COMMISSION

COMMISSION DECISION

of 30 April 1991

relating to a proceeding under Article 85 of the EEC Treaty

(IV/33.473 — Scottish Nuclear, Nuclear Energy Agreement)

(Only the English text is authentic)

(91/329/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty [1], as last amended by the Act of Accession of Spain and Portugal, and in particular Articles 6 and 8 thereof,

Having regard to the notification dated 27 February 1990 by Scottish Nuclear Limited, concerning the Nuclear Energy Agreement drawn up in the context of the reorganization of the electricity industry in Scotland,

Having regard to the summary of the notification [2] published pursuant to Article 19 (3) of Regulation No 17,

After consulting the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas :

I. FACTS

A. The notification

(1) On 27 February 1990, Scottish Nuclear Limited notified to the Commission, pursuant to Article 4 of Regulation No 17, an agreement between itself and Scottish Power plc and Scottish Hydro-Electric plc.

(2) Scottish Nuclear Limited has applied for negative clearance or, failing that, exemption pursuant to Article 85 (3) of the EEC Treaty.

B. General framework

(3) Until 31 March 1990 Scotland's electricity requirements were met by two publicly-owned corporations, North of Scotland Hydro-Electric Board and South of Scotland Electricity Board, which generated, transmitted and distributed electricity in their assigned geographical areas, covering the north and south of Scotland respectively.

(4) In reorganizing the industry in advance of privatization, the United Kingdom Government decided to maintain vertical integration in the Scottish electricity industry, since it is better suited for the supply of electricity to sparsely-populated areas which are characteristic of many areas of Scotland.

(5) The United Kingdom Government has therefore decided to create two separate, independent and competing vertically-integrated electricity utility companies from the two Boards. Scottish Power plc ('Scottish Power') has taken over the non-nuclear business of the South of Scotland Electricity Board and Scottish Hydro-Electric plc ('Hydro-Electric') the business of the North of Scotland Hydro-Electric Board. Both companies will be privatized. The Scottish nuclear stations at Hunterston and Torness which previously were owned by the South of Scotland Electricity Board are now owned and operated by a separately established generating company, Scottish Nuclear Ltd ('Scottish Nuclear') which will remain in public ownership. Scottish Nuclear does not supply direct to customers, selling all its output under contract to Scottish Power and Hydro-Electric.

(6) The Electricity Act 1989 and subordinate legislation made thereunder set out the framework for the new regulatory system for the electricity industry in Scotland. Under this Act any undertaking generating, transmitting or supplying electricity in Scotland needs a licence issued by the Secretary of State for Scotland or the Director-General for Electricity Supply, unless exempted by order under the Act. Scottish Power and Hydro-Electric are each by licence obliged and entitled to transmit and supply electricity to customers within their authorized areas. These areas are essentially the same as those of the former Boards. Both utilities are entitled to generate electricity themselves. There is no restric-

[1] OJ No 13, 21. 2. 1962, p. 204/62.
[2] OJ No C 245, 29. 9. 1990, p. 11.

tion on the proportion of its electricity requirements which either utility can meet from its own generation resources.

(7) The right of the two companies to supply customers within their authorized areas is however not exclusive; premises having a demand above 1 MW are free to choose their supplier; after four years this threshold will be reduced to 0,1 MW and after eight years totally phased out.

(8) It is possible for Scottish Power and Hydro-Electric, on receipt of the appropriate 'second-tier licences' to supply to those customers in each other's authorized area or their supplier (as described above). The opportunity to apply for such 'second tier licences' is available to any person in the United Kingdom or the rest of the Community wishing to supply electricity to customers in Scotland. It should be noted that Scottish Nuclear has been granted a generation licence only.

(9) The licences place obligations on Scottish Power and Hydro-Electric not to discriminate between comparable customers, to avoid cross-subsidies and to allow all other users access to their transmission and distribution systems on a transparent and non-discriminatory basis.

(10) Furthermore the licences oblige the licence holders to comply with certain codes and agreements which have been approved by the Director-General of Electricity Supply, including codes governing the operation of the transmission and distribution systems and the trading of electricity.

(11) In the view of the United Kingdom Government it is essential for Scottish Power and Hydro-Electric to have access to a balanced mix of different types of generating capacity in order to be financially viable and capable of independent operation. Therefore the non-nuclear generating assets of the two former Boards, which had been built to meet Scotland's requirements in their entirety, had to be redistributed between the new companies. This could not be achieved by simply allocating the different power stations to one or the other utility, since the nature and location of the generating assets rendered this impractical. The United Kingdom Government therefore decided that the necessary restructuring should be achieved by means of contractual arrangements which create rights and obligations between the two utilities in relation to certain of the generating assets and transmission systems of each, effectively replacing ownership of these assets with long-term contractual entitlements the duration of which corresponds to the currently expected lifetime of the power stations concerned. These contractual arrangements replace the former loose non-commercial agreements between the two Boards on cost-sharing and operational matters. The principal contracts between Scottish Power and Hydro-Electric concern the sharing of coal-fired plant capacity, hydro capacity and gas/oil-fired capacity. Furthermore, Scottish Power and Hydro-Electric divide between them the total output of Scottish Nuclear at present.

(12) The new structure of the electricity industry in Scotland is designed to introduce competition progressively both at the level of electricity generation and at the level of electricity supply. At present the electricity sector in Scotland has substantial overcapacity in electricity generation, which on present estimates is likely to continue at least for the next ten years, and a high concentration of nuclear generation capable of meeting over 50 % of current Scottish electricity demand. Trading with England and Wales is possible through the interconnector which links the transmission grids in Scotland and England.

C. The product and the market

(13) The relevant product market is that of the production, supply and distribution of electricity.

(14) Total electricity generation in the United Kingdom reached 312 Twh [1] in 1989, total net production 292 Twh and total imports 12,9 million Kwh (0,013 Twh). Exports reached 0,8 million Kwh.

(15) The energy sources are conventional thermal production (71,6 %), nuclear production (21,7 %) and hydroelectrical production (2,2 %).

(16) Generating capacity in England and Wales reached 56,679 GW [2] on 31 March 1990. Coal is the most important fuel source (62,8 %), followed by oil (17,7 %) and then nuclear (14,7 %).

[1] 1 Tw = 10^3 Gw = 10^6 Mw (output capacity).
[2] 1 Twh = 10^3 Gwh = 10^6 Mwh (electricity output).

(17) Generating capacity in Scotland reached 11,640 GW on 1 April 1989 and the electricity sent out in the year up to 31 March 1989 reached 29,3 Twh. Nuclear power stations are the most significant source of electricity in Scotland (13 Twh, 44 %), followed by coal fired stations (30 %), hydro (14 %) and then gas oil (10 %).

(18) The turnover relative to the production and supply of electricity for the financial year ended 31 March 1989 was £ 11,284 million, 90 % of sales being in England and Wales and 10 % in Scotland.

D. The agreement

(19) Under the terms of the Nuclear Energy Agreement, Scottish Power and Hydro-Electric are obliged to purchase all the electricity generated by Scottish Nuclear from its Hunterston and Torness plant on a take or pay basis. Scottish Nuclear is obliged to try to produce maximum output from these two nuclear power stations which have together a capacity of 2 400 MW. Scottish Power will have to take 74,9 % of Scottish Nuclear's output and Hydro-Electric 25,1 %. Scottish Nuclear is not permitted to supply electricity to any other party without the consent of both Scottish Power and Hydro-Electric. Scottish Nuclear Ltd cannot supply power except for Scottish Power and Hydro-Electric unless the contract has been terminated.

(20) Because of the existing overcapacity in electricity production in Scotland and in particular nuclear electricity there is no present intention for there to be a non-fossil fuel obligation in Scotland nor a corresponding fossil fuel levy. This non-fossil fuel obligation was imposed in England and Wales by the British Government in order to favour nuclear electricity and renewable electricity.

(21) The agreement contains provisions for the calculation of the prices to be paid to Scottish Nuclear by Scottish Power and Hydro-Electric. From 1991 to 1994 the price is fixed on the basis of a two-tier structure ; a base price per kilowatt hour for the first tranche of 5 000 Gwh and a lower set price for units in excess of 5 000 Gwh, this lower price being similar to the cost of replacement energy to the purchasers (1).

(22) The companies are obliged to pay against availability even if they do not take energy, but Scottish Power and Hydro-Electric can request Scottish Nuclear to reduce their individual share of generation.

(23) Scottish Nuclear is required to declare availability one day in advance. If it fails to achieve the declared level, it pays compensation in addition to the loss of revenue resulting from lower availability.

(24) The actual two-tier price arrangement in the Nuclear Energy Agreement was set in 1990, and combines an energy charge of 1,5p/kWh with a payment recognizing the value of Scottish Nuclear's baseload capacity, of 4,5p/kWh spread over the first 5 000 units of Scottish Nuclear's output per annum. The basis and level of the prices which Scottish Power and Hydro-Electric have been paying to independent producers of electricity pre-date by several years the reorganization of the electricity industry in Scotland, and have not been affected by it. According to the affirmation of the notifying parties, there is no link at all between the respective methodologies.

(25) The Nuclear Energy Agreement will remain in force until 31 March 2005 although it may be terminated earlier if, for example, Scottish Nuclear consistently fails to meet production requirements.

E. The arguments of the parties to the agreement

(26) The Nuclear Energy Agreement promotes economic progress as it is part of the United Kingdom Government's proposals for the privatization of the electricity industry in Scotland which aims at promoting competition and efficiency within the energy supply market within the United Kingdom.

(1) This point has already been examined within the framework of the decision on state aid to the electricity sector in Scotland (30 March 1990). The Commission decided not to raise any objections against the proposed aid for the reorganization of the production of nuclear electricity.

(27) There will remain competition between Scottish Power and Hydro-Electric and with other types of fuel. Accordingly the parties do not consider that their arrangements eliminate competition in respect of a substantial part of the goods in question. The price at which Scottish Power and Hydro-Electric can resell the electricity purchased from Scottish Nuclear is not fixed in terms of the Nuclear Energy Agreement.

II. LEGAL ASSESSMENT

A. Article 85 (1)

1. *Agreement between undertakings*

(28) The Nuclear Energy Agreement is an agreement between undertakings within the meaning of Article 85 (1) of the EEC Treaty.

2. *Restrictions of competition*

(29) The agreement restricts competition in three ways :

— the requirement that nuclear electricity be sold exclusively to Scottish Power and Hydro-Electric limits Scottish Nuclear's market. Scottish Nuclear is not permitted to supply electricity to any other parties unless the contract has been terminated. If the contract has been terminated, Scottish Nuclear can sell electricity only to other parties not situated in the same geographical area as the purchaser in respect of which the contract is still in force,

— the requirement that Scottish Power and Hydro-Electric purchase, on the basis of quotas arranged between them, all the nuclear electricity generated restricts the two companies' sources of supply, with Scottish Power having to purchase 74,9 % of Scottish Nuclear's output and Hydro-Electric 25,1 %. Since they may not deviate from the quotas, they are unable to gain any competitive advantage one over the other,

— the price at which nuclear electricity is purchased is fixed under the agreement and is identical for the two companies. The fact that, from 1995 to 1998, the price will be based on the terms of the agreement and on alignment with the market price in England and Wales and that, after 1998, it will be entirely aligned on the market price indicates that the present price derives from a restrictive agreement.

3. *Restriction of trade between Member States*

(30) Intra-Community trade is confined to that between the United Kingdom and France via the interconnector linking the French grid to the grid in England and Wales. Its capacity is 2 GW, equivalent to 4 % of the electricity output of England and Wales. During the last three years, the net flow of trade was from France to England and Wales, amounting to 12,9 Twh in 1988 and 13,6 Twh in 1989.

(31) However, the reorganization of electricity generation in Scotland and the prospect of a medium-term increase in the transmission capacity of the interconnector (net capacity of 850 MW in 1991, planned increase to 1 600 MW in three to four years) will help to reduce the relative isolation of the Scottish market, to create greater interdependence between the markets and to increase trade between Member States. Because of the interdependence of the networks, on the one hand between Scotland and England and on the other hand between England and France, and also because of the proposed development of these interconnections, the agreement is therefore likely to affect trade between Member States.

B. Article 85 (3)

(32) The Nuclear Energy Agreement, covering a 15-year period from 27 February 1990 to 31 March 2005, meets the necessary conditions for exemption under Article 85 (3) of the Treaty.

1. *Improving the production or distribution of goods*

(33) The Nuclear Energy Agreement forms an integral part of the electricity privatization scheme in Scotland, the aim of which is to improve the generation and distribution of electricity. It gives Scottish Nuclear a guaranteed market by requiring Scottish Power and Hydro-Electric to purchase all the nuclear-generated electricity on a take or pay basis. It thus allows the long-term planning that is required for reliable production ensuring security of supply and an independent energy supply market.

Furthermore in order to ensure the profitability of the nuclear power stations and to offset the investment costs which are particularly high, it is necessary to have the stations functioning at their full capacity.

(34) Because their marginal cost is much lower than the marginal cost per KW generated by a thermal power station (between 0,55 and 0,75 p per unit in the case of nuclear generation and 0,97 p in the case of gas, 1,7 p in the case of coal and 1,55 p in the case of oil), it is economical to have the nuclear power stations operating at maximum capacity. Consequently, the agreement allows considerable economies of scale to be achieved by increasing nuclear generation and thus makes it possible to rely less on generators whose generation and transmission costs are higher.

(35) So as to induce Scottish Nuclear to maximize its output, the price at which electricity is sold to Scottish Power and Hydro-Electric has been fixed, under the agreement, for the initial four years, in such a way that the first-tier price for the first tranche of 5 000 Gwh allows a satisfactory rate of return on the capital invested. The second-tier price is set in terms of the full costs resulting from the operation of a coal-fired power station, which is equivalent to the marginal cost of the electricity generated by the Scottish system.

(36) The improvement in the generation and distribution of electricity in Scotland which the agreement will help to achieve will allow overcapacity to be gradually eliminated. Measures to organize generation and the market, limited in time, are necessary in order to allow transition from the structure which has applied hitherto to a market-based electricity industry.

2. *Fair share of the resulting benefit for consumers*

(37) The Nuclear Energy Agreement forms part of the reorganization of a system which has hitherto been monopolistic. The benefit to consumers, both industrial and private, derives from the gradual introduction of competition into the system. It is notable that premises whose demand exceeds 1 MW are already free to choose their supplier; after four years this threshold will be reduced to 0,1 MW and after eight years totally phased out.

3. *Need for the restrictions*

(38) Competition between Scottish Power and Hydro-Electric under the privatization of electricity in Scotland is not restricted by the agreement beyond what is necessary. Although the two companies are obliged to purchase nuclear-generated electricity at the same price, the agreement will gradually allow them to compete in their relations with their customers.

(39) The quotas which have been fixed between Scottish Power and Hydro-Electric for the purchase of nuclear electricity output do not reflect the market share of both companies as each company is free to determine individually their output and meet their demand.

(40) The agreement, which was originally to apply for a period equivalent to the remaining lifetime of the nuclear power stations, i.e. 30 years, has, at the Commission's request, been limited to 15 years. This period of validity provides the stability and guarantee necessary for long-term planning and allows the necessary adjustments to be made to the new situation after a reasonable start-up period. However, this period seems necessary to allow Scottish Nuclear to attain full profitability and become competitive.

(41) The price set in the agreement is independent of the price at which Scottish Power and Hydro-Electric purchase electricity from the other generators, particularly the independent generators.

The formula used for the first four years and taken as a basis for setting prices for the following four years is considered to be an internal calculation formula which does not in any way prejudice the setting of the price at which electricity is purchased from independent generators. The price set in the agreement should not, in particular, be improperly used to justify a very low purchase price that would dissuade independent generators and Scottish Nuclear's competitors. This could be deemed to be an abuse of the exemption.

4. *No elimination of competition*

(42) The agreement introduces a system of gradual competitiveness into the electricity industry and creates scope for competition between Scottish Power and Hydro-Electric. In addition, the market in the generation of electricity, except nuclear-generated electricity, remains sufficiently open for the agreement not to create any barriers to entry. Nuclear-powered generation plays and will continue to play a important role, but there are real alternative sources of supply.

C. **Articles 6 and 8 of Regulation No 17**

(43) Pursuant to Article 6 (1) of Regulation No 17, this Decision will take effect as from the date of the notification, i.e., 27 February 1990. Exemption is granted, pursuant to Article 8 (1) of Regulation No 17, for the period of the validity of the agreement, reduced at the Commission's request from 30 to 15 years, i.e., from 27 February 1990 to 31 March 2005, the expiry date for the present agreement,

HAS ADOPTED THIS DECISION:

Article 1

Pursuant to Article 85 (3) of the EEC Treaty, the provisions of Article 85 (1) are hereby declared inapplicable, for the period between 27 February 1990 and 31 March 2005, to the Nuclear Energy Agreement concluded between Scottish Nuclear Ltd and Scottish Power plc and Scottish Hydro-Electric plc.

Article 2

This Decision is addressed to:

— Scottish Nuclear Limited
Incorporated in Scotland No SC117121
Cathcart House
Spean Street
UK-Glasgow G44 4BE

— Scottish Power plc
Incorporated in Scotland No SC117120
Cathcart House
Spean Street
UK-Glasgow G44 4BE

— Scottish Hydro-Electric plc
Incorporated in Scotland No 117119
16 Rothesay Terrace
UK-Edinburgh EH3 7SE.

Done at Brussels, 30 April 1991.

For the Commission
Leon BRITTAN
Vice-President