply to a transaction the CMA has stated that it will endeavour to investigate the cases together, however two separate F fees will be payable.

Interplay with National Security and Investment Act

As energy is one of the sectors where the government has powers to scrutinise and intervene in acquisitions and investments for the purposes of protecting national security, this regulatory framework will also be relevant in assessing any transactions involving an energy network company.

Conclusion

This new regime will potentially add a further regulatory layer on transactions in the sector. Parties looking to transact in the UK will need to consider this regime (along with the existing regimes described above) to prepare effectively for any regulatory hurdles to overcome.

If you have any questions concerning any of the areas covered in this update, please do not hesitate to contact the following Paul Hastings London lawyers:

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About Paul Hastings

Paul Hastings has widely recognised elite teams spanning all areas of corporate law. With more than 25 years of experience representing clients on all sides of projects, we have one of the most experienced teams of infrastructure and energy lawyers in the world, working closely with our experienced antitrust and competition practice to advise on merger control and FDI issues.