



Information Paper:
**Guidelines on Evaluation of Merger and Acquisition Proposals
in the Electricity Industry**

September 2004

ENERGY MARKET AUTHORITY OF SINGAPORE

EMA'S GUIDELINES ON EVALUATION OF MERGER AND ACQUISITION PROPOSALS IN THE ELECTRICITY INDUSTRY

The Electricity Act stipulates, *inter alia*, that any agreement that prevents, restricts or distorts competition in the electricity market is prohibited unless an exemption is granted by the Authority, with the approval of the Minister.

2 The Authority also imposes, as a licence condition, a prohibition against any electricity generation licensee acquiring or holding shares in, *inter alia*, other generation licensees, unless a waiver is granted by the Authority. A retail licensee is prohibited against acquiring or holding shares in, *inter alia*, other retail licensees, unless a waiver is granted by the Authority.

3 In line with the policy to separate, at ownership level, the contestable from the non-contestable parts of the industry, the electricity generation licensees ("gencos") and electricity retail licensees ("retailers") will be prohibited from acquiring shares in the electricity transmission licensee, the market support services licensee, the wholesale market operator and the gas transporter.

4 Where a genco or retailer who wishes to engage in merger and acquisition activity applies to the Authority for an exemption/ waiver, the Authority would apply the following evaluation guidelines.

Evaluation Guidelines

5 The Authority's evaluation of merger and acquisition proposals would be predicated on its assessment of the impact on competition in the industry which may arise from the proposed merger or acquisition. The Authority may also consult the public for views on the proposed merger or acquisition. The Authority's decision on the proposed merger or acquisition will be posted on its website.

Cross ownership among the gencos and retailers

Three large gencos not allowed to hold shares in each other

6 The Authority will not allow the three large gencos, viz Senoko Power Ltd, PowerSeraya Ltd and Tuas Power Ltd to hold any interest in each other or in each other's related retail companies. This is to ensure that their market power is not exacerbated. No other genco or retailer related to a genco will be allowed to own any interest in the three large gencos unless the group of companies divests some of its generation capacity such that the aggregate generation capacity after acquisition does not exceed the generation capacity of the large genco before acquisition.

No restriction on gencos and retailers cross owning up to 5%

7 Except for Senoko Power Ltd, PowerSeraya Ltd, Tuas Power Ltd and their respective related retail companies and as set out in paragraph 6 above, there would be no restriction on

- a) any genco owning up to 5% of the voting shares in any other genco or in any retailer other than its existing related retailer; and
- b) any retailer owning up to 5% of the voting shares in any other retailer or in any genco other than its existing related genco.

Cross ownership of more than 5% between the gencos and retailers

8 Where any proposed merger and acquisition activity would result in cross ownership of more than 5% between (a) a genco and another genco, (b) a retailer and another retailer or (c) a genco and any retailer other than its existing related retailer, the Authority would take into account the following guidelines in its evaluation:

Market concentration

Impact on market concentration

9 A merger or acquisition is unlikely to create or exacerbate market power and impact on competition unless it significantly increases market concentration. Change in market concentration is generally considered to be evidenced by the impact of a proposed merger on the market share of the respective players.

Measures of market concentration

10 In USA¹ and UK², a Herfindahl-Hirschman Index (HHI) in excess of 1800 is considered indicative of a highly concentrated market.³ Separately, a study by Oxford Economic Research Associates (OXERA) concluded that in a competitive market, the combined market share of the 3 largest companies would not exceed 50%.

HHI as indicator of market concentration

11 The HHI will be used in the assessment of market concentration. Currently, the HHI for Singapore's electricity generation market is around the 2800 level and the combined market share of the 3 largest gencos is in excess of 80%.

¹ Source: Horizontal Merger Guidelines, US Department of Justice and the Federal Trade Commission

² Source: Mergers: substantive assessment, Office of Fair Trading

³ The HHI is a measure of market concentration. It is calculated as the sum of squares of the market shares of the individual companies in an industry sector.

12 As a guide, any proposed merger that results in a significant increase in HHI of 100 points or more will require further review as to whether it should be allowed.

Barriers to Entry

13 Failure of the market concentration test would not necessarily mean that the Authority will reject an application. If the proposed merger or acquisition results in a significant increase in the HHI, the Authority may still allow the proposed merger if it determines that barriers to entry into the market is low.

14 Low barriers to entry would not impede the entry of new companies into the market and this would serve as the competitive force that would curb market power possessed by the merged entity. Some factors that may be considered in determining whether barriers to entry are low or high are the costs of capital investments, regulatory restrictions, brand loyalty, access to inputs and market growth.

Other Factors

15 In addition to the above, other relevant factors may be considered. For example, even if the proposed activity “passes” all guidelines above, it may involve the “removal” of a vigorous and effective competitor. As such, the proposed activity would lead to a substantial lessening of competition and would not be allowed.

16 The Authority would also be guided in its evaluation by any views/ feedback garnered from the public consultation, if any.

Note:

This document is intended to provide an account of the Authority’s policy on this matter. It does not in any way bind the Authority to grant any approval or official permission for any matters, including but not limited to the grant of any exemption nor to the terms of any exemption. The Authority reserves the right to change its policies and/or to amend the terms of this document without prior notice.