

Nuclear Energy Agreement

Second Set of Amendments by Agreement between the Parties

Provisional decision by the Gas and Electricity Markets Authority

Introduction

1. The Nuclear Energy Agreement (the NEA) is one of a series of agreements entered into on the privatisation of the electricity industry in Scotland. It was entered into between Scottish Power Plc (now Scottish Power Generation Limited (SPGL)), Scottish Hydro-Electric Plc (now SSE Energy Supply Limited (SSEESL)) and Scottish Nuclear (now British Energy Generation (UK) Limited (BEG)). SPGL, SSEESL and BEG are collectively referred to as “the Parties”.
2. In summary, under the NEA, BEG is required to sell all of its output from its Scottish nuclear plants to SPGL and SSEESL in agreed proportions and, except in certain limited circumstances, SPGL and SSEESL agree to pay for electricity declared by BEG whether or not they take delivery of it.
3. The NEA was entered into on 1 June 1990 and is due to expire on 1 April 2005. The agreement was notified to the European Commission under Article 85 (now Article 81(1) of the Treaty of Rome (the Treaty)) and received an individual exemption under Article 85(3) (now Article 81(3) of the Treaty). The NEA was excluded from the operation of the Restrictive Trade Practices Act 1976 by virtue of an order of the Secretary of State made in 1990¹.
4. The NEA was then amended by a supplemental agreement between the Parties (the first supplemental agreement) dated 17 May 1996. These changes were notified by the parties to the European Commission.
5. The Parties have now negotiated further amendments to this agreement by virtue of a Memorandum of Agreement (MoA) dated 15 July 2002.
6. The existence of the NEA is recognised in each of the licences held by the Parties (namely Special Condition 2(3) of the Generation Licence granted to BEG, Special Condition B(1) of the Supply Licence granted to SSEESL and Special Condition B(1) of the Generation Licence granted to SPGL). Under the conditions named above in the Parties respective electricity licences, the Parties cannot make an amendment to a specified agreement (of which the NEA is one) or enter into an agreement which amends a specified agreement without the prior written approval of the Gas and Electricity Markets Authority (the Authority).

¹ The Electricity Restrictive Trade Practices Act 1976 (Exemptions)(No4) Order 1990.

7. As such, in accordance with their respective licences, on 23 July 2002, each of the Parties to the NEA wrote to the Authority to seek the Authority's prior written approval to the MoA and associated changes to the NEA.
8. Non-confidential details of the NEA and the further changes made by the MoA are set out in Appendix 1 to this document.

The role of the Authority in this matter and legal basis of the Authority's decision

9. Before setting out the Authority's provisional decision in this matter, it is important to clarify the Authority's role in this matter and the legal basis for its provisional decision. The reasons for the provisional decision are set out later in the document.
10. In reaching a decision (provisional or otherwise) on the request made by the Parties, the Authority is discharging a function contained in licence conditions under the powers contained in the Electricity Act 1989. As such, the decision to grant or withhold approval of the amendments to the NEA must be made with reference to the Authority's principal objective and statutory duties as set out in Electricity Act 1989, principally section 3A. The full text of section 3A is set out in Appendix 2 of this document.
11. For the avoidance of doubt, it is important to note that the function the Authority is discharging is to consider whether to approve or not to approve the amendments to the NEA. The Authority does not have the power or the discretion to require amendments to the NEA to introduce policy changes or initiatives, which the Authority may have considered desirable. This is a commercial contract and it is a decision for the parties to decide how to vary a contract. Therefore the Authority's decision is restricted to approving or not approving the changes presented to it.
12. In deciding whether or not to approve the proposed changes, the Authority must have regard to, among other things its principal objective and general duties. For the avoidance of doubt, in reaching its provisional decision the Authority is **not** exercising any functions under the Competition Act 1998 and is only exercising its functions under the Electricity Act 1989.
13. This is the background and legal basis for the Authority's provisional decision. The reasons for this provisional decision are set out later in this document.

The Authority's provisional decision

14. Against the background described above and subject to:
 - i. consideration of any representations received by the Authority in response to this document; and
 - ii. the caveats expressed in paragraphs 15 – 17 – Scope of Approval inclusive below,

for the reasons set out in this document, the Authority is minded to approve the proposed amendments to the NEA as set out in the MoA. The Authority is not minded

to attach conditions to its approval and seeks the view of third parties on this provisional decision. For the avoidance of doubt, this provisional decision:

- (a) is not intended to, nor shall it constitute, a temporary approval of the proposed amendments to the NEA as set out in the MoA; and
- (b) does not determine or limit in any way the scope or content of the final decision of the Authority on the Parties' requests.

Scope of Approval

- 15. In exercising its powers to give or withhold approval to the MoA's amendments to the NEA under the relevant licence conditions, the Authority is bound to act within and apply its statutory duties. In so doing as mentioned above, the Authority is not exercising its concurrent powers under the Competition Act 1998. Consequently, any decision pursuant to the parties' application for the Authority's approval to the MoA is without prejudice to such powers and to any other approval, exemption or clearance which may be required under either EU or UK competition legislation.
- 16. For the avoidance of any doubt the scope of the decision of the Authority in this matter is limited to the MoA and amendment of the NEA made as a consequence of the MoA ; it does not extend to or deal with any agreement based on the Electricity Forward Agreement Association's Grid Trade Master Agreement or associated confirmation notes.
- 17. This Provisional Decision and any final decision (subject to consideration of consultation responses) regarding the requested approval is based on the assumption that the documents and information provided to the Authority are faithful reproductions of the originals of the same, are complete and accurate and do not have any misstatements or omissions which may be material to the Authority in considering the application and reaching a decision. Therefore, the Authority does for the purposes of this document and will in its final decision reserve the right to rescind or amend any approval given (subject to consideration of any representations received by it) in the event that this assumption should prove to be incorrect or misplaced.

Way forward – views invited

- 18. Ofgem invites comments on the provisional decision set out in this document. Written representations should be made by 5pm on Monday 28 October 2002 and should be sent to:

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Ofgem
9 Millbank
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Fax: 020 7901 7479

Or by e-mail to colin.sausman@ofgem.gov.uk

19. Where possible, it would be helpful to receive an electronic copy of all representations. It is Ofgem's intention to place responses received in the Ofgem Research and Information Centre. However, it is open to respondents to mark responses as confidential where appropriate.

The reasons for the Authority's provisional decision

20. In summary, the provisional decision of the Authority to approve the proposed amendments to the NEA has been made for two reasons:

- ◆ The proposed changes (insofar as they do not endure beyond the NEA's original expiry date) to the pricing formula envisaged by the MoA represent a small but positive step towards reducing market distortions in the commercial context within which the NEA operates; and
- ◆ The proposed changes to the duration of the NEA (insofar as they do not endure beyond its original expiry date) are more consistent with the implementation of the proposed wider market reforms collectively known as British Electricity Transmission and Trading Arrangements (BETTA)².

21. These reasons and their relationship to the Authority's statutory duties under section 3A of the Electricity Act 1989 are explained in more detail below.

MoA amendments to the NEA pricing formula

22. The NEA accounts for a significant proportion of the energy procured by SPGL and SSESL on behalf of their consumers. The terms of the revised NEA will continue therefore to influence the competitive process within Scotland. The price paid under the contract is clearly a key contract term. As such, it is appropriate for the Authority to consider how the amendments to the pricing formula might affect competition in the commercial context within which the NEA operates.

23. Section 3A of the Electricity Act 1989 sets the principal objective and general duties of the Authority. These are set out in Appendix 2 to this document. As stated above, in summary, the Authority has a duty to protect the interests of consumers wherever appropriate by promoting effective competition. Against this background, contracts containing terms that place parties to the contract at a significant commercial advantage or disadvantage relative to other market participants might reasonably be viewed as having a distortionary effect on competition.

24. The proposed amendments to the NEA pricing formula are understood by the Authority to reduce differences between the NEA and the wholesale prices faced by other suppliers operating in Scotland, as determined by the administered wholesale

² A more detailed discussion of BETTA can be found in the Ofgem/DTI document of May 2002, 'The Development of British Electricity Trading and Transmission Arrangements (BETTA) – Report on consultation and next steps'

and imbalance prices. As such, the contract is an improvement in continuing efforts to reduce distortion in the market and the modifications will reduce the differences between the Parties to the NEA and third parties.

Amendments to the duration of the NEA and BETTA

25. Another important consideration for the Authority in considering whether or not to approve the proposed amendments to the NEA has been how the amendments relate to wider reforms to wholesale markets, and in particular the proposed BETTA reforms being jointly progressed currently by the Authority and the Department for Trade and Industry (DTI). These wider reforms, which are subject to the granting of the necessary legislative powers, will protect the interests of current and future consumers by providing a more effective, unified electricity wholesale market operating across Great Britain.
26. The proposed amendments to the NEA change the duration of that agreement. The existing contract terminates 1 April 2005. The revised contract terminates on 1 April 2006 or BETTA Go Live, whichever is sooner. The target date for BETTA Go Live is 1 April 2004. While this date is subject to the granting of the requisite legal powers and the otherwise smooth progression of the necessary work, as a consequence it is possible the revised NEA will terminate sooner than the existing NEA. Such early termination would be a positive step in achieving as far as practicable parity of trading terms within Scotland and GB more generally.
27. The current administered arrangements in Scotland provide a counterbalance to market distortions that might otherwise arise as a consequence of the operation of the NEA in its revised form. BETTA is expected to remove the administered wholesale and imbalance price arrangements in Scotland. The proposed amendments to the NEA will ensure that the NEA and BETTA do not co-exist. This can be expected to increase the efficiency in which the GB market operates under BETTA, to the benefit of consumers.
28. The proposed changes to contract duration also, however, provide for the possibility that BETTA Go Live is later than planned or, indeed, does not happen at all. As a result, it is possible that the duration of the NEA might be extended by one year from that approved by the European Commission in its individual exemption (1 April 2005). As explained in paragraphs 12 and 15 above, the Authority is not exercising its functions under the Competition Act 1998 in respect of this matter. It is exercising its functions under the Electricity Act 1989 and under the relevant licence conditions set out in paragraph 6 above. This decision does not affect any decision under EU or UK Competition Law.

Pricing issues

29. In considering the issues raised by this request for approval, the Authority has also considered and reviewed whether and how the proposed amendments impact directly on prices to consumers in Scotland in the short term. In the longer term, consumers across GB are expected to benefit from more effective competition as a consequence of the BETTA, and paragraphs 25 to 28 discuss how this decision on approval of changes to the NEA relates to BETTA. While it is the Authority's understanding that

the amendments are expected to reduce the price paid by SSES and SPGL under the contract, in the absence of price controls on the SSES and Scottish Power Energy Retail Limited (SPERL) (Scottish Power supply arm) and in the light of the continuing existence of administered arrangements for wholesale and imbalance prices in Scotland, the Authority does not consider there to be a material effect on prices to consumers in Scotland. Having regard to Section 3A, the Authority considers the lack of a direct effect on prices to consumers in Scotland in the short term as being neutral to its decision (i.e it neither provides a reason for approval nor a reason for rejection).

Conclusion

30. For the reasons stated in this document, and, subject as provided above, the Authority is minded to approve the changes proposed by the MoA to the NEA on the terms and conditions set out herein.

Gas and Electricity Markets Authority

11 October 2002

Appendix 1

Appendix 1

1. The Nuclear Energy Agreement (the NEA) is one of a series of agreements entered into on the privatisation of the electricity industry in Scotland. It was entered into between Scottish Power plc (now Scottish Power Generation Limited (SPGL)), Scottish Hydro-Electric Plc (now SSE Energy Supply Limited (SSEESL)) and Scottish Nuclear (now British Energy Generation (UK) Limited (BEG)). SPGL, SSEESL and BEG are collectively referred to as “the Parties”.
2. Under the NEA, BEG is required to sell all of its output from its Scottish nuclear plants to SPGL and SSEESL in agreed proportions and, except in certain limited circumstances, SPGL and SSEESL agree to pay for electricity declared by BEG whether or not they take delivery of it. Total capacity at these plant is around 2,500 MW, with average output for 1998/99 to 2000/01 being 17.3 TWh. This is in the order of 5% of GB demand, or 50% of demand in Scotland.
3. The price paid under the NEA is calculated with reference to price markers in England & Wales. The contract prior to the MoA uses price markers derived from the England & Wales Electricity Pool. The MoA proposed to change the price markers used to a basket of England & Wales price indices, ranging from seven months forward prices down to spot half-hourly prices and, in some instances, System Sell Price (SSP) and System Buy Price (SBP) as calculated under the England & Wales Balancing & Settlement Code (BSC). The revised pricing formula will take effect from 1 April 2002.
4. Additionally, the MoA cites a premium to be paid to BE of £88.5M. This is a negotiated sum reflecting an estimate of the difference between the existing and proposed new pricing formula for the period between the date at which the New Electricity Trading Arrangements (NETA) commenced and the expected date of British Electricity Transmission and Trading Arrangements (BETTA) Go Live. The Parties have indicated to the Authority that, even allowing for the premium payment, the average price paid under the MoA pricing formula is expected to be lower than the price paid under the existing agreement.
5. The MoA will also change the duration of the contract. The NEA in its current form terminates at 02:00 on 1 April 2005. The MoA proposes to alter this termination date to be 02:00 on 1 April 2006 or BETTA Go Live, whichever is sooner. The current target date for BETTA Go Live is 1 April 2004.

Appendix 2

The principal objective and general duties of the Secretary of State and the Authority

3A

- (1) The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as "the Authority") in carrying out their respective functions under this Part is to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.
- (2) The Secretary of State and the Authority shall carry out those functions in the manner which he or it considers is best calculated to further the principal objective, having regard to-
 - (a) the need to secure that all reasonable demands for electricity are met; and
 - (b) the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under this Part or the Utilities Act 2000.
- (3) In performing that duty, the Secretary of State or the Authority shall have regard to the interests of-
 - (a) individuals who are disabled or chronically sick;
 - (b) individuals of pensionable age;
 - (c) individuals with low incomes; and
 - (d) individuals residing in rural areas;but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.
- (4) The Secretary of State and the Authority may, in carrying out any function under this Part, have regard to-
 - (a) the interests of consumers in relation to gas conveyed through pipes (within the meaning of the Gas Act 1986); and
 - (b) any interests of consumers in relation to-
 - (i) telecommunication services and telecommunication apparatus (within the meaning of the Telecommunications Act 1984); or
 - (ii) water services or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

- (5) Subject to subsection (2), the Secretary of State and the Authority shall carry out their respective functions under this Part in the manner which he or it considers is best calculated-
- (c) to promote efficiency and economy on the part of persons authorised by licences or exemptions to transmit, distribute or supply electricity and the efficient use of electricity conveyed by distribution systems;
 - (d) to protect the public from dangers arising from the generation, transmission, distribution or supply of electricity; and
 - (e) to secure a diverse and viable long-term energy supply, and shall, in carrying out those functions, have regard to the effect on the environment of activities connected with the generation, transmission, distribution or supply of electricity.
- (6) In this section "consumers" includes both existing and future consumers.
- (7) In this section and sections 3B and 3C, references to functions of the Secretary of State or the Authority under this Part include a reference to functions under the Utilities Act 2000 which relate to electricity conveyed by distribution systems.
- (8) In this Part, unless the context otherwise requires-
- "exemption" means an exemption granted under section 5;
"licence" means a licence under section 6 and "licence holder" shall be construed accordingly."