

**AID C 52/03 (EX NN45/03)**

**RESTRUCTURING AID IN FAVOUR OF BRITISH ENERGY PLC (“BE”)**

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**COMMENTS SUBMITTED ON BEHALF OF GREENPEACE LIMITED  
PURSUANT TO THE COMMISSION’S INVITATION PURSUANT TO  
ARTICLE 88(2) OF THE EC TREATY<sup>1</sup>**

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<sup>1</sup> OJ 2003/C180/03 at Annex 1

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## **INTRODUCTION**

1. Greenpeace Limited is the UK arm of Greenpeace International, a body with offices in more than 30 countries, two of whose main activities are:
  - (i) campaigning to end the use of nuclear power in view of the extreme operational dangers and the severely toxic (and effectively permanent) pollution that it creates in the form of radioactive waste, for which no safe solution for disposal has yet been found; and
  - (ii) promoting the use of clean and renewable energy resources in the UK, in the form of wind, solar and wave power, in the place of polluting energy sources.
2. The grant of unlawful aid to BE (and, accordingly, any decision approving such aid) directly affects the campaigning interests of Greenpeace but, more importantly, Greenpeace has a direct interest in the operation of the electricity market and in the effect of the granting of unlawful aid to the nuclear industry.
3. Greenpeace has entered into a contract with a major utility company, NPower Limited, jointly to market electricity to be generated by offshore wind power. Greenpeace's commercial interest in the production and marketing of electricity generated by offshore wind power is inevitably affected adversely by any distortion of competition (resulting from the grant and approval of State aid) between BE, as a generator of electricity from nuclear power, and generators who use wind power.
4. In view of both its campaigning and its commercial interests, Greenpeace was involved in domestic proceedings concerning the failure to notify the Commission of the grant of rescue aid to BE and is currently party to proceedings against the Commission in respect of the Commission's decision NN 101/02 (adopted on 27 November 2002) to approve that rescue aid as compatible with the common market.

5. Greenpeace now submits these comments on the restructuring aid granted or to be granted in favour of BE as interested parties within the meaning, and for the purposes, of Articles 1(h) and 20 of Regulation No. 659/1999 on detailed rules for the application of Article 88 of the EC Treaty.
6. The full detail of the restructuring package is not in the public domain. Greenpeace can therefore comment on the package only to the extent that details of the package are set out in the Official Journal. In its decision inviting comments, the Commission has described the restructuring package as constituting 7 measures, labelled A to G (briefly summarised in Part II of the Summary). These comments, which focus on a small number of key issues identified in the Commission's analysis, adopt the same categorisation in relation to those measures.

#### **SUMMARY OF SUBMISSIONS**

7. In terms of the aid measures themselves, Greenpeace wish to draw the Commission's attention to specific matters in relation to Measures A (funding of nuclear liabilities), B (BNFL contracts) and, in so far as it concerns BNFL, Measure C (debt stand-still). In summary Greenpeace contends that:
  - (i) Measure A, in capping BE's contributions to the funding of its nuclear liabilities, constitutes unjustifiable State aid to BE and/or to its shareholders as a means of enhancing BE's attraction to investors on the market;
  - (ii) Measures B and, as regards BNFL, C constitute unjustifiable operating aid since they confer ongoing support by BNFL acting or deemed to be acting as the State or at the behest of the State (and not as a market economy investor) in circumstances where:
    - (a) it is itself an ailing undertaking which survives only with the benefit of State aid;

- (b) it was party to tri-partite negotiations with the government and BE which led to the formulation of BE's restructuring package immediately following BNFL's own refusal to vary the terms of its contracts with BE;
- (c) the agreements are in any event lacking in genuine commerciality; and
- (d) the renegotiated pricing terms do not reflect the actual costs associated with the service provided but are linked to wholesale prices;

8. Greenpeace also makes submissions with regard to the compatibility of the aid measures with the Guidelines on State aid for rescuing and restructuring firms in difficulty ("the Guidelines"). In that connection it endorses the Commission's current analysis of the aid and wishes to emphasize the following matters:

- (i) The aid measures in question do not restore BE's viability through internal means and, in so far as they externalise costs, particularly in relation to nuclear liabilities, offend against the polluter pays principle;
- (ii) the grant of aid does indeed lead to distortions of the electricity market: in particular, in artificially depressing prices so as to render unattractive or uneconomic entry on the market of alternative capacity from new forms of electricity generation such as renewable sources;
- (iii) it is likely that significant structural overcapacity already exists on the market and is set to increase: it may be appropriate therefore for the Commission to examine compensatory measures which lead to a reduction in BE's capacity;
- (iv) the UK authorities' arguments in relation to detrimental effects of capacity reduction are unfounded and suffer from flawed analyses; and
- (v) not only is it impossible to determine that the measures in question constitute aid limited to the minimum necessary but also the UK authorities have failed to consider the option of partial or phased closure which may result in a more limited intensity of aid being

required.

9. Finally Greenpeace makes submissions in relation to the UK authorities' contentions concerning the overlap between the purpose of the aid and the objectives of the Euratom Treaty. It contends that the Euratom Treaty is irrelevant to the Commission's analysis of the aid, which must be considered under the State aid provisions of the EC Treaty. Greenpeace further contends that even if the objectives of Euratom are as the UK contends and are relevant to the assessment of the aid, the aid cannot be justified by reference to those objectives and it is unlikely that those objectives are in any event achieved by the measures in question.

#### **MEASURE A: FUNDING OF NUCLEAR LIABILITIES**

10. According to paragraph 31 of the Commission's Letter to the United Kingdom ("the Letter"), BE's contributions to the funding of its nuclear liabilities will be capped "so that shareholders benefit from retained cash flow and proceeds of new subscriptions for shares...". However, any shareholder in a commercial venture must normally take the risks associated with the venture. The rewards that a shareholder can normally expect under normal conditions of competition reflect the extent to which the venture performs above its normal liabilities.
11. The proposed system of funding nuclear liabilities is therefore a State aid (as both the United Kingdom and the Commission acknowledge: see paragraph 117 of the Letter). The State aid can be regarded either as an aid to BE itself or as an aid to the shareholders in BE. In either event, it does not appear to be justifiable.
12. As a State aid to BE's shareholders, Measure A's justification would have to be assessed by reference to the position of each shareholder. So far as Greenpeace can see, there is no basis for asserting that any of them is in need of State aid and no basis for believing that, if they were in need, the aid falls under any of the grounds of justification set out in the Treaty.

13. As a State aid to BE, the benefit flows through to the shareholders and presumably takes the form of keeping BE as an attractive vehicle for investment (in competition with other listed companies) and of assisting the maintenance of its share price. Greenpeace does not consider that that can be justified as restructuring aid. It is, in effect, a permanent form of aid designed not to return BE to commercial viability but to enhance its attractions on the stock market. Since the amount of any aid should be the minimum amount that is justified, Greenpeace considers that, whatever else may be said about Measure A, it involves the grant of an unjustifiably high level of aid.

#### **MEASURES B AND C: THE RENEGOTIATION OF BNFL CONTRACTS AND THE STANDSTILL ON BE'S DEBTS TO BNFL**

14. Greenpeace notes that the Commission currently considers that Measures B and (insofar as it concerns BNFL) C constitute aid within the meaning of Article 87(1) of the EC Treaty. That conclusion is wholeheartedly endorsed by Greenpeace for the following reasons.

#### **BNFL is not acting as an arm's length market participant**

15. BNFL is a wholly owned state company which is itself in a precarious financial position. Its Annual Report and Accounts for 2003<sup>2</sup> indicate that it continues to be technically insolvent with net liabilities exceeding net current assets by nearly £2.7 million (marking a significant increase in its deficit by comparison with the previous year). Additionally it appears to be to a large degree dependent itself upon aid from the UK government. Current assets include an undertaking by the Secretary of State which amounts to nearly £5.2 billion in value and relates to nuclear liabilities. It is not known at this stage whether that undertaking has been notified to the Commission or whether BNFL has received the same tax disregard as has been granted to BE.

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<sup>2</sup> Annex II page 33

16. According to its Annual Report for 2003, BNFL has also suffered as a result of continuing low prices in the wholesale electricity market which increased its operating loss<sup>3</sup> and undermined the economic viability of its power stations, resulting in the premature closure of two of them<sup>4</sup>. The directors of BNFL used the going concern basis in preparing the accounts in reliance on a promise made by the United Kingdom Government in 2001 to remove most of BNFL's nuclear liabilities and associated assets from its balance sheet and in anticipation of the activation of that promise<sup>5</sup>. Otherwise, BNFL clearly could not be regarded as a going concern.

17. It is Greenpeace's understanding, as confirmed by the Commission at paragraph 121 of the Letter that BE had been trying for some time to renegotiate its fuel contracts with BNFL and had failed to do so (owing no doubt to BNFL's own financial situation). The statement made by BE's Chairman, Adrian Montague, in the company's Annual Report and Accounts for 2002-3<sup>6</sup> says:

“For some time, British Energy had been seeking to renegotiate its fuel contracts with BNFL and thereby secure a significant reduction in its fixed cost base. On 3 September 2002, BNFL delivered its final proposal to British Energy but the terms proposed fell short of those which the Company required. In any event, having reviewed the longer-term prospects of the Group, including future market prices and trading conditions, the Board concluded that it should not draw down on existing undrawn loan facilities and decided that there was no alternative but to seek support from the Government.

On 5 September 2002, the Company announced that it had entered into discussions with the Government to seek immediate financial support and to enable a longer-term restructuring to take place...

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<sup>3</sup> Annex II page 2, col. 2.

<sup>4</sup> *Ibid.*, page 13, col. 1.

<sup>5</sup> *Ibid.*, page 27, col. 2.

<sup>6</sup> Annex III page 1, column 1 at paragraph 6



On 28 November 2002, the Company reached agreement *with the Government and BNFL* on the principles of a restructuring plan intended to achieve long-term financial viability, and the credit facility was extended until March 2003. The principles for restructuring included:

- Amending and extending the BNFL contracts for front-end and back-end related fuel services for our AGR stations;
- Establishing a new Nuclear Liabilities Fund (NLF) for all uncontracted nuclear liabilities and decommissioning costs to which British Energy would make ongoing contributions;
- British Energy making contributions to the NLF including 65% of the Group's consolidated net cash flow after tax, financing costs and the funding of cash reserves of up to £490m;
- The Government funding liabilities relating to historic spent fuel and any shortfall in the NLF;
- Compromising the existing claims of significant creditors, in exchange for new bonds and new ordinary shares;
- British Energy disposing of its interests in Bruce Power and AmerGen;
- Implementing a new trading strategy to hedge the majority of British Energy's output." (Emphasis added).

18. That statement makes clear that BNFL, which, on 3 September 2002, had not agreed to BE's proposed terms for re-negotiated contracts was nevertheless involved shortly thereafter and in any event before 28 November 2002 in negotiations with BE and the UK government concerning the entire restructuring package proposed for BE.

19. Greenpeace submits that it is inconceivable that BNFL would have been privy to those discussions (which extended beyond re-negotiation of BNFL contracts) unless it had been acting on the instruction of, or under pressure from, the UK government. It is further incredible that BNFL would have agreed either to the re-

negotiated terms of Measure B or to the debt standstill of Measure C if it had been acting as a market economy investor<sup>7</sup> in view of its own extensive liabilities. At the very least, the participation by BNFL in tri-partite discussions with the government and BE preclude the notion that the assistance conveyed by BNFL is based on an arm's length negotiation.

20. In the light of the above, and in view of the importance of the market economy investor test to any analysis of the relevant aid, Greenpeace urges the Commission to ask BNFL to produce copies of internal BNFL documents which show the considerations that were taken into account by it in deciding to re-negotiate the contracts which it had previously refused to vary.

### **The BNFL contracts lack commerciality**

21. Furthermore and in any event, the spent fuel contracts appear on the face of it to lack commerciality. As the Commission notes in the Letter<sup>8</sup>, BE has no contract for PWR spent fuel because it stores it on site. It could also store AGR spent fuel on site. The AGR spent fuel contracts were entered into in 1995, prior to the privatisation of BE<sup>9</sup>. BE considers that it would be considerably cheaper for it to store the spent fuel instead of having it reprocessed by BNFL<sup>10</sup>. The only conclusion that one can draw is that the contracts are not and were not commercial arrangements from the outset. They look more like an artificial device, put in

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<sup>7</sup> See also the article of 8 September from "The Business" at Annex IV which also suggests that BNFL were unwilling participants in the restructuring negotiations.

<sup>8</sup> Annex I At footnote 6.

<sup>9</sup> Annex I paragraph 50

<sup>10</sup> See paragraphs 85-87 of BE's submissions to the Government's Energy Review, September 2001(Annex V page 10): BE said that storing spent AGR fuel would cost it £50 million whereas having it processed by BNFL cost it £300 million per annum.

place when both BE and BNFL were State-owned and controlled, and designed to provide BNFL with a guaranteed income stream.

22. The private investor test is based upon the premise that the State aid rules are not intended to prevent the Member States from engaging in genuine commercial activity. The test is not intended to cast the mantle of protection over artificial arrangements.
23. Further, insofar as the restructuring plan for BE keeps uncommercial contracts with BNFL in place, there must be a very real concern that part at least of the restructuring aid package has the function of providing BNFL with a continuing stream of income that it would not in ordinary market circumstances have. BNFL is not structured, financed or operated as an ordinary commercial undertaking. It could therefore face with equanimity the cancellation of those uncommercial contracts, which would in turn reduce the burdens on BE and, presumably, lead to a reduction in the amount of the rest of the State aid required by it.

**The agreed payment terms are not linked to the actual cost of the service**

24. Furthermore, Greenpeace contends that, as regards the BNFL contracts, the payment terms extended to BE constitute the conferral of a significant advantage in linking payment for the services to wholesale baseload market prices as opposed to the actual costs that BNFL will incur in providing those services.
25. There is no question but that the advantage is being granted on the instruction of the State through state resources owing to the fact that BNFL is a wholly owned State company and was not acting, in these circumstances, either as an independent undertaking or as a private investor.
26. Moreover, since the advantage conferred by the contracts is ongoing and pursuant to an open-ended agreement, the aid involves long-term support for BE, not a one-off benefit designed to restore its viability: BE's nuclear liabilities are effectively limited to its obligations under the new contracts with BNFL, which vary cost

according to wholesale electricity prices, and whatever contribution if any is made by BE to the NLF the taxpayer is making up for the shortfall and carrying all the risks in the future. The benefit is therefore “operating” and not “restructuring” aid and cannot be compatible with the common market.

27. Both the preferential contract terms and the debt stand-still provisions should, in so far as they are benefits conferred by BNFL, have been included in the notification which the Commission is being asked to approve as restructuring aid or should have been separately notified. In any event, the contracts should not have been effected unless and until the Commission had reached a decision concerning their compatibility with the common market. This is particularly so in view of the fact that they constitute operating aid which is unlikely to be approved.

#### **COMPLIANCE WITH THE GUIDELINES ON STATE AID FOR RESCUING AND RESTRUCTURING FIRMS IN DIFFICULTY (“the Guidelines”)**

##### **Improvement of viability and the polluter pays principle**

28. Paragraph 32 of the Guidelines provides that:

“The improvement in viability must derive mainly from internal measures contained in the restructuring plan and may be based on external factors such as variations in prices and demand over which the company has no great influence if the market assumptions made are generally acknowledged. Restructuring must involve the abandonment of activities which would remain structurally loss-making even after restructuring”.

29. Greenpeace notes that the Commission’s current view (set out at paragraphs 157 to 163 of the Letter) is that it is doubtful that that condition is met by the restructuring plan and that the duration of the plan is as short as possible (also point 32) and fully endorses the Commission’s analysis in that regard.

30. In so far as concerns Measure A which relates to the funding of decommissioning liabilities, the Commission makes the additional point that the measure relieves BE in part from its obligations under the polluter pays principle. That principle is enshrined in Community policy by virtue of Article 174 EC Treaty. There can be no justification for that principle to be contravened in connection with this measure, particularly where additional measures aimed at sustaining the continued operation of BE's stations, without restoring its long term viability, clearly serve only to increase future nuclear liabilities without ensuring that such liabilities can be met.

### **Undue Distortions Of Competition**

31. In its preliminary assessment of the measures in the light of point 35 of the Guidelines, namely whether compensatory measures are necessary in relation to those measures, the Commission has examined first whether the aid distorts competition and secondly whether there exists structural overcapacity on the relevant market. If overcapacity exists on a Community or EEA wide basis, compensatory measures are required and must take the form of an irreversible reduction in production capacity (point 39 of the Guidelines). If no such excess capacity exists the Commission will nevertheless examine whether compensatory measures should be required. Thirdly, the Commission has considered the arguments of the UK authorities concerning capacity reductions and the detrimental effects thereof. Greenpeace intends to deal with each of those 3 areas of consideration in turn.

#### **(1) Impact of the aid on competitors**

32. It cannot be doubted that the electricity market in the United Kingdom is highly competitive and is currently characterised by low prices. It also cannot be doubted that, under normal conditions of competition, less efficient operators would in those circumstances go out of business, leaving present in the market the more efficient operators.

33. The effect of the restructuring aid is to introduce a serious distortion into the

normal competitive process and, more particularly, to inflict serious damage on operators and, perhaps more importantly, potential market entrants who are more efficient than BE but who are being denied the largesse that the United Kingdom Government wishes to shower on BE.

34. In that connection, Greenpeace endorses the Commission's analysis at paragraphs 192 to 199 of the Letter and, in particular, its conclusion at paragraph 196 to the effect that the aid is likely to result in a decrease in electricity market prices. *A fortiori*, lower prices render it more unattractive for new forms of electricity generation to enter the market.
35. As a matter of basic economics regarding market prices (and at the risk of stating the obvious), it is worth noting that, in normal conditions of competition where the balance between supply and demand at a given point in time produces a market price of X, then an increase in supply will produce a fall in price as long as demand remains the same. X may well be a price at which a potential new entrant could operate profitably. However, if that new entrant enters the market, the immediate effect (other things being equal) will be that the price will fall below X.
36. If the new entrant is more efficient than an incumbent supplier, that will not matter because the competitive process will in principle lead to the total or partial replacement of the incumbent by the new entrant. In those circumstances, prices will not go higher than X and may be lower.
37. If the incumbent goes out of business before the new entrant enters the market, then (other things being equal), prices will rise above X, because supply has fallen while demand has remained the same, unless other incumbents increase supply or there is new entry into the market. When a new entrant enters the market, prices will in principle decline because supply has increased. If the volume of supply reverts to what it had been before (whether because of new entry or an increase in supply from other incumbents, or both), prices will return to X (other things being equal).

38. The problem about the grant of State aid to the incumbent is that it deters both competition from other incumbents and new entry because other incumbents and new entrants are prevented from exploiting their own efficiencies: if they increase supply or enter the market, the market price will decline but they will be unable to use that to shift the inefficient incumbent because the State aid shelters it from the effects of competition.
39. Where the market price (X) *is* too low (that is, it is below the level that it would reach under undistorted conditions of competition), the grant of State aid to the weakest operator in the market is about the most unacceptable form of State aid that can be imagined. In such circumstances, the most common response, where a Member State envisages the grant of State aid, is for the aid to be given to the undertaking(s) most likely to survive (“picking the winners”) because they are the ones most likely to be viable in the longer term and because that is the best way of restoring the market to healthy competition.
40. By comparison, “picking the loser” is a perverse reaction. It damages or knocks out of the market existing operators who are more efficient and, as noted above, deters new entry by more efficient operators. The inevitable result is a less competitive and less efficient market.<sup>11</sup>
41. The distortive effects of the restructuring aid therefore would be permanent and would either prevent or impede the evolution of the electricity market into a market that is better able to deliver energy to consumers efficiently and consistently with legitimate environmental and other policy concerns.

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<sup>11</sup> It should also be noted that the Government’s readiness to grant State aid on this occasion sends out a strong signal that BE comes under its protection so that operators are more likely to assume (and compete on the basis) that, in the future, the Government is more likely than not to be inclined to aid BE again, should it face a new challenge.

42. The United Kingdom Government itself acknowledges that nuclear energy is a declining source in the United Kingdom<sup>12</sup>, that “its current economics make it an unattractive option for new, carbon-free generating capacity” and that “there are also important issues of nuclear waste to be resolved”<sup>13</sup>.
43. It says: “The best way of maintaining energy reliability will be through energy diversity. We need many sources of energy, many suppliers and many supply routes. Renewables and smaller-scale, distributed energy sources – eg micro-CHP and fuel cells – will help us avoid over-dependence on imports and can make us less vulnerable to security threats”.<sup>14</sup> Accordingly, “renewables will become a more significant source of electricity as we seek to tackle climate change”.<sup>15</sup>
44. Further, the Government considers that “the nationwide and local electricity grids, metering systems and regulatory arrangements that were created for a world of large-scale, centralised power stations will need restructuring over the next 20 years to support the emergence of far more renewables and small-scale, distributed electricity generation”.<sup>16</sup>
45. Maintaining the continued existence of BE in its present form would be wholly inconsistent with those considerations.

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<sup>12</sup> The Energy White Paper, “Our energy future – creating a low carbon economy”, Cm 5761, February 2003, paragraphs 1.13 and 1.16. Annex VI pages 8 and 10

<sup>13</sup> *Ibid.*, paragraph 1.24. page 12

<sup>14</sup> *Ibid.*, paragraph 1.14. page 9

<sup>15</sup> *Ibid.*, paragraph 1.16. See also paragraphs 1.19 and 1.29. page 10

<sup>16</sup> *Ibid.*, paragraph 1.40, 5<sup>th</sup> bullet point. Page 16



46. Not only would the continuing presence of BE in the market act as a break on the emergence of more efficient renewable sources of energy<sup>17</sup> through its depressive effect on prices but BE would continue to block access to the National Grid at key points on the coast of the United Kingdom, thus hampering significantly the development of sea-based wind power.

## **(2) Overcapacity**

47. Turning now to the question of overcapacity, the Commission has concluded that the relevant geographical market is likely to be that of the United Kingdom.<sup>18</sup> The question arises therefore whether there is excess capacity in that market.

48. The Commission is of the view that the question of overcapacity must take account of the desired capacity margin so as to allow the network operator to satisfy peak demand. The Commission is of the current view that it cannot exclude the possibility that there is some structural overcapacity in the UK.

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<sup>17</sup> All renewable sources can feasibly meet the United Kingdom's energy demands at a cheaper price than nuclear energy when the full capital investment and liabilities' costs incurred by nuclear generation are taken into account. When one compares the energy required to construct and decommission plant with the energy output of the plant, the ratio between input and output energy is 1:16 in the case of nuclear generation (Net Energy Payback CO2 Emissions from Wind Generated Electricity in the Midwest, Annex VII page 32 paragraph 1) and 1:80 in the case of wind power ( The Energy Balance of Modern Wind Turbines Annex VIII page 1)

<sup>18</sup> The electricity system in the UK is separated into the transmission system that serves England and Wales, which is operated by National Grid, and the transmission system that serves Scotland, which is operated by Scottish and Southern. Both systems are regulated by OFGEM. Neither system supplies electricity to Northern Ireland. Although there are areas where the two systems combine – such as electricity generated by Chapelcross nuclear power station being supplied to England and Wales under the New Electricity Trading Arrangements (NETA) – they are predominantly separate. It is difficult therefore to calculate accurate figures of the exact overcapacity in the UK market. Since the figures provided by National Grid refer only to England and Wales. However, as the Commission refers to NG figures in the Letter, we shall do the same.

49. Greenpeace urge the Commission however to take account of the purpose of desired capacity margin in any analysis of current and future overcapacity in the relevant market.
50. According to National Grid, “plant margin” is “the amount by which the installed generation capacity exceeds the peak demand” (on an Average Cold Spell)<sup>19</sup>. The desired capacity margin or “planning margin” however is a tool used by the National Grid for planning the need for future generation in order to maintain safe capacity. It is calculated on basis of a forecast into future so as to enable the planning of plant de-commissioning, re-commissioning and new commissions. It does not relate to a current capacity margin requirement and does not represent the National Grid’s recommendation for the network to face winter safely. In its Seven Year Statement of 2002, National Grid states at Chapter 5:

“5.10 The higher certainty associated with short term forecasts of say demand and generating unit availabilities means that the same level of security of electricity supply can be achieved with lower plant margins. Accordingly, the required margin for the earlier years would be much lower and the operational planning margin requirement for real time generation may generally be less than say 10% depending on prevailing circumstances.

5.11 In the privatised electricity supply industry within England and Wales there is no set standard for the planning margin and the need for new plant is determined by market forces. However, taking account of international experience, a notional planning margin of 20% may be appropriate for discussion purposes .....

51. It is against this desired notional capacity margin of 20% that National Grid assesses how future security of supply is to be obtained over an extended time-

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<sup>19</sup> Chapter 5, paragraph 5.6 of National Grid’s Seven Year Statement 2002 Annex IX page 40

scale on the basis of existing capacity, new capacity under construction and planned capacity for which consent has been obtained<sup>20</sup>.

52. Thus, the further into the future margins are estimated, the greater the statistical uncertainty surrounding the figures. This increased uncertainty is partly due to the unpredictability of new capacity build and economic variables that may bring capacity in and out of the market. It is also due to the greater uncertainty over peak demand (dependant on the weather) the further into the future it is estimated. So the further ahead one looks, the greater the margin needed to be certain that demand is met in the future. Conversely the nearer one is to real time (as in real time demand and capacity availability) the less margin is required to be secure.

53. The relationship between overcapacity and security of supply therefore requires a sophisticated analysis of current and future capacity and demand. Thus, adopting the analysis of National Grid, as set out above, a current overcapacity of 20% may exceed the current desirable capacity margin by 10% or more.

54. The degree of current overcapacity has been variously stated at figures between 20% and 30%<sup>21</sup>. According to OFGEM, there is a currently a margin of between 22 and 25+ per cent of present spare capacity over present maximum demand<sup>22</sup>.

55. It is also important to note that National Grid's projected plant margin over the next 5 years signifies a steady increase in plant margin rising to 37.5%<sup>23</sup> in

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<sup>20</sup> See Chapter 5 generally of National Grid's Seven Year Statement 2002. Annex IX page 40 - 45

<sup>21</sup> See the fourth paragraph of section 3.2.3 of the Commission Decision NN 101/02 on rescue aid to BE.

<sup>22</sup> According to OFGEM Review of the First Year of NETA (summarised at Annex X pages 1- 4) and OFGEM fact sheet of 14 October 2002 (at Annex X 5 - 7).

<sup>23</sup> See Chapter 5 National Grid Seven Year Statement 2002, Table 5.1.\*

2008/09. Even if one accepts therefore that the current desired capacity margin must remain at or around 20%, overcapacity is set to increase significantly in the short term.

56. In its Energy White Paper, the United Kingdom Government itself points out that the installed plant margin in England and Wales fell from around 27% in 2001/2 to around 20% in 2002/3, the decline being partly due to plants being mothballed. However, as it points out that “recently mothballed plant could be returned to service at relatively short notice and low cost”<sup>24</sup>, there is good reason for taking the plant margin as an overestimate of the true available capacity always bearing in mind that there is a distinction between capacity that is available immediately and without notice and capacity that is available at short notice.

57. Greenpeace submits therefore that it is likely that significant structural overcapacity already exists in the relevant market and is set to increase. Since the relevant market is not EEA or Community wide, compensatory measures which result in irreversible reduction of production capacity are not mandatory but may be considered appropriate by the Commission in any event.

### **(3) Compensatory measures and capacity reductions**

58. In connection with compensatory measures, the UK authorities have contended that they are not required. In any event they contend (as set out in paragraphs 183 to 187 of the Letter) that closing nuclear plants would have a number of detrimental effects including:

- (i) increase in electricity prices;
- (ii) increase in nuclear liability costs to the tax payer;
- (iii) a detrimental impact on the environment as a large amount of CO<sub>2</sub> free generation would be removed from the network; and

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<sup>24</sup> Energy White Paper, paragraph 6.39. Annex VI page 83

(iv) a detrimental impact on diversity of fuel supply in the UK.

59. As regards increase in electricity prices, to the extent that BE's withdrawal from the market will cause prices to rise, a "detrimental effect" does not of necessity follow. *A fortiori*, an increase in price renders it more attractive for other operators to increase capacity and for new entrants to emerge. This is likely in turn to increase diversity in the market, as is the United Kingdom Government's professed objective. Greenpeace repeats the paragraphs above in relation to market prices and the distortive effect of the aid on competition.

60. Thus, the argument that there should be no closure of BE's capacity because that would produce a rise in prices is a false argument and, more particularly, an argument that is based upon a misunderstanding of how the competitive process works and why the grant of State aid to BE distorts that process.

61. As regards the alleged increase in cost to the taxpayer in relation to nuclear liabilities, the continued operation of BE's plants will lead to additional liabilities arising, with there being little or no prospect of those future liabilities being met by it. Continued operation is also likely therefore to lead to further costs for the taxpayer. The Government has not shown that the closure of some or all of BE's plant would be a more expensive option for the taxpayer. BE's ability to generate internally any contribution towards paying off its existing liabilities is doubtful, as is its ability to contribute to future liabilities.

62. As regards any detrimental impact on CO<sub>2</sub> emissions and diversity of fuel supply, the Energy White Paper referred to above makes it clear that nuclear power does not form part of the Government's strategy to reduce CO<sub>2</sub> emissions. Instead, its efforts are concentrated on energy efficiency and renewables.<sup>25</sup> For reasons which have already been stated above, BE's continued presence in the market is more likely than not to impede the achievement of the Government's objectives

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<sup>25</sup> Energy White Paper, paragraph 4.3. Annex VI page 51

regarding the reduction of CO<sub>2</sub> emissions and diversity of supply. In the immediate term, the closure of all BE's plant would inevitably mean that there would be an increase in CO<sub>2</sub> emissions because renewables are not yet in a position to make up for the resultant shortfall.

63. However, in the short term perspective, there is no reason to believe that the United Kingdom would not be able to hit its targets under the Kyoto Protocol. Finally, the disadvantages of a transient increase in CO<sub>2</sub> emissions must be set against the advantages of facilitating the long term decrease in CO<sub>2</sub> emissions, diversity of supply, and healthy competition.

64. To the extent that any or all of the effects referred to by the United Kingdom Government in fact may arise as a result of closure of nuclear plants, the detrimental impact if any will in any event depend on the extent of the closures. Immediate, partial or phased closure which, according to the independent evidence obtained by Greenpeace<sup>26</sup>, can be carried out both safely and without adversely impacting upon security of supply, will clearly limit the degree to which those detrimental effect will arise, if they arise. Whilst Greenpeace would support immediate and total closure, the fact that a number of closure options exist is clearly relevant to any consideration of the impact and desirability of compensatory measures and the proper nature and extent of those measures.

65. Greenpeace has commissioned an independent report from Large & Associates, consulting engineers to the military and civil nuclear industry. The report, which is at Annex XI concerns, *inter alia*, the practicability, both in terms of nuclear safety and in terms of security of supply, of the immediate and phased closure of British Energy's plants. The report states that the nuclear safety systems in each of the individual nuclear energy plants will permit an immediate shut down of the generated supply of electricity [paragraph 6.1 of the report]. At paragraph 7.2 and 7.3, the report states:

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<sup>26</sup> See Annex XI hereto

“7.2 Shutting down the high pressure boiler and the nuclear reactor systems of both the AGR and the PWR nuclear plants is a matter of routine. Nuclear power plants are capable of automatically shutting down in the event of a fault condition and, as previously discussed, such plants are periodically shut down for refueling and maintenance.

7.3 No additional nuclear safety risk would arise from shutting down all of BE’s nuclear plants immediately although, as noted previously, BE may not have the resources to undertake the shut down of the plants simultaneously and a period of up to 12 months may be required to complete the overall shutdown (switch off) programme.”

66. The report explains the procedures which would follow both an immediate and permanent shutdown and a phased shut-down and state that removal of the fuel from the reactor core is a routine operation and such end-of-life fuel transfer would not incur any additional nuclear risk from that of day to day operation of the power station. For a plant being held temporarily mothballed, the fuel would remain safely in the reactor core<sup>27</sup>.

67. The Commission has stated at paragraph 207 of the Letter that any compensatory measures must take account of the need to preserve the desired capacity margin in the UK. Further to the submissions Greenpeace has made above in relation to overcapacity, it draws attention to the fact that nuclear generating capacity was already significantly reduced when aid was first extended to BE and is set to reduce in any event in view of BE’s scheduled decommissioning programme.

68. Owing to recent plant difficulties with BE’s AGRs, 3 of its plants, namely those at Dungeness, Heysham and Torness, were already shut down as at 26 September

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<sup>27</sup> Paragraph 7.7 of the report Annex XI page 17

2002 and were not likely to be operational for some months. BE was at that time (and hence at the time the government granted rescue aid prior to formulating its restructuring package) operating at 62% of its total generating capacity (paragraph 3.5 report) and therefore its contribution to the UK's total generating capacity was significantly diminished.

69. The report concludes that the reason that UK supplies remain secure even with this large reduction in generating capacity is because BE is only one of several generators and because there is general over-capacity of supply in the UK (paragraph 3.8 of the report). In that regard the report concludes that the present plant margin is ample to absorb BE's closure of Dungeness, Heysham 2 and Torness and to cover any unplanned abrupt losses to the grid (paragraph 3.14 of the report).
70. The report proceeds to examine the already scheduled decommissioning programme of BE's plants against security of supply concerns and then examines the impact of an immediate and of a phased closure of BE's plants in advance of that decommissioning programme.
71. As regards BE's scheduled decommissioning the report concludes that this, coupled with the unlikelihood of any new nuclear plant being commissioned in the near future, will almost certainly lead to a significant reduction in UK nuclear generating capacity. As with BE's short term losses of generating capacity however, substantial reduction in nuclear capacity does not cause any concern over security of supply in the interim term since there is sufficient reserve in the plant margin and the introduction of additional sources of renewable energy is likely to strengthen security of supply (paragraph 3.24 of the report). In that connection it is important to recall that National Grid's projected plant margin over the next 5 years signifies a steady increase in plant margin rising to 37.5%<sup>28</sup> in 2008/09.

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<sup>28</sup> See Chapter 5 National Grid Seven Year Statement 2002, Table 5.1. \*



72. As regards immediate closure of all of BE's plants the report concludes that it is technically possible to shut down immediately and safely all of BE's plants without affecting the grid's ability to meet the peak winter demand. However this would reduce the current plant margin to around 8%. This would not necessarily cause security of supply concern even according to the National Grid Seven Year Statement, which states that real time security of supply can be achieved with a plant margin of less than 10% (see paragraph [ \* ] above). The report states however that in order to achieve a higher plant margin for security of supply purposes it would be possible to close 3 plants immediately and permanently (3 plants are in fact already closed) whilst mothballing the others and keeping them in reserve to be operated at base-load level during 3 winter months. This would not have any adverse effect on the security of supply. The number of plants required to remain in reserve would depend on the desired plant margin. If a plant margin of 20% is required, 5 plants would have to be held in reserve; if a 15% margin is required, only 3 plants would have to be held in reserve: paragraphs 6.1 to 6.6 of the report.

73. If a phased withdrawal, as opposed to immediate closure or mothballing, were carried out, the report concludes that no security of supply concerns arise (paragraphs 5.1 to 5.14). This is echoed by an earlier report commissioned by Greenpeace from ILEX Energy Consulting Limited<sup>29</sup> which suggests that all of BE's plants could be closed in a planned phase-out by 2005/6 without plant margin falling below 20% (based on National Grid's capacity predictions).

74. In brief conclusion, closure of BE's plants ahead of its decommissioning programme therefore would not give rise to any concern in terms of security of supply. Although it is occasionally said that an electricity system must be based upon baseload capacity, nuclear energy is not an essential element of such

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<sup>29</sup> At Annex XII

capacity.<sup>30</sup> Fossil fuel sources would easily meet the shortfall if BE's plants were shut down and, over the long term, both tidal and biomass sources would be more than capable of providing all the baseload capacity required.

### **Proportionality Of The Aid Measures**

75. The Commission currently considers that the aid is not possible to determine that the measures are limited to the minimum within the meaning of points 40 and 41 of the Guidelines. Again, Greenpeace endorses the Commission's analysis and adds that, again, the option of partial or phased closure of BE's plants may result in a more limited intensity of aid being required.

### **THE STATE AID RULES UNDER THE EC TREATY ARE APPLICABLE IN FULL**

76. Paragraph 223 of the Letter indicates that the UK authorities seek to argue that all of the measures in question fall to be assessed according to the objectives of the Euratom Treaty in so far as they purport to preserve the safety of nuclear power stations, to ensure the safe management of nuclear liabilities, to enhance security of supply and to avoid carbon dioxide emissions. It is not clear from the Letter how precisely the UK considers that these objectives are relevant to the Commission's consideration of the measures as aid.

77. It is not clear from the Letter to what extent and on what legal basis the Commission may consider the Euratom Treaty to be relevant to its consideration

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<sup>30</sup> For example, on pages 18-19 of the Energy White Paper (Annex VI) , the United Kingdom Government envisages that, by 2020, the electricity system in the United Kingdom will have as its "backbone" "a market-based grid, balancing the supply of large power stations. But some of those large power stations will be offshore marine plants, including wave, tidal and windfarms". By that time, "the existing fleet of nuclear power stations will almost all have reached the end of their working lives"; and it is not presently envisaged that any new nuclear plant will be built. Thus, the Government envisages that there will be baseload capacity without nuclear generation.

of the measures in question. The Commission does not appear to suggest that it is precluded from examining the measures under the State aid provisions of the EC Treaty. However, for the avoidance of doubt, Greenpeace contends that the provisions of Euratom are irrelevant.

78. Title II, Chapter 3 of Euratom confers on the Community the extensive competence to act in the field of nuclear health and safety<sup>31</sup>. The existence of Community competence and objectives in that field cannot however preclude the examination of that aid under the State aid provisions of the EC Treaty.

79. The Euratom Treaty does not contain sectoral rules applicable to aid to the nuclear industry. Indeed that contention was made by the Commission in Joined Cases 188 to 190/80 *France and others v Commission*.<sup>32</sup> In the absence of such regulation therefore, particularly in relation to nuclear health and safety, the general State aid provisions of the EC Treaty must apply. In that connection, Article 305(2) of the Euratom Treaty (which does not permit derogation from the Treaty by virtue of any provision of the EC Treaty) is irrelevant to the Commission's consideration of the measures in question because the grant or refusal of State aid does not amount to a derogation from the provisions of Euratom.

80. Moreover, to date the Commission has consistently assessed proposed national measures to the nuclear sector, including, specifically, the UK nuclear industry

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<sup>31</sup> Case 187/87 *Saarland and Others* [1988] ECR 5031 at paragraph 11; Case C-29/99 *Commission v Council* [2002] ECR I-11221 at paragraph 79 ff.

<sup>32</sup> [1982] ECR 2545. In that case France failed to establish that Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings, enacted pursuant to Article 87(3) of the EC Treaty (ex Article 90(3)), infringed Article 232(2) of the EC Treaty (the predecessor to Article 305(2) Euratom) on the basis that the Directive did not derogate from the Treaty provisions.

under the EC Treaty state aid rules<sup>33</sup>. Furthermore, that aid to the nuclear industry falls to be considered under the State aid provisions of the EC Treaty cannot be in any doubt following the amendment of Article 4 of Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings by Directive 2000/52/EC which removed any exclusion of the nuclear energy industry from the remit of the Directive.

81. Greenpeace further contends that:

- (i) the stated purposes of the aid measures do not all coincide with the objectives of the Euratom Treaty;
- (ii) since there is nothing in Euratom which permits or regulates aid to the nuclear industry, the state aid provisions of the EC Treaty are applicable in full;
- (iii) in any event, the mere fact that the aim of the measures might coincide with the objectives pursued by Euratom does not in any manner enable Member States to grant aid or indeed justify any such aid in order to achieve those ends where aid distorts or threatens to distort competition in the electricity market as a whole; and
- (iv) even if the aims of the aid do seek to achieve objectives pursued by the Euratom Treaty it is unlikely that those objectives are achieved by the measures in question.

### **The Objectives of Euratom**

82. The objectives of Euratom are set out in Article 2 of the Euratom Treaty and are to:

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<sup>33</sup> The Commission authorised aid to the UK nuclear sector in or around March 1990: IP/90/267. The Commission also considered aid to the German nuclear sector pursuant to the state aid rules of the EC Treaty in a decision of 11 December 2001: IP/01/1799. Both press releases are attached at Annex XIII

- “(a) promote research and ensure the dissemination of technical information ;
- (b) establish uniform safety standards to protect the health of workers and of the general public and ensure that they are applied ;
- (c) facilitate investment and ensure , particularly by encouraging ventures on the part of undertakings , the establishment of the basic installations necessary for the development of nuclear energy in the community ;
- (d) ensure that all users in the community receive a regular and equitable supply of ores and nuclear fuels ;
- (e) make certain, by appropriate supervision, that nuclear materials are not diverted to purposes other than those for which they are intended ;
- (f) exercise the right of ownership conferred upon it with respect to special fissile materials ;
- (g) ensure wide commercial outlets and access to the best technical facilities by the creation of a common market in specialised materials and equipment, by the free movement of capital for investment in the field of nuclear energy and by freedom of employment for specialists within the community ;
- (h) establish with other countries and international organisations such relations as will foster progress in the peaceful uses of nuclear energy.”

83. Of those objectives, only the establishment of uniform safety standards is of any conceivable relevance to the measures in question. Thus, only to the extent that the aid measures relate to the safety of nuclear installations or the safety aspects of decommissioning, do they relate to matters which may be regulated by Euratom.

84. The Commission appears to suggest at paragraph 224 of the Letter that a further objective of Euratom is to achieve security of electricity supply. In that connection it refers to the 3rd recital of the Euratom Treaty which provides:

“Resolved to create the conditions necessary for the development of a powerful nuclear industry which will provide extensive energy resources, lead to the modernisation of technical processes and contribute, through its many other applications , to the prosperity of their peoples....”

85. Greenpeace contends that that wording cannot be construed so as to establish security of supply through nuclear energy as an objective of Euratom. The recital, which is any event anachronistic, does no more than to encourage the use of nuclear energy and does not extend to requiring or recommending that nuclear energy play any part in a Member State's overall security of electricity supply whether that be short term or long term security of supply.

86. In brief conclusion therefore, the only objective of Euratom which is conceivably relevant to the measures in question is that pursued by Title II, Chapter 3 of the Treaty, namely health and safety.

**Health and safety objective cannot provide justification for the measures in question**

87. The existence of Community competence and objectives in terms of the protection of health and safety does not and cannot provide in itself a justification for Member States to grant aid, even with those objectives in mind. This is particularly so where the grant of such aid, as well as having adverse effects on competition, runs counter to the polluter pays principle (enshrined in Community policy by Article 174 of the EC Treaty) by externalising safety and environmental costs, and is designed merely to facilitate compliance with existing mandatory Community standards. In that regard, to the extent that the UK authorities contend that the measures in question are aimed at preserving the safety of nuclear power stations, ensuring the safe management of nuclear liabilities, and avoiding carbon dioxide submissions, the Commission ought in its consideration additionally to apply, or at the very least, have regard to the provisions of the Community Guidelines on State aid for environmental protection<sup>34</sup>, which also contain specific provisions concerning aid to the energy sector.

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<sup>34</sup> OJ 2001/C37/03

## **Objectives not achieved in any event**

88. The Commission has noted that the UK authorities have not sufficiently explained whether and how the measures in question take account of the stated objectives and has stated the need for it to check whether the measures are necessary to fulfil those objective and whether they distort competition in the internal market. In the absence of the UK's submissions as regards necessity of the measures Greenpeace is unable to provide extensive comment on their justification. However, without prejudice to further comments Greenpeace may make when the UK authority's contentions are made known, it is contended that the measures in question are not necessary to achieve their stated objectives. For example, it is difficult to see how Measure B (the renegotiation of fuel supply and spent fuel management contracts), which, in Greenpeace's view, the Commission has correctly classified as continuing operating aid, is necessary to preserve the safety of nuclear installations.
89. Furthermore, Greenpeace contends that continuing operating aid of any sort cannot be considered necessary to preserve safety in circumstances where there exists a safe, viable option of a phased total or partial closure of BE's plants. There is no economic reason why consideration of aid should be approached on the assumption that all of BE's stations must be kept in operation, whether for reasons of safety, cost or security of supply and that there is no reason to suppose that none of BE's stations is viable in the absence of aid.
90. *A fortiori*, if phased total or partial closure of BE's stations is capable of being carried out safely and economically in the absence of aid, or with a lower intensity of aid, there can be no justification for operating aid on any ground, least of all on grounds of safety.
91. Further, none of the aid measures can be justified as necessary to achieve security of supply. As referred to above, Greenpeace has been advised by experts in the nuclear industry that all of BE's stations can be withdrawn, whether on a phased

or immediate basis, without giving rise to security of supply concerns.

## **CONCLUSIONS**

92. The rationale behind the restructuring proposals is, in effect, to put BE into what can be described as “Government administration” not dissimilar to the uncommercial regime under which BNFL operates.
93. In granting State aid, the Government is allowing a company with high operating costs and no long term future to maintain its existing presence on the market. In turn, that harms existing competitors and raises barriers to more cost-effective new entrants into the market. The result is to threaten future security and diversity of supply.
94. The grant of State aid does not make sense from a short term perspective and, from the longer term perspective, it is a positively perverse step to take. It should not be approved.

Signed on behalf of Greenpeace Ltd.:

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Stephen Tindale, Executive Director.

Date:.....



## Schedule of Annexes to the Comments

<b>Annex Number</b>	<b>Document Description</b>	<b>Date</b>	<b>Pages</b>
<b>I</b>	the European Commission's Letter to the United Kingdom ("the Letter")	Jul-03	I, 1 to 42
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<b>III</b>	British Energy Annual Report and Accounts 2002-3	25/06/2003	III, 1 to 74
<b>IV</b>	"Whitehall farce that lit the fuse for British Energy's meltdown", <u>The Business</u>	08/09/2002	IV, 1 to 3
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<b>IX</b>	National Grid Seven-Year Statement	May-02	IX, 1 to 128
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<b>XI</b>	Report by Large & Associates on the Closure of British Energy's UK Nuclear Power Plants	09/04/2003	XI, 1 to 21
<b>XII</b>	Report from Ilex to Greenpeace	26/09/2002	XII, 1 to 19
<b>XIII</b>	European Commission Press Releases: IP/90/267 and IP/01/1799	28/03/1990; 11/12/2001	XIII, 1 to 2; 1.