



House of Commons
Committee of Public Accounts

The sale of the Government's interest in British Energy

Twenty-second Report of Session
2009–10

*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Angela Eagle MP (*Labour, Wallasey*)
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Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Sian Woodward (Clerk), Lori Verwaerde (Senior Committee Assistant), Pam Morris and Jane Lauder (Committee Assistants) and Alex Paterson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee’s email address is pubaccom@parliament.uk.

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Summary

In January 2009, the Government sold its 36% interest in British Energy, as part of EDF's purchase of the Company. The sale had potentially important implications for future energy security as British Energy, though not financially strong enough to invest in new nuclear power stations itself, owned land viewed by industry as being in the most suitable places for them. The Government had identified new nuclear power stations as having an important contribution to make to future energy security when existing power stations close and it therefore wanted to open up British Energy's sites to a new owner.

The Department's primary objective was to ensure nuclear operators would be able to build and operate new nuclear power stations with no public subsidy. The Department did not, however, secure a binding commitment from EDF to build new nuclear power stations. It also failed to establish whether EDF had previously built any new nuclear power stations without public subsidy. A number of factors, including planning decisions, could result in EDF abandoning its plans to build new nuclear power stations, with or without public subsidy.

This Committee is not convinced the Department's reliance on a rapid acceleration in renewable energy to fill any gaps in future energy supplies is adequate, but note the Department is working with the Treasury to determine whether the current configuration of the United Kingdom's energy market is fit for purpose for the longer term.

The Shareholder Executive hired investment bankers UBS at a cost of £4 million, equivalent to a monthly payment of around £400,000, to advise on sale tactics, assist with negotiations and provide valuations of British Energy. We consider it unacceptable that the Shareholder Executive considered it necessary to spend so much on external advice when it is supposed to possess expertise in these areas. Its explanation of why this was necessary was unconvincing, and we are particularly concerned that it agreed to pay UBS a success fee when UBS had significantly under-estimated what EDF was willing to pay for British Energy. The Government was, however, fortunate in selling its interest in British Energy when energy prices were at a peak, and this was reflected in the price.

The £4.4 billion sale proceeds were allocated to the Nuclear Liabilities Fund, to put towards the future cost of decommissioning British Energy's existing power stations. As required by the Treasury, proceeds were invested in gilts, which carry a lower risk of capital losses compared to equity investments but, in the longer term, may offer lower returns. This could affect the ability of the Fund to cover British Energy's liabilities. We found, just as the Committee concluded in its three previous reports on British Energy, that there are still weaknesses in the monitoring and management of the risks relating to these liabilities.

On the basis of a report by the Comptroller and Auditor General,¹ we took evidence from the Department of Energy and Climate Change (the Department), which was responsible for the sale objectives, and the Shareholder Executive. The Shareholder Executive works

1 C&AG's Report, Session 2009–10, *The sale of the Government's interest in British Energy*, HC (2009–10) 215

with departments to improve the Government's capabilities and performance as a shareholder, and managed the sale of the Government's interest on the Department's behalf.

Conclusions and recommendations

- 1. The Department received a good price as it sold the Government's interest in British Energy when energy prices were at a peak.** The sale increased the value of the Nuclear Liabilities Fund to £8.3 billion, more than double the estimated cost of decommissioning British Energy's existing power stations, which the Fund is responsible for meeting. However, there were some weaknesses which the following recommendations are designed to address.
- 2. The Department has no guarantee that EDF will build new nuclear power stations without public subsidy, which could have potentially serious implications for future energy security.** The Department should, as a matter of urgency, complete and publish the result of its work with the Treasury to determine whether the market as it is currently configured will deliver the new generating capacity needed to avoid an energy shortage. It should also develop contingency plans showing how energy demands will be met if EDF does not proceed with its plans to build new nuclear power stations. We intend to return to this subject in due course to examine progress.
- 3. The Department does not know how much nuclear generating capacity will be required to meet future energy needs.** The Department should develop a more systematic approach to assessing how and when new generating capacity will be delivered, and consult with Infrastructure UK on its approach.
- 4. The Shareholder Executive and the Department demonstrated scant regard for the potentially adverse impacts of the sale on competition in electricity markets.** The Department should closely monitor the operation of the electricity market to determine whether the sale contributes to future price increases, and should be prepared to intervene should this risk materialise. In future sales, departments should set out how they are addressing the risk of adverse impacts on competition from selling Government shareholdings.
- 5. Treasury guidelines required all the sale proceeds to be invested in gilts, which carry a lower risk of capital losses than equity investments but, in the longer term, may offer lower returns.** The Treasury should carry out a cost-benefit analysis of the investment policy it has set for the Nuclear Liabilities Fund to assess whether a more balanced investment portfolio would be likely to provide a better balance of risk and return.
- 6. The failure by the Department and the Shareholder Executive to carry out a timely risk assessment indicates a systemic weakness in their approach to monitoring and managing risk, a weakness that persists despite recommendations in this Committee's three previous reports on British Energy that risk management should be strengthened.** The Department should carry out systematic and timely risk assessments in sales of strategically important assets, particularly where there are residual liabilities that could fall to taxpayers. It should also set out each year in its Annual Report how it has monitored British Energy, and the results. In future asset sales emerging from the Operational Efficiency

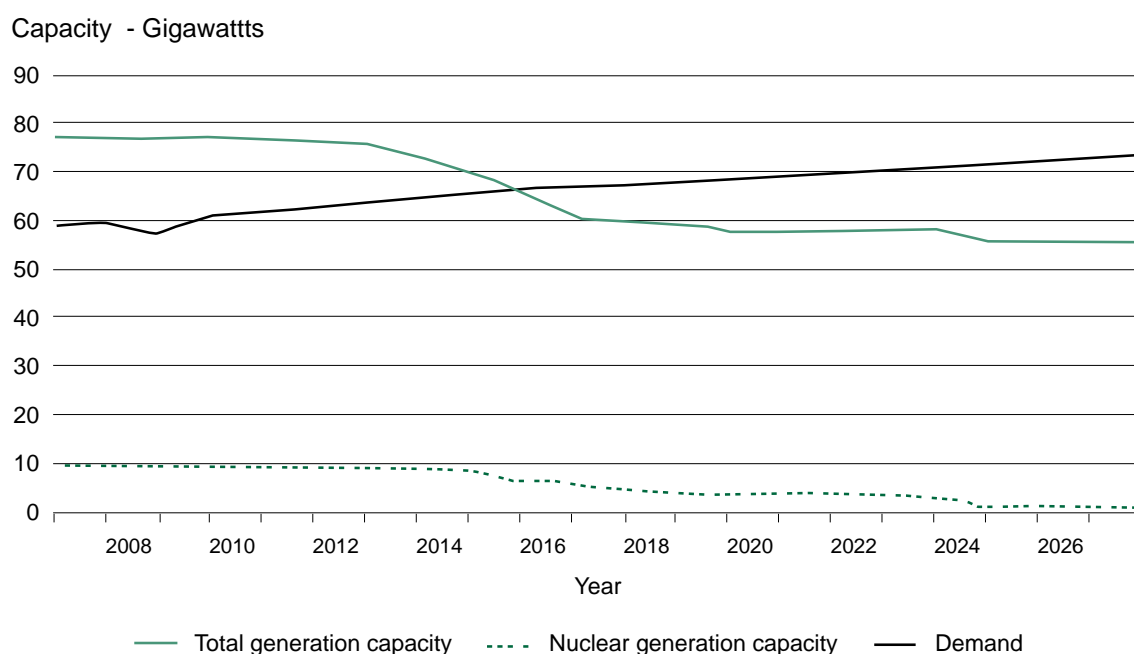
Programme, departments should allocate clear responsibilities for managing all the risks associated with these sales.

7. **The Shareholder Executive is supposed to bring its own financial and commercial expertise to bear on deals of this type, but it still considered it necessary to hire UBS at a cost of £4 million to assist with negotiations and the valuation of British Energy.** In future sales, the Shareholder Executive should seek to make full use of the skills it already possesses and avoid placing undue reliance on costly external advisors.
8. **The Shareholder Executive approved a £4 million success fee for financial advice that significantly under-estimated what EDF was willing to pay for British Energy and did not reflect the judgement of the other main shareholders.** Departments should require financial advisors to take into account the views of the other main shareholders and the value to the buyer. In future sales, departments should also ask prospective advisors to propose alternative fee structures, such as separate prices that reward more directly the work done, rather than opting for a blanket success fee that may not, in practice, reflect their performance.

1 The impact of the sale on energy security

1. On 5 January 2009 the Government sold its 36% interest in British Energy as part of EDF's purchase of the Company. The sale was of strategic importance to achieving the Government's policy goals for encouraging investment in new nuclear power stations, as British Energy owned land viewed by industry as being the most suitable for new nuclear power stations, but was not financially strong enough to invest in new nuclear power stations itself. The Government therefore wanted to open up British Energy's sites to a new nuclear operator.² New generating capacity from nuclear or other sources of energy is needed as the closure of existing stations could result in energy shortages from 2016 if they are not replaced (**Figure 1**).³

Figure 1: Forecast generation capacity of existing stations



Source: C&AG's Report, Figure 2

2. The Department of Energy and Climate Change (the Department) told us that future shortfalls in energy generation from existing power stations would be met by 60 gigawatts of new generation by 2025. It estimated that 35 gigawatts of this would be generated using renewable sources such as wind, with a 'significant proportion' of the remainder provided by nuclear power.⁴ EDF had announced that they were intending to provide 6.4 gigawatts, which would account for around 10% of new capacity.⁵

3. The Department was responsible for the sale objectives, with support from the Shareholder Executive, which works with departments to improve the Government's

2 Q 131

3 Q 55; C&AG's Report, para 1.8

4 Qq 38 and 39

5 Qq 11

capabilities and performance as a shareholder and managed the sale of the Government's interest in British Energy. The Department's primary objective was to enable nuclear operators to build new nuclear power stations without public subsidy. The Department did not, however, obtain a binding commitment from EDF to build new nuclear power stations. Nor was it able to tell us whether EDF had previously built any nuclear power stations without public subsidy.⁶ This is of particular concern as the Department advised us after the hearing that it did not know whether EDF had previously built a nuclear power station without some form of public support.⁷

4. EDF planned to deliver its first new nuclear power station in England by 2017. For other sites, including Heysham in Lancashire, the Department said that it had not estimated the likely timescales for planning and construction.⁸ The Department's analysis showed that achieving the 2017 timetable depended on a complex set of decisions that had yet to be taken. The outcome of individual decisions could prevent EDF from building its first new nuclear power station by 2017, or at all, either with or without public subsidy.⁹ For example, EDF would have to submit its first planning application in 2010 and the Infrastructure Planning Commission would have to approve it by the end of 2011. EDF could also choose not to build new nuclear power stations unless it received a public subsidy.¹⁰ These factors were likely to influence the plans of the two other consortia that intended to build new nuclear power stations.¹¹

5. The Department only had an outline strategy for filling the energy gap if EDF did not build new nuclear power stations.¹² It was relying on the market to deliver a solution to the potential energy gap. It was also relying on a six-fold increase in less than 10 years in the amount of renewable energy that would be generated to help address any shortages.¹³ On the day of our hearing, however, Ofgem announced that there was reasonable doubt whether the UK's energy market would be able to deliver sustainable supplies in the coming decade.¹⁴ The Committee is therefore not convinced that the Department can rely on the market and renewable energy to fill any gaps in supply in the event that plans to build new nuclear power stations do not proceed. We note that the Department is working with the Treasury to determine whether the operation of the energy market is fit for purpose for the longer term.¹⁵

6. The Department recognised the sale would reduce choice and potentially increase prices for industrial and commercial customers, but did not seek possible remedies from EDF on the basis that this was a matter for the competition authorities.¹⁶ The sale has further

6 Qq 12–14, 16, 60 and 128; C&AG's Report, para 1.7

7 Ev 16

8 Qq 77–80

9 C&AG's Report, para 1.12

10 Qq 15, 138 and 140–145

11 Qq 37 and 39

12 Qq 18–20

13 Qq 21 and 52

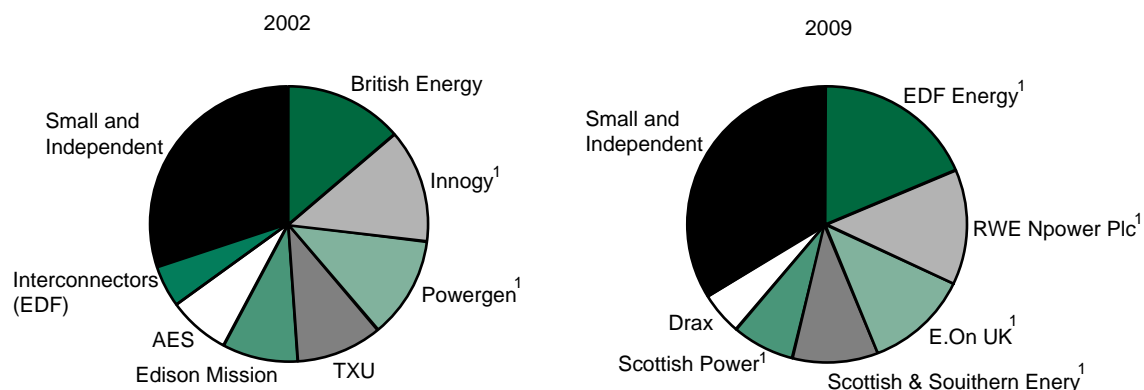
14 Q 10

15 Q 63

16 C&AG's Report, para 1.20

consolidated the electricity generation market in the UK around businesses that combine electricity generation and supply, known as ‘vertically integrated companies’ (**Figure 2**). In 2002, only 20% of suppliers had been integrated in this way. In 2009, 60% of the market was vertically integrated. There is a risk that in the longer-term, this could reduce competition and increase electricity prices.¹⁷

Figure 2: Consolidation of the UK electricity generation market



Note: Vertically Integrated companies are shown in bold text

Source: C&AG's Report, Figure 4

2 The financial aspects of the sale

7. The Government received £4.4 billion for its 36% interest in British Energy. It sold its interest when energy prices were at a peak, and this was reflected in the sale price. The Shareholder Executive told us that since the completion of the sale, the share price of British Energy's closest comparator had dropped by 47%.¹⁸

8. The sale proceeds were transferred to the Nuclear Liabilities Fund, which was responsible for meeting the future cost of decommissioning British Energy's existing nuclear power stations. The income from the sale had increased the value of the Fund more than two-fold, to £8.3 billion. This significantly exceeded the current estimate of £3.6 billion for decommissioning British Energy's existing power stations.¹⁹

9. The Nuclear Liabilities Fund deposited the proceeds of the sale in the National Loans Fund as gilts. This was in line with the investment policy set by the Treasury.²⁰ Gilts carry a lower risk of capital losses than equity investments but, in the longer term, may offer lower returns. There is therefore a risk that any increases in the value of the Fund's assets could be outstripped by future increases in the liabilities estimate, which relates to costs that will be incurred over many decades. Although the investment approach to meeting the cost of decommissioning new power stations had not yet been established, the Department told us it was likely to be different from the approach it had used when investing funds for decommissioning of existing power stations.²¹

10. This Committee has, on three previous occasions, recommended improvements to strengthen departmental oversight of British Energy.²² We were therefore surprised to find the Shareholder Executive had not, before the sale was concluded, assessed the possible longer-term impact of the sale on taxpayers' exposure to British Energy's nuclear liabilities. It had, instead, relied on an undertaking from British Energy to be 'reasonable and prudent'. The Shareholder Executive only prepared a formal risk assessment after the sale was completed in response to a request from the National Audit Office. The Shareholder Executive and the Department then took 10 months after the completion of the sale to establish new risk monitoring arrangements.²³

11. The Shareholder Executive's financial advisors, UBS, received a success fee of £4 million, which was equivalent to a monthly payment for their work of around £400,000. The Shareholder Executive told us that UBS had played a central role in negotiations and developing tactics, and had provided numerous valuations.²⁴ The success fee that UBS

18 Qq 95 and 100

19 Q 75; C&AG's Report, para 2.26

20 Qq 29–31

21 Qq 162–165

22 Committee of Public Accounts, Forty-third Report of Session 2006–07, *The Restructuring of British Energy*, HC 892; Committee of Public Accounts, Thirty-seventh Report of Session 2003–04, *Risk management: the nuclear liabilities of British Energy plc*, HC 354; Committee of Public Accounts, Fifth Report of Session 1998–09, *The Sale of British Energy*, HC 242

23 Qq 64, 70, 93 and 94

24 Q 2

received was not, however, directly linked to the amount of work they actually carried out. The Committee is not convinced by the Shareholder Executive's explanation of why it needed to spend so much on external financial advice when it already employed a number of investment bankers, or that its financial advisor's targets were sufficiently stretching.²⁵

12. One of the main tasks carried out by the financial advisors was to provide the Shareholder Executive with a valuation of British Energy. UBS valued the Company at 703 pence per share.²⁶ This proved to be 10% less than EDF was willing to pay, because it did not take into account the specific value of British Energy to EDF.²⁷ Acquiring British Energy had, for example, moved EDF from a relatively weak position in the UK electricity generation market to owning nearly one-fifth of generating capacity, and given it a central position in the market for new nuclear power stations in the UK.²⁸ The Government ultimately received a higher price as the other main shareholders were able to increase EDF's offer to 774 pence per share because of their views on the strategic value of British Energy to EDF and future energy prices.²⁹

25 Qq 2–8, 115 and 118

26 Q 115

27 Qq 116, 118; C&AG's Report, para 2.11

28 C&AG's Report, para 2.11

29 Q 118

Formal Minutes

Monday 15 March 2010

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr Douglas Carswell

Rt Hon David Curry
Nigel Griffiths

Draft Report (*The sale of the Government's interest in British Energy*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 12 read and agreed to.

Conclusions and Recommendations 1 to 8 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Twenty-second Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Wednesday 17 March at 3.30 pm]

Witnesses

Wednesday 3 February 2010

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Ms Moira Wallace, Permanent Secretary, **Mr Mark Higson**, Chief Executive of the Office for Nuclear Development, Department for Energy and Climate Change and **Mr Stephen Lovegrove**, Chief Executive, Shareholder Executive

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Oral evidence

Taken before the Committee of Public Accounts on Wednesday 3 February 2010

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr Paul Burstow
Mr Ian Davidson
Keith Hill

Mr Austin Mitchell
Geraldine Smith
Mr Alan Williams

Mr Amyas Morse, Comptroller and Auditor General, **Mr Rob Prideaux**, Director, Parliamentary Relations and **Mr David Clarke**, Director, National Audit Office, gave evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

THE SALE OF THE GOVERNMENT'S INTEREST IN BRITISH ENERGY (HC 215)

Witnesses: **Ms Moira Wallace**, Permanent Secretary, and **Mr Mark Higson**, Chief Executive of the Office for Nuclear Development, Department for Energy and Climate Change; **Mr Stephen Lovegrove**, Chief Executive, Shareholder Executive, gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts where we are considering the Comptroller and Auditor General's Report on the sale of the government's interest in British Energy. We welcome back to our Committee Moira Wallace, who is the accounting officer for the Department of Energy and Climate Change, and we also welcome Stephen Lovegrove, chief executive of the Shareholder Executive. Would you like to introduce your other colleague?

Ms Wallace: I will let him introduce himself.

Mr Higson: I am Mark Higson. I am the chief executive officer of the Office for Nuclear Development.

Q2 Chairman: What the Report says, in very brief summary, is that you achieved good value from selling your interest in British Energy, but we have absolutely no guarantee that we are going to get these new nuclear power stations with or without public subsidy. Also, there are aspects of the sale which are a concern to me and we want to pursue these so that we can learn lessons for future sales of government interests. Mr Lovegrove, perhaps I could start with you, please. I want to ask you about the management of the sale which is dealt with, amongst other paragraphs, in paragraph 19 of the Report on page eight. You paid your financial advisers, the merchant bank UBS, £4 million. What did you get for it?

Mr Lovegrove: This was a very complex sale that was governed by the Takeover Code and it had many players with many different objectives. It was multi-jurisdictional so, with the best will in the world, the staff in the Shareholder Executive were not going to be able to do all of the heavy lifting that we needed to get done throughout the sale. For the nine or ten months or so that we had UBS working for us as well

as other advisers, we had four managing directors I think working for us on a daily basis, three directors, a couple of vice-presidents and more junior staff to call on at will. In terms of what they actually did for us, they were integral in our approach to the negotiations. They were integral in our approach to the tactics we adopted with the board. They were very important in the development of the Nuclear Power Note that eventually was instrumental in getting the deal done. They provided us with numerous valuations and two fairness opinions, so they were very important in the success of the transaction.

Q3 Chairman: You have your own merchant banker working for you, do you not?

Mr Lovegrove: We have a number of merchant bankers working for us, yes.

Q4 Chairman: The whole purpose of your organisation is to advise the government on this sort of thing. They did a couple of valuations for you. They advised on strategy but let us look at it in more detail, Mr Lovegrove, shall we? This is dealt with on page seven, paragraphs 12 and 13 and page nine, paragraph 22. British Energy effectively ran the sale, did it not?

Mr Lovegrove: The board of British Energy ran the sale, yes.

Q5 Chairman: They had their own merchant bankers, Rothschild, did they not?

Mr Lovegrove: Yes, they did.

Q6 Chairman: We do not know how much they were paid, do we?

Mr Lovegrove: I do not know.

Q7 Chairman: We cannot find out. The price was negotiated by its main investors. The EU had a big role, did they not?

Mr Lovegrove: They had a big role in making sure that the site disposal—

Q8 Chairman: They determined the impact on UK electricity markets, so I ask you again: what exactly did you do and, given that you have the expertise in house, why do you need to spend £4 million on merchant bankers? What is the point of your organisation?

Mr Lovegrove: The point of our organisation I think, as much as anything else in this kind of instance, is to be an intelligent client. I do not think that a deal of this complexity and of this unpredictability could have been done without proper—

Q9 Chairman: Precisely what value did you add to this deal?

Mr Lovegrove: We advised the Secretary of State closely at the beginning of the process about the hierarchy of objectives which governed all of our decisions throughout the process. We did that with colleagues from the Energy Group. We ultimately dictated the tactics that we had to adopt throughout the process of the sale. We led the exercise of integrating the site disposal package with the potential bidders, with the site disposal package which was being done simultaneously with the NDA. All of these I think were very important in being able to get a successful transaction completed and, without a successful transaction, none of the government's objectives would have been obtained.

Q10 Chairman: Let us have a look now at the risk to energy security, Ms Wallace. Shall we look at figure two? Obviously this deals with the very worrying strategic issue of the energy gap facing this country. To be absolutely up to date, Ofgem issued a press release only today saying that there is reasonable doubt about whether the UK's energy market will be able to deliver sustainable supplies in the coming decade. Obviously Ofgem is not going to exaggerate what they say. You see in that figure that we have this rather worrying gap between electricity supply and demand. How much of this gap is going to be filled with these EDF nuclear power stations?

Ms Wallace: This gap can be filled in a number of ways. What this chart shows is the generating capacity that currently exists. Of course we have a whole range of generating capacity that is under construction or that has planning permission. About 20 gigawatts is currently in that position. The dark line that goes down will be increased by a range of sources of supply that are coming on stream and we published full details of those in the Low Carbon Transition Plan.¹

Q11 Chairman: You are giving a very general answer to a very specific question. I asked you how much of this gap will be filled by EDF's new nuclear power stations.

Ms Wallace: In total, there are three consortia of which EDF is obviously one, who are planning to bring on nuclear and EDF is planning to bring on I think six gigawatts.

Mr Higson: 6.4 gigawatts is what they have announced with their plan.

Q12 Chairman: How many nuclear power stations has EDF built, Ms Wallace, without a public subsidy?

Ms Wallace: I do not know the answer to that.

Q13 Chairman: I am surprised you do not know. I would have thought it was a fairly obvious point. Generally you judge people's future actions by what they have achieved in the past, so I repeat: can anybody tell me how many nuclear power stations EDF, a French company, has ever built without a large public subsidy?

Mr Higson: EDF has built 58 power stations but it is impossible to say what level of public support there is because—

Q14 Chairman: In France. It is very difficult to penetrate, is it not?

Mr Higson: It is very difficult. You are correct.

Q15 Chairman: If I suggested to you that it is almost inevitable that EDF, this French company, will come back for public subsidy, would you dispute that?

Ms Wallace: It is our very clear policy which we legislated in the Energy Act that there will not be public subsidy. We have taken a series of measures to require operators to meet the costs.

Q16 Chairman: This report is not worth the paper it is written on. It is there. They have given you absolutely no guarantees whatsoever, no promises, no commitments that they are going to build these things, have they?

Ms Wallace: No and nor would you expect them to. Nor, before the sale was undertaken, was it remotely likely that British Energy was going to do that. We have a very clear policy. They understand our policy. So do the other operators that are interested in nuclear.

Q17 Chairman: There are all sorts of caveats in here about what might happen, depending on this. We just do not know, do we?

Ms Wallace: We have a very clear policy. I would not agree with you that it is almost inevitable. Our policy is clear. There are many barriers to overcome in implementing it but our whole policy is about getting those barriers—

Q18 Chairman: What happens if they do not build any nuclear power stations? What happens if we believe your stated policy and you refuse to give them public subsidy and they say that it is not economic? What happens then? What is your plan B?

Ms Wallace: We are not betting the farm on EDF. We are indeed not betting the farm on nuclear. Our policy is about diversity of supply, a range of different forms of supply and competition between them.

¹ Note by witness: Chart 5, page 73.

3 February 2010 Department for Energy and Climate Change and Shareholder Executive

Q19 Chairman: Tell me in detail what you are going to do. How are you going to meet this energy gap? What are your plans?

Ms Wallace: We have a range of plans which are well set out in—

Q20 Chairman: You have already said you have a range of plans. What are these plans?

Ms Wallace: We have plans to bring on renewables which are well known. We have plans to bring on—

Q21 Chairman: How much of this gap will renewables deal with?

Ms Wallace: Our lead scenario is that 30% of electricity will come from renewables in 2020.

Q22 Chairman: By when?

Ms Wallace: By 2020.

Q23 Chairman: You believe that, do you?

Ms Wallace: We are currently on target to do that. Renewables have grown very fast. We have plans to advance clean coal and we have plans to bring forward new nuclear. We have a range of actions that are clearly set out which the industry agrees are what is necessary to bring new nuclear on. We have a range of operators interested in doing this. I am not saying it is not difficult but we are on schedule. We are doing the things we said we would and we have people interested in it.

Q24 Mr Bacon: It is correct, is it not, Ms Wallace, that the ownership of the government's interest in British Energy was held through the Nuclear Liabilities Fund?

Ms Wallace: They received the cash sweep.

Q25 Mr Bacon: It says in paragraph one that British Energy was a publicly listed company in which the taxpayer held an interest through the Nuclear Liabilities Fund. That is right, is it not?

Ms Wallace: Yes.

Q26 Mr Bacon: Can you just remind us what the Nuclear Liabilities Fund was established for?

Ms Wallace: It was established to meet the costs of decommissioning British Energy's bid.

Q27 Mr Bacon: It was established to meet the cost of decommissioning British Energy's stations without recourse to the taxpayer, was it not?

Ms Wallace: Ultimately, the government has to stand behind it but its purpose was—

Q28 Mr Bacon: The purpose of the fund was that the fund would be sufficient to pay for the decommissioning costs without additional cost to the taxpayer. Somebody behind Mr Lovegrove is nodding vigorously which is always dangerous in this Committee, but very welcome nonetheless. That is right, is it not? It was essentially to cover the costs of the decommissioning?

Ms Wallace: Yes.

Q29 Mr Bacon: What has now happened to the money from the sale? EDF bought this government owned interest. What has now happened to the money?

Ms Wallace: It has gone into the NLF.

Q30 Mr Bacon: What is it being invested in?

Mr Lovegrove: It has been put into the National Loan Fund and is basically in gilts.

Q31 Mr Bacon: If you wanted that fund to have a future life of 100 years or so, so that it would cover the costs of decommissioning, would you put it into gilts?

Mr Lovegrove: I think that is probably a question for the Treasury. Effectively, we are following Treasury guidance on where the Nuclear Liabilities Fund is investing its money.

Q32 Mr Bacon: Fortunately we have a representative of the Treasury here. If you wanted to cover this liability going forward for 100 years, is gilts where you would put it?

Ms Diggle: It is a very difficult judgment to strike, as you might think. Over the last decade, anything else mostly would have gone down. Gilts are a safe place to put it. It is where we tend to put things if in doubt. I will look into it further and let you have a note.²

Q33 Mr Bacon: Is not the real reason for putting it into gilts because it counts as a reduction of the national deficit?

Ms Diggle: I think wherever it went that would be the case.

Q34 Mr Bacon: Would it?

Ms Diggle: I think so.

Q35 Mr Bacon: That is very interesting because it is not my information, but perhaps you could send us a note from the Treasury on precisely that point,³ where it would and where it would not count as a reduction in the deficit.

Ms Diggle: Of course. I think you will find that, as it is a government asset, it would always count like that.

Q36 Mr Bacon: I am intrigued to hear you say that. That is very interesting but if you would send us a note that would be very kind. Ms Wallace, this policy is designed to give us energy security, is it not, basically, to ensure that we get enough nuclear power stations built in time?

Ms Wallace: That is the top objective, yes.

Q37 Mr Bacon: What is your main safeguard? The assumption that you have a developer that has a great deal of experience? They are the largest or one of the largest developers of nuclear power stations in the world. They have a lot of experience. We know that France has a lot of nuclear power capacity and that they have developed a lot of that. Is it essentially

² Ev 15

³ Ev 15

a punt that they, because they have a lot of experience, are more likely than anybody else to be able to deliver what this country needs?

Ms Wallace: That is part of it. I have to hand over to Mr Higson who is going to comment on this in more detail.

Mr Higson: We have a layered approach to give as much protection to our public interest as we can. You are right. Having a company that is financially reasonably strong and that has experience is a great help. However, we have not put all our eggs in one basket. As you will know from our objectives, we also had the objective of making sure that we were not unduly dependent on one nuclear operator. We have two more operators who have announced plans and already have sites that are suitable for new development. If EDF declines to invest for whatever reason, the next stage would be maybe the other companies will proceed with their plans. The stage below that is that we are not completely dependent on nuclear power for meeting our objectives. We said in our various White Papers that nuclear power has an important role to play, but there are many other policies: bringing on renewables, increasing energy efficiency, a whole range of measures, so that if no nuclear was to come forward we would clearly have to do more elsewhere in order to meet our objectives.

Q38 Mr Bacon: If no nuclear was to come forward at all, for the sake of argument, what is the percentage contribution that you are expecting in your plans that would then be missing? We know France is 80% nuclear. In 30 years' time, what do your plans call for in terms of the proportion of energy supply that is nuclear?

Mr Higson: What we said in the National Policy Statement is that by 2025 we are expecting a need for 60 gigawatts of new capacity, of which 35 is renewable and 25 is non-renewable. Out of that 25—

Q39 Mr Bacon: Can you just say that again?

Mr Higson: For 2025, total new capacity expected on projection of this is 60 gigawatts, of which 35 is renewable. That leaves 25 for non-renewable, all non-renewable sources, so that is coal, abated coal, gas, nuclear, to fill that amount by 2025. We have not taken a view about how much of that 25 gigawatts should be supplied by nuclear. That will be a matter for commercial decisions taken in the market place.

Q40 Mr Bacon: Can you just remind us: if we are going to have the 60 gigawatts for additional capacity, what is the current capacity at the moment of generation in the UK?

Ms Wallace: It is 80.

Q41 Mr Bacon: If we have an additional 60, is that because we are going to need 140 or is it because some of the existing 80 is dropping out and needs replacing?

Ms Wallace: Some of it is dropping out and the nature of generation is changing so that some of it is intermittent.

Q42 Mr Bacon: Because of the wind, yes. How much of the 80 will drop out?

Ms Wallace: In this decade, I think it is something like 16.⁴

Q43 Mr Bacon: I am talking about in total. You have said by 2025. If by 2025 we are going to have 60 gigawatts of new capacity, Mr Higson, what is your expectation of the total capacity, given that some of the 80 will have dropped out? What will the new 60 then comprise part of in 2025? What total will it be part of?

Mr Higson: I am not too sure of that figure but I think it must be around 100 gigawatts.⁵

Q44 Mr Bacon: I am surprised. These are fairly global figures that I am looking for. I am slightly surprised that you do not know. The Office for Nuclear Development, of which you are the chief executive, is within the Department for Energy and Climate Change?

Mr Higson: It is, yes.

Q45 Mr Bacon: Your job is to promote nuclear within the department, is it? Are you a champion for nuclear?

Mr Higson: My primary job is to identify the unnecessary obstacles to the deployment of new nuclear power and to work in partnership with the industry to remove them to enable nuclear to come forward.

Q46 Mr Bacon: Of this 25 gigawatts of new capacity that will be non-renewable, do you have a view on how much you expect to be generated from nuclear?

Mr Higson: I do not have a view precisely about what we would expect. What we have said in our National Policy Statement is that we would expect a significant proportion of that 25 to be met by nuclear and I would just note that, if you add together the announced plans of the three consortia, that would come to 16 gigawatts. Again, we are talking around 2025.

Q47 Mr Bacon: 16 out of the 25.

Mr Higson: Correct. That is what the companies have announced by way of their plans.

Q48 Mr Bacon: What guarantees can you give us that the new generating capacity which the UK needs will be delivered on time?

Mr Higson: I cannot guarantee that nuclear power will be delivered on time. What I can guarantee is that the government will do everything in its power to remove unnecessary obstacles to facilitate the development of nuclear power.

⁴ *Note by witness:* Around 18GW are due to close by 2018. Further power station closures will be driven by the Industrial Emissions Directive (IED) which is currently under negotiation in Europe and will replace the regulatory framework established by the Large Combustion Plant Directive (LCPD).

⁵ *Note by witness:* There could be a need for around 110GW of total electricity capacity by 2025.

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Q49 Mr Bacon: What guarantees can you give us that the necessary generating capacity will be delivered on time, not necessarily nuclear—perhaps it is a question for Ms Wallace—but from whatever sources?

Ms Wallace: We are very confident, for the reasons I gave earlier in response to a different question, in our security of supply in the medium term. Longer term, the whole purpose of the department is to deal with the very significant challenges that there are as we see a decarbonised economy and a change in the pattern of generation. We are looking very hard at how much electricity we are going to need in the 2020 to 2050 period. As the Secretary of State has made clear, we are looking very hard at the market framework that we will need to incentivise that. No one is saying that this is an easy task. It is a very significant task that requires action on a range of fronts and that is the department's job.

Q50 Mr Bacon: Can I just ask you about risk management arrangements? What risk management arrangements do you have in place and what have you done to comply with the previous recommendations of this Committee in relation to risk management?

Ms Wallace: I am glad you have touched on that because, having read the previous recommendations of this Committee, we have learned a lot from looking at them and making sure that we have the right monitoring in place. Indeed, the sale of British Energy was part of our risk reduction strategy because it was so obvious that the NLF was exposed. It was relying on a company doing well when all its liabilities would arise if the company did badly. We do our monitoring through the Shareholder Executive and I would like to invite Mr Lovegrove to say a little bit more about how we do that, but it does build on what this Committee has recommended before.

Mr Lovegrove: We are very conscious of the Committee's understandable interest in this area. I think we accept the recommendation in the Report that we should formally have recorded our monitoring arrangements sooner than October 2009, although in practice we have quite an elaborate set of monitoring frameworks to look at these matters. Formally within DECC it is the director general of energy markets and infrastructure who is responsible for this. He is also responsible for the NDA. He delegates responsibility on an operational basis to the Shareholder Executive. The director who works for me, who also looked after the sale, is the individual who does that. There is a great deal of liaison with colleagues in DECC to talk about the various issues which may arise from the conduct of the monitoring of NLF and indeed issues arising from the NDA BE team as well. There are quarterly meetings between those two individuals which are formal. There is a great deal more *ad hoc* communication. Junior officials have a great deal of *ad hoc* communication as well. There is a schedule of reserved matters for DECC where we know that it falls outside the competence of the Shareholder Executive to take a view on these

things without specific reference to DECC officials. We do have a very elaborate framework for that. I am sure it can be improved over time and we will continue to try to do that.

Q51 Mr Bacon: Ms Wallace, this question is about something you said about the intermittency of some of the supply. If you are doing a calculation about the total supply including the new that is coming on and the dropping out of the existing, you must have made some assumptions about what you get from supply from alternative renewable sources that are intermittent, by which mainly we mean wind because things like tidal tend to be highly predictable. You can predict the tide years ahead. What assumptions have you made about the level of intermittency in your models?

Ms Wallace: I cannot give you the detailed assumptions. I do not have them here, but we have made an allowance for them because that is implicit in going for that different form of generation. We will continue to look at the likely composition of supply and the likely composition and amount of demand. That is one of the pieces of work that we are doing in our road map for 2050 because this will continue to change as we go forward.

Q52 Chairman: On renewables that Mr Bacon was asking about, this is a very important point. Obviously you are very confident but renewables have gone slowly. In 2008 only 5% of electricity supply came from renewables. If you want 30% by 2020, you need a six fold increase.

Ms Wallace: That is right, yes.

Q53 Chairman: Is that likely?

Ms Wallace: That is what we are planning. There is a very significant programme behind this. There are powerful incentives. We have just announced another round of offshore wind. We are doing a lot to facilitate it. There is an Office of Renewable Energy Development which parallels Mark Higson's work in the nuclear field. We are aware it is a very steep increase but that is what we are planning to do. We announced only this week incentives for micro-generation, for small scale renewables that people can have in their homes or in small businesses, so there is quite a lot of punch behind this programme. We do recognise it is a steep line but we are doing all we can.

Q54 Chairman: Apparently Ofgem do not agree with you. Your comments are contradictory to what they announced this morning.

Ms Wallace: Ofgem are pointing to the risks. We agree there are risks. As I have tried to make clear, we are not at all complacent about this. It is a very significant programme of change and it requires change in incentives. It requires investment and it requires us to remove barriers.

Chairman: If that is government policy, that is fine.

Q55 Mr Burstow: I want to come back to this question about plans, how real and hard those plans are and try to go a little bit further on this issue of

the delivery of 60 gigawatts of new supply by 2025. In figure two the lines cross in 2016 so I am wondering if you could tell me what amount of those extra 60 gigawatts will be available by 2015.

Ms Wallace: There is 20 gigawatts at the moment.

Q56 Mr Burstow: 20 of the 60 is already available?

Ms Wallace: It is not available but it is under construction or it has planning permission. We would expect that to come on in the next few years. Our own predictions when we last published them in the strategy that was published last July, the Low Carbon Transition Plan, had us by 2014–15, in terms of what was under construction—we took into account what was already under construction then—over 20 gigawatts above that line.

Q57 Mr Burstow: By 2020 what would you be planning to have on stream?

Ms Wallace: There are obviously broader uncertainties there but what we have again under construction now—assuming it has been constructed by then, which you would assume—and taking account of some things that by then will have dropped out, it looks like it will be about 70 gigawatts, so you would be ten gigawatts above the navy blue line on the chart. There is more dropping out. There is more for which consent will be sought, which will then be coming under construction. It is two moving lines. That chart is completely accurate for what it is trying to set out, but there is a range of lines above that that you will want to draw in of supply that is under construction.

Q58 Mr Burstow: I am sure when I read the transcript I will understand that but I want to make sure I understand it now as well. In terms of 2020, how much additional, new capacity of that 60 gigawatts that we are being told is planned to be available by 2025 will actually be on stream?

Ms Wallace: I cannot answer that definitely because we do not know. There are many contingencies. In terms of supply that is being considered, where people may seek consent and may get it, we could have 40 gigawatts by then, but we do not know that that will all come on stream.

Q59 Mr Burstow: Obviously that issue of risk management is one I am about to come on to but, specifically to go back to the issue of EDF and the question the Chairman asked at the beginning of the session, 6.4 gigawatts I think is the figure that was mentioned earlier on in terms of possible nuclear generation from EDF. What if the company does not come or will not build that capacity? What is the plan B, because that is a significant chunk of the capacity you are envisaging, notwithstanding the potential obstacles that are in the way, to have available by 2020?

Ms Wallace: I come back to this point which is that we are committed to diversity as the strategy for supply of electricity and that is why we are pursuing several different strategies including renewables, which we have just talked about, including nuclear, which we are talking about here, including clean coal

as well as gas, which we have plenty of now. Our strategy is to have a range of different forms of supply.

Q60 Mr Burstow: Would not part of the strategy also be to make sure there is the contingency built in to deal with a situation where EDF have acquired land for one purpose but then decide they cannot use it for that purpose, for that land then to have to be sold on to be put to that purpose?

Ms Wallace: I think I will ask Mr Higson to comment on that specific point. I do not know whether that is something that there is any obstacle to.

Mr Higson: There are no requirements on EDF to sell land that it owns if it chooses not to build power stations on that land.

Q61 Mr Burstow: Why were no conditions of that sort put on?

Mr Higson: We negotiated with EDF a package which we believe was sufficient to enable more than one operator to enter the market. We think we have been successful in that. We do have two other operators who have other sites, who have announced plans to enter the market. That is our protection in depth. We have worked to identify the obstacles with EDF. If EDF do not invest, we have made sure that they are not the only show in town and if nuclear is not built there is a wide range of other sources of power. We have to do more on each of them.

Q62 Mr Burstow: On that basis, given that you cannot be certain and you are hedging everything understandably around uncertainty here, what impact would it have on energy security if EDF in the end decide they cannot build?

Mr Higson: Our intention is that we have a diverse system so that if nuclear power is not built by EDF then all other things going on in the market end up in a market based system, ensuring that we have adequate capacity to serve our needs.

Q63 Mr Burstow: The market will fix it all?

Mr Higson: As we have said, our department together with the Treasury is actually looking at the operation of the market and in the Energy Market's Assessment we ensure that we do have a market framework that is fit for purpose for the longer term.

Q64 Mr Burstow: This discussion has been about risks and management risks. Mr Bacon started to ask some questions about that. Why was it that it required the NAO to ask you to undertake a strategic risk assessment before you actually did it?

Mr Higson: I think it might be helpful if the Committee allowed us to spend a moment explaining what the risks are that we are addressing and were addressed by the sale. The most important risk that the government was exposed to before the sale was a total loss of the cash sweep through the NLF because the NLF was responsible for the liabilities and the government stood behind that. Potentially, the government was at risk for the whole

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of the value of that cash sweep which, in the sale, was £4.4 billion. You can imagine a risk of that magnitude required the most intensive monitoring. That risk has been completely closed out, I understand.

Q65 Mr Burstow: That is applauded and the NAO Report acknowledges that but, having managed that risk, there are then consequential risks from the approach you have taken which do not appear to have been identified until afterwards.

Mr Higson: That is not correct. We did spend a lot of time thinking about the risks and there are four other kinds of financial risk and two policy risks that we are exposed to. It is correct that we did not put in place the formal monitoring arrangements and document them until later on in the year, although in practice they were operating and there were meetings with EDF as early as August.

Q66 Mr Burstow: Would you though think it would be sensible in future to make sure as part of your practice that there were such risk assessments taken prior to sale?

Mr Higson: Clearly it is very important that the risks of sales like this are assessed and that is what we did.

Q67 Mr Burstow: Can I ask the NAO, just to be absolutely clear about this, because in the briefing we have had, in the Report we have had, I take it that the NAO requested this exercise to be undertaken. Was there anything that you would recognise as a risk assessment around this particular aspect, post sale or even pre sale?

Mr Clarke: There were obviously previous risk assessments in place. What we were asking for was for those to be updated given that there was a new owner.

Q68 Mr Burstow: Would you have expected those to have been updated without you asking for it?

Mr Clarke: We asked for them, expecting them to be there, yes.

Q69 Mr Burstow: I think that was yes, in a way.

Mr Clarke: I said yes.

Q70 Mr Burstow: Can I ask you about the monitoring that is now in place? It took ten months to set that up. How is that now working?

Mr Lovegrove: It took ten months to formally record the arrangements for the monitoring and that was too slow. I think we fully accept that. It is working in practice very well. As I said, the director general of energy markets and infrastructure who reports at board level in DECC delegates most of the operational monitoring to the Shareholder Executive. That is done by a team within the Shareholder Executive who liaise very closely with colleagues in DECC at a senior Civil Service level at least once a quarter, on a formal basis. Much more often on an *ad hoc* basis, there is a great deal of liaison also with the NAO BE team. At the moment we feel that it is working well. As I said before, I think we should always keep those things under

review because the nature of risks tends to change and I think the monitoring framework will have to try and reflect that.

Q71 Geraldine Smith: Can you tell me a bit about decommissioning nuclear power stations? Who is meeting the cost of that?

Mr Higson: Are we talking about new power stations for the future?

Q72 Geraldine Smith: No; existing power stations. I am thinking that Heysham 1 will be coming up for decommissioning in the near future. What year will that be?

Mr Higson: I think that is 2014 but I believe the company has also sought a lifetime extension.

Q73 Geraldine Smith: That information will be important, I guess, when you are deciding the deal and how much to pay for the sites containing power stations. It is much more valuable if Heysham 1 is given an extension than if it is not and if it is decommissioned in 2014. You would need to know what the position was before that sale went ahead, to make sure that the taxpayer got the best value for that site.

Mr Higson: I am not sure I am entirely following. Clearly, it is in the commercial interests of the operator of the station that they should extend its life as long as is possible, consistent with safety and it being economic to do so.

Q74 Geraldine Smith: Who will pay for the decommissioning?

Mr Higson: The decommissioning is paid for by the NLF.

Q75 Geraldine Smith: They have a fund of £8.3 billion for all decommissioning. Do you think that is adequate?

Mr Higson: It is difficult to answer that question because the liabilities are long term. However, set out in the NAO Report itself against that figure of the assets is a liability of £3.6 billion. At this stage, the assets exceed the liabilities as discounted.

Ms Wallace: The NLF's assets exceed their liabilities by over four billion at the moment.

Q76 Geraldine Smith: To me that seems not very much money really for nuclear decommissioning. You are talking about a very large amount of money once you start decommissioning a nuclear power station. Do you think those figures could have been under estimated?

Mr Higson: They are the best estimates that we have.

Ms Wallace: Just to come back to the issue of risk management, one of the key results of this sale is that we have turned round the risk position of the NLF in that their assets do now exceed their liabilities by a significant margin. We are using the best estimate we have of those decommissioning costs. This is the decommissioning cost for the British Energy fleet. It is not the decommissioning costs for things that are not in the British Energy fleet or nuclear power stations that may be built at some point in the future.

It is a distinct group of the British Energy fleet. These are the best estimates we have, but we do have a margin of four billion there and we will keep a close eye on the value of the liabilities. That is one of the risks that they are monitoring as well as when they come to pass.

Mr Lovegrove: The decommissioning estimates are put together by British Energy and then they have to go through a process of audit by the Nuclear Decommissioning Authority BE team. That is what comes up with the 3.6 billion number. In fact, in the DECC resource accounts, there is a more conservative approach to that even, so the decommissioning liabilities in the resource accounts are actually nearly a billion higher than that. Ms Wallace is absolutely right to say that these are long term liabilities and there is a degree of uncertainty about them.

Q77 Geraldine Smith: What about new build at Heysham? The situation at the moment is you need quite a large percentage of energy to come from nuclear. Most people in my area think there is going to be a new power station built by 2020. I think that seems pretty optimistic because EDF potentially have to sell the land on. I think there is a choice between Heysham and another site. Can you tell me where you are up to and what is happening with that?

Mr Higson: There is a sale process currently under way by EDF as required by the European Commission.

Q78 Geraldine Smith: How long will that take?

Mr Higson: That is a commercial matter. I am afraid I do not know how long it will take.

Q79 Geraldine Smith: An estimate?

Mr Higson: I cannot estimate. I am sorry.

Q80 Geraldine Smith: If you cannot estimate how long it is going to take and you have the planning process, the building time and everything, how can you estimate when you are going to have more energy on tap and more electricity if you cannot estimate the timescales?

Mr Higson: We are not making a specific forecast or estimate that there will be a nuclear power station operational at any particular date at Heysham. That will be a commercial matter for the operators. What we say in the National Policy Statement is that, subject to public consultation, that is a site which we believe at a strategic level is suitable and credible for deployment by 2025.

Q81 Geraldine Smith: To make sure that is suitable, would there have been checks carried out on the land at Heysham because again, for years and years, local people were always told that there would never be another power station at Heysham because there was a geological fault and it would not have been viable to build one?

Mr Higson: Issues like a geological fault are very much site specific so clearly they would have to be examined in detail if and when an operator came

forward with specific plans. At the strategic level that we conducted the nuclear National Policy Statement, we have not looked at details like that. We have only looked at a strategic level.

Q82 Geraldine Smith: At the moment EDF will be allowed to build four nuclear power stations, two power stations on each of the two sites?

Mr Higson: EDF have plans to build two twin reactors at each of Hinkley Point and Sizewell.

Q83 Geraldine Smith: Are those plans at the moment without any public subsidy?

Mr Higson: Our policy remains that there is no public subsidy for nuclear power stations. EDF are proceeding on the basis that that is our policy.

Q84 Geraldine Smith: What if EDF said, "It does not really make financial sense to us any more"? What would be the position then, because obviously the government needs those nuclear new builds?

Ms Wallace: There are two things to say about that. First of all, EDF have very well known views on what they need to go forward and they do not include public subsidy. They want us to take lots of the actions that we are taking to facilitate nuclear and to remove barriers. They are not asking for public subsidy. The second answer is the one we have been giving before, which is that our plans cover a range of technology to diversify so that we are not betting the whole farm on any one operator or any one technology.

Q85 Geraldine Smith: Are you fairly confident you will get the new nuclear power stations?

Ms Wallace: We have done everything we can to get them. We have a very well developed plan which we think makes sense. I cannot say that unquestionably this will deliver new nuclear, but we think it should and we are looking at all the things that anyone is suggesting we should look at. We are not looking at public subsidy.

Q86 Geraldine Smith: Is there any new information that is coming to light on any potential problems or delays?

Ms Wallace: No, not that I can think of.

Q87 Geraldine Smith: When would you anticipate seeing the first power station up and running?

Ms Wallace: We should be seeing people starting to make applications in the next year.

Mr Higson: EDF's plans are for the first station to become operational at the very end of 2017.

Q88 Geraldine Smith: When would the last of the four be?

Mr Higson: That is a commercial matter for them. I think that will depend on how well they get on with the first station but potentially they could be rolling out power stations at 18 month intervals.

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Q89 Geraldine Smith: There is still quite a bit of uncertainty over the timescales for meeting the energy gap and for having this new supply in place.

Mr Higson: I think that is the nature of the market. We have published a timetable of the things the government need to do in order to meet the requirements of an operator to build a station ready for about that timetable. You can see where the progress has been made along that timescale.

Q90 Geraldine Smith: There are also still questions hanging over the lifetime of certain nuclear power stations and Heysham, whether it is 2014 or whether it is going to be later. Could you perhaps send me a note about Heysham, about 2014 and the extension of the life of that power station?

Ms Wallace: It is always open to operators to apply for an extension and, to the extent they do, that helps the graph.

Q91 Geraldine Smith: They have not as yet done that, have they?

Ms Wallace: We believe they are likely to or have but we will send you a note on it.⁶

Q92 Chairman: Just for the sake of completeness, in paragraph seven it states: “EDF’s purchase of British Energy will not necessarily lead to new nuclear power stations being built in the UK with no public subsidy. This will depend on a number of factors, many outside EDF’s control, including: wider economic and market considerations such as the price of carbon; the achievement of all necessary consents, including the design of new power stations; and EDF’s overall strategic priorities and financial position.” It means everything or nothing, does it not?

Ms Wallace: There is no guarantee. We are not saying there is a guarantee. If the question is: has security of supply been advanced and indeed has the taxpayers’ interest been advanced by the sale of British Energy, yes, it certainly has. We are now in a position where not just EDF but also two others are looking to build new nuclear here. That does not mean we can guarantee they will do it. No one is going to sign up to do that given the uncertainties, but they are very interested. They are spending a lot of money planning it. All the signs are they want to do it.

Q93 Mr Mitchell: Apparently there was no assessment of risk to the taxpayer if there was an earlier need to decommission. You relied on an undertaking. The Shareholder Executive believed a risk assessment was unnecessary because of a legal undertaking British Energy had made to be reasonable and prudent, scout’s honour. Imagine under private ownership reasonable and prudent became hell for leather because of the cross over point in 2016 illustrated on figure two between total generation capacity and demand and demand shoots ahead in 2016. Suppose at that point the

private owner changes reasonable and prudent to hell for leather and we need decommissioning. Why was that not taken into account in the sale?

Mr Lovegrove: There clearly was a risk register. The point that the NAO has picked up was that we did not perform a formal risk assessment of the change which was brought about by the change in ownership.

Q94 Mr Mitchell: But with a shift from public to private, public is more easily controllable than private, is it not? It is nine months after the sale and the NAO gets you to do this assessment.

Mr Lovegrove: The point that you make about reasonable and prudent is not a subjective test. That is a test which is applied by the Nuclear Installations Inspectorate (NII).⁷ It is not a question I think of scout’s honour or them deciding that reasonable and prudent can be substituted with hell for leather. There is a regulatory system which will make sure that reasonable and prudent behaviour is undertaken by the owner of BE.

Ms Wallace: If they did not observe that—by the way that is not happening—there is a whole range of sanctions right down to closing the things if the regulators were not happy with the way they were being run.

Q95 Mr Mitchell: You were satisfied before the sale that you could monitor the activities effectively without a tighter risk assessment?

Ms Wallace: Yes. What I would like to say about the risk assessment is: I think it is a fair point that there should have been a formal risk assessment and it should have been put that way, but actually the whole policy was about risk reduction. By having this policy and by selling British Energy for a good price, we made substantial inroads into two enormous risks, the first being that the NLF depended on British Energy’s success for costs that would fall due if British Energy went under because obviously it would be an extremely unsatisfactory position to be in. At the top of the market we got a very good price. That money went into the NLF and means the NLF is looking an awful lot more healthy than it was. That is the first risk that was reduced and the second risk that was reduced was the security of supply one that we have been discussing. We opened up site access and—

Q96 Mr Mitchell: I will stop you there. You say the NAO’s insistence was not really necessary. That tells us something. Let us move on again with the Shareholder Executive because you were happy with a lower price for the shares than the private shareholders in British Energy. Were they smarter than you or were they greedier?

Mr Lovegrove: We were obviously happy with the maximum amount of money that we could get.

⁷ *Note by witness:* In addition, under the Restructuring Agreements, there is a contractual obligation on EDF to run BE’s nuclear power stations in a reasonable and prudent manner.

Q97 Mr Mitchell: That was not the maximum amount of money. They got a bigger maximum.

Mr Lovegrove: If you look at the two key, private shareholders who held out for a much higher price, they were not at all happy even at £7.74.

Q98 Mr Mitchell: Why were they unhappy? You representing the taxpayer were happy.

Mr Lovegrove: The reason that they were unhappy was because they had a very, very bullish view of future energy prices.

Q99 Mr Mitchell: And you did not?

Mr Lovegrove: We did not. It has to be said we have been proved to be more accurate in that than they have. They took seven pounds of cash and the nuclear power note and we took £7.74 in cash. The nuclear power note is now trading at 35p, so if they tried to sell what they have at the moment as a result of the sale they would be getting £7.35, whereas we banked £7.74. That is the reason why they—

Q100 Mr Mitchell: I will stop you there again. You are saying you were better at anticipating than they were. Is it not true still basically that EDF got a real bargain? They got the best sites for development. Therefore they are in a better position than competitors to develop. They had an inside track with government and they knew in the end if there were problems the government would always fork out. You were really selling them a bargain, were you not?

Mr Lovegrove: I will just talk about the sale. I do not think we did sell them a bargain. I think we sold British Energy at an absolute peak in energy prices. Since the time when we sold British Energy, the closest comparator to the company, another merchant generator, has come off in share price terms by 47%. Oil prices have come off by 55%. By the time that we sold it to EDF, there was absolutely no other competitor in the auction at all.

Q101 Mr Mitchell: You were better with energy prices but at the same time as that was one factor construction costs were going up. If it does not pay them to construct, they can walk away.

Mr Lovegrove: I will pass that question to my colleague on my right.

Ms Wallace: There was no prospect of British Energy building us new nuclear power stations. The prospect of—

Q102 Mr Mitchell: Can I just stop you there? I am the geriatric on this Committee. I was brought up on *The Daily Express* and the great hopes of the 1950s that Britain would lead the world in the construction of nuclear power stations. Now all of a sudden we cannot build them. All that expense has gone to waste and it is the French who have taken over. Why did that happen?

Ms Wallace: I am not sure I can answer for all the years of history that you are asking me to, even though I remember *The Daily Express*. I think we have to operate in the world as it is and the world

as it is, well painted in a series of reports from the NAO and recommendations from this Committee, is that we need to manage the risk, both the risk of British Energy as it was and the risk to security of supply. We took a decision. We set priorities for the sale.

Q103 Mr Mitchell: Could they not walk away if the costs of construction become too high?

Ms Wallace: There is nothing in this sale that requires them to build new nuclear power stations. We are not—

Q104 Mr Mitchell: The costs of construction are escalating. I have a note here about the Finnish one which is causing a lot of controversy. That is going to be operated by a Finnish company, TBO, but it is constructed by Areva, a French company. A French company, EDF, is likely to pass construction work to another French company, possibly Areva. Costs are escalating and the whole thing is in danger because of the escalation in costs. That could happen here, could it not? In that situation EDF has you over a barrel.

Ms Wallace: No, it does not because, as we have already said, one of the objectives of the sale was to avoid depending on one company, one technology, and as a result of developments over the last year, of which selling British Energy was a major part, we now have three different consortia.

Q105 Mr Mitchell: The European Commission had to step in there and put that loan into you. You put fewer constraints on them and the European Commission came in and said they had to sell other sites if they were going to get this bargain.

Ms Wallace: The European Commission did impose further conditions on the basis of competition.

Q106 Mr Mitchell: Which you did not.

Ms Wallace: They imposed some extra conditions and fair enough. So they did, but actually in terms of achieving our objectives for the sale, including opening up to highly competent nuclear operators, we achieved our objectives. We achieved them, as I think Stephen Lovegrove has just pointed out, in a way we probably could not if we were selling it now. We found the right moment to do it so it was a very good deal. I do not know who had who over a barrel here, but this was an extremely good deal from our point of view.

Q107 Mr Mitchell: What if they decide that they will not build without a subsidy? At the kind of escalation of costs we have seen in Finland, they are going to have to have a subsidy. What do you do?

Ms Wallace: I can only repeat that our very clear policy is that we believe these can and should be built without subsidy.

Q108 Mr Mitchell: Your very clear policy is to hand over the money whenever the nuclear interest gets threatened. That is what you always do. If there are costs of disposing of all the stuff, you fork out. If

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the costs overrun, you fork out. This is not a very good habit of mind to face a company which might well face a huge escalation of costs.

Ms Wallace: We have tried to learn the lessons from the past which have been spelt out in the NAO Report about this very subject. The framework for new nuclear is all about calculating the costs of decommissioning and waste up front, requiring people to make safe and secure provision for that, getting independent advice on what that is so that this is not something that is all to be confronted—

Q109 Mr Mitchell: You could have required them to sell more sites if they were going to need a subsidy for building.

Ms Wallace: Well, they are not asking for a subsidy for buildings. I am afraid that is—

Q110 Mr Mitchell: Well, they are not yet, but my condition was a future situation in which they might well be because of the costs of construction.

Ms Wallace: I am afraid that is so hypothetical.

Q111 Mr Mitchell: You could have solved it. You could have put in a requirement that they should sell sites so that you could have more competition.

Ms Wallace: Well, they did have to sell sites and we put in some requirements like that and the Commission added some more.

Mr Higson: We were very mindful of our objective of making sure that the Government was not unduly dependent on one operator and, therefore, as part of our agreement to sell going ahead, we required EDF to sell their land at Wylfa, we required them to sell, subject to conditions, either Heysham or Dungeness, and we also required them to sell, subject to conditions, land at Bradwell. The European Commission did a modest additional tightening by removing the conditionality that we had envisaged being attached to Heysham or Dungeness, and we think that is quite a modest tightening of the package. We think the package that we had agreed was adequate for our objective which was to ensure that a second operator could enter the market. They have done so, which I think demonstrates that we had actually judged that right.

Q112 Chairman: Ms Wallace, I want you to send us a note please, detailing the nuclear power stations that EDF has built without a subsidy.⁸

Ms Wallace: Okay.

Chairman: We will look forward to receiving that.

Q113 Mr Davidson: Like most of my colleagues, I think I have a deepening and wide knowledge of the nuclear industry gained from watching *The Simpsons*, so I want to discuss how you got on with the French Mr Burns! In terms of prices for electricity, have prices in the UK gone up faster than prices in the rest of the EU?

Ms Wallace: I know our prices are, in general, lower. I am not sure I can actually give that comparative information, I am not sure we have it here.

Q114 Mr Davidson: Well, maybe we could just come back to this because this is obviously part of it. What I am interested in really, I think, is whether or not the prices in the UK are high compared to the rest of the EU and whether or not they have risen faster or slower. I think I would also be interested in knowing whether or not EDF's prices in the UK compare well or badly to EDF's prices elsewhere in Europe, just to get an indication of the sort of nature of the people we are dealing with, but you do not have any of that at all?⁹

Ms Wallace: No, I am afraid it does not come up in the Report, so we have not brought that.

Q115 Mr Davidson: Fine, okay. I wonder if I could turn to the Shareholder Executive and come back to this question of valuation because, you see, my understanding from looking at the Report is that you took the view that a valuation of 703p was reasonable at one point, you then anticipated that the company would accept an offer of 765p and then eventually an offer of 774p was got. Now, in these circumstances, when your estimates were that you would have let this company go for 703p, I cannot understand why you gave your bankers a success fee.

Mr Lovegrove: I think the answer to that question is that clearly, to a degree, assessments with these very big and volatile inputs of valuation can change. I think the lesson of this particular transaction was that there were some shareholders who had a view of value which was well over £10 and there were other shareholders who took the view that the shares were only worth about £4. We were not at the one end or the other.

Q116 Mr Davidson: I understand, but the valuation, to some extent, is what the buyer is prepared to pay.

Mr Lovegrove: Indeed.

Q117 Mr Davidson: Your advice was that 703p was a reasonable price and you were then accepting or prepared to accept, not unnaturally, an offer that came in at 765p.

Mr Lovegrove: Yes.

Q118 Mr Davidson: But in fact other people who had a better idea of the nature of the market managed to get it up to 774p, even though they would have wanted more. Now, in all of this, the question of professional advice comes into it. What would the bankers have had to have done not to have got a success fee? Anybody can sell something for threepence, as it were, but it seems to me that, given that they were advising you that 703p was a reasonable price and you actually got 10% more than that, if people get a success fee for that, then that really is money for old rope, is it not?

⁸ Ev 16

⁹ Ev 16

Mr Lovegrove: It would be if you took the view that the only thing that they were doing was providing us with a fairness opinion, which was very, very far from the case. The bankers also advised us throughout the process when there were a number of the biggest European utilities looking at this, which was a very complex matter. They advised us in the way in—

Q119 Mr Davidson: Sorry, how many of the major European utilities bid?

Mr Lovegrove: Well, by the time that the auction was concluded, clearly only EDF was left in the auction.

Q120 Mr Davidson: So it was only for people who did not do anything at the end of the day.

Mr Lovegrove: At the beginning of the process, there were obviously eight or nine, I think. They were instrumental in the construction of this quite complex financial instrument, called the 'nuclear power note', and I think it would have to be said that, without the nuclear power note, no transaction would have occurred at all.

Q121 Mr Davidson: So they were your merchant bankers then that constructed the nuclear power note when in fact that was not actually a part of your submission?

Mr Lovegrove: We did not take the nuclear power note, no.

Q122 Mr Davidson: No, but you put it together. I just want to be clear about that. Given that you were not interested in taking it, you are saying that it was your bankers that did that, as distinct from British Energy's bankers, as distinct from the other shareholders' bankers?

Mr Lovegrove: All of the bankers worked together, but I can say that our bankers, UBS, were absolutely instrumental in bringing about the successful design of that instrument, without which there would have been no transaction.

Q123 Mr Davidson: But would the other bankers say that they were also instrumental in bringing that about? It is a question of who gets the success fee for this. You see, it is a question of success having lots of fathers, et cetera, et cetera, so that you will give me my success fee. I just do not understand how people manage to underquote by 10% and still rake in a huge success fee. As I say, it sounds like money for old rope and that essentially you were just a soft touch.

Mr Lovegrove: I think we are very far from a soft touch. When we went through the procurement process to be able to get our bankers in, I believe and still believe that in this very complex situation governed by the Takeover Code we needed professional banking advice. When we then went through that procurement process, we ended up with a fee of ultimately around £4 million. The fee scale that is normally quoted in these kinds of situations by investment banks, and I am conscious that people may not like this, for a transaction of this scale was around £12 million, and indeed one of the banks that we spoke to at that time did put £12 million on the table. UBS started off at £6 million and we ended up

at £4 million ultimately, so I would certainly not agree that we are a soft touch when we are hiring professional advisers like this.

Q124 Mr Davidson: So, if you had not been there, are you saying then that British Energy's bankers would not have been able to put this together because they were not bright enough and it was only your bankers who could?

Mr Lovegrove: No, I am not saying that.

Q125 Mr Davidson: I see that British Energy's bankers also got a success fee, did they not?

Mr Lovegrove: They did.

Q126 Mr Davidson: For a scheme that you put together.

Mr Lovegrove: Which we were instrumental in. Nobody is claiming sole responsibility for all of these things.

Q127 Mr Davidson: Not when there are bonuses going, yes, I can understand that.

Mr Lovegrove: The Government's objectives in this sale were much, much more complicated and much, much more subtle than those of the board of British Energy. We not only wanted to get maximum value, but there was a secondary objective for us—

Q128 Mr Davidson: But you did not get that.

Mr Lovegrove: We wanted to maximise value, which we did, but another secondary objective was that we wanted to avoid undue dependence on one supplier, but the two primary objectives were that we wanted to bring forward new nuclear at no subsidy to the taxpayer and we wanted to ensure the viability and safety of the British Energy fleet. Now, that put us into a position where our, as I say, hierarchy of objectives was much, much more complicated than the simple objectives.

Q129 Mr Davidson: But am I not right in thinking that in fact you have not got new nuclear capacity brought forward and you have not got a guarantee of no subsidy, so in fact you have almost managed to scoop the pool by managing to achieve none of your objectives.

Mr Lovegrove: I would not agree with that.

Q130 Mr Davidson: Let me just go back then again. You have got a clear guarantee about no subsidy then, have you?

Mr Lovegrove: No.

Ms Wallace: No, we have not got a clear guarantee about subsidy—

Q131 Mr Davidson: Sorry, let me just be clear. That was one of your objectives, was it not, but you did not get that though?

Ms Wallace: Our top objective was to ensure that nuclear operators were able to build and operate new nuclear power stations from the earliest possible date, and they could not do that with British Energy, as it

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was, and what we needed to do was open up the sites and get a new operator in. Of course, we want to do it without subsidy; that is our policy.

Q132 Mr Davidson: Are you not now getting these sites developed with a minimum delay?

Ms Wallace: We believe so, yes.

Q133 Mr Davidson: So we can expect to see them coming forward to what timetable?

Ms Wallace: Well, we have already touched on this.

Mr Higson: The first electricity from the first station under EDF's plans is at the end of 2017.

Mr Davidson: So, if that does not happen and there is a failure of that objective, do we get any of the bankers' bonus back?

Chairman: They will be in Bermuda by then!

Q134 Mr Davidson: That was an objective. If it is not achieved, do you get any of it back or do they keep it?

Mr Lovegrove: They will certainly be keeping it, but the objective was not for new nuclear to be built, the objective was to remove the obstacles and ease the path of new nuclear being built, and on that basis I think that objective has been achieved.

Mr Higson: There has been good progress.

Q135 Keith Hill: So EDF hopes to have the first nuclear power plant operational by the end of 2017, and could I just ask what our general experience is of the length of time it takes from start to finish to get a nuclear power plant up and running?

Mr Higson: Experience around the world is obviously very mixed. We would expect and hope that nuclear power stations in the UK could be constructed within five years, but that is very much a matter for the operator, their skill at contract management and the way they go about the job; it is a commercial matter for them.

Q136 Keith Hill: So the key variable is the skill of contract management. What are the other variables in the situation?

Mr Higson: There are a whole host of things that need to be done, for example, the reactor design needs to be approved by regulators, so there is a process going on at the moment of generic design assessment, the site will need planning approval, so that will need to go through the planning system, and the site itself will need to be licensed by the Nuclear Installations Inspectorate.

Q137 Keith Hill: Are there any planning applications in yet?

Mr Higson: No planning applications have been made so far, no.

Q138 Keith Hill: When do we anticipate that the planning applications will be made?

Mr Higson: Again, this is a commercial matter for EDF, but I would personally be disappointed if they did not submit a planning application during the current calendar year.

Q139 Keith Hill: During the current calendar year? Just remind us about the current planning framework for the development of these plants.

Mr Higson: The planning framework has been reformed and the Infrastructure Planning Commission will now deal with major infrastructure projects, of which a new nuclear power station would be one. They are guided by a national policy statement, and we have issued a national policy statement for nuclear in draft and it is currently out for public consultation. It would then need to be formally designated before it became operational to the Infrastructure Planning Commission.

Q140 Keith Hill: The NPS, the national policy statement, is out for consultation right now. When is that process of consultation anticipated to conclude?

Mr Higson: On 22 February.

Q141 Keith Hill: And that forms really the guidance framework for the way in which the Infrastructure Planning Commission handles the planning application?

Mr Higson: That is correct. It sets out guidance for the Infrastructure Planning Commission and will include a list of sites which, at the strategic level, are deemed to be suitable for new nuclear.

Q142 Keith Hill: Has the IPC started work yet?

Mr Higson: The IPC has been created, but it has not started work on assessing any nuclear applications because as at this stage none has yet been made.

Q143 Keith Hill: How long is it anticipated that the IPC will take to assess a planning application?

Mr Higson: There is a defined timetable which should lead to a decision being taken within one year.

Q144 Keith Hill: Within one year, so that would potentially take us, if an application went in before the end of this calendar year, to the end of 2011?

Mr Higson: 2011.

Q145 Keith Hill: You are aware of course that it is official Conservative policy to scrap the IPC and, in the event, Heaven forfend of course, of a Conservative electoral victory, what is going to happen to these nuclear power plant planning applications without an IPC to look after them?

Ms Wallace: I do not think you would really expect us to speculate on that.

Q146 Keith Hill: You do not answer hypothetical questions?

Ms Wallace: I think not.

Keith Hill: So will you confirm then that it is actually official Conservative policy to scrap the IPC?

Q147 Chairman: You know that because you are having discussions with them.

Ms Wallace: I am Accounting Officer for many things, but one of the things I am not Accounting Officer for is that, so there are plenty of people you could ask about that.

Q148 Keith Hill: Since it is rather salient to your energy plans, the role of the IPC, surely at least you must be aware of Conservative policy on the IPC?

Ms Wallace: Yes, we are preparing, as you would expect, for a General Election, but I am really not going to be asked to confirm Conservative official policy. As you know, that is not my job.

Q149 Keith Hill: But this Committee is at least at liberty to suppose that, in the event of the scrapping of the IPC, there would be something of an impediment to the immediate progress at least of the nuclear power plant process.

Ms Wallace: I think, Mr Hill, you are doing quite enough supposing for both of us!

Keith Hill: Okay, I will leave it at that!

Q150 Mr Williams: I was not going to ask you a question, but, in view of the mischief of my colleague, it is perfectly in order to ask you a simple question. If the IPC were to be scrapped, what would be the practical results of it?

Ms Wallace: I really am not in a position to comment on what other arrangements would be made. What I will say is that this—

Q151 Mr Williams: But what would be the consequences of its not being there?

Ms Wallace: Well, can I answer it in my own way and then, if you find that unsatisfactory, no doubt you will come back. The Government's policy is to bring in the IPC in order to simplify and shorten the planning process on the grounds that that will help deal with the challenges to security of supply, so the Government is doing that because it will make things better. If another policy is the policy of the Government, then we will implement that and we will risk-assess it at the time.

Q152 Mr Williams: So you would have lost the process which would have shortened the procedure?

Ms Wallace: That is the purpose of the policy.

Q153 Mr Williams: And you do not have any evaluation of the options that would be available to you, if that happened, to minimise the impact, or what sort of impact would you expect it to have on the programme?

Ms Wallace: I have already commented on the intention of the policy and I really do not think there is anything more I can say about this. The Government that we work for has not asked us to evaluate the alternatives at this point because it has a policy that it is pursuing.

Q154 Mr Williams: But it is not an unrealistic question to ask. If it were taken away tomorrow by this Government, what would be the effect, and I mean by this Government, I am not asking you about the next Government?

Ms Wallace: Well, in fact we would be extremely surprised, given that we have been operating on the assumption that this Government is going to bring it in, so all our plans are built around the assumption that it comes in and that it has the effect described.

Q155 Mr Williams: So you are saying it would make no difference?

Ms Wallace: No, I am not saying that.

Q156 Mr Williams: I thought you were saying it would make no difference.

Ms Wallace: Well, obviously, if we have a change of policy, it will make a difference, and the Government's purpose in introducing this is to shorten the planning process.

Q157 Chairman: Poor Ms Wallace! I feel a bit sorry for you!

Ms Wallace: Thank you, how kind! You are all heart; you are famous for it!

Q158 Mr Mitchell: Just a quickie: the French need much less by way of planning permission than we have. If you want to establish a nuclear power station, well, make your objections to the CRS and they will move in and satisfy your discontent, whereas we have very tortuous planning procedures here. Was there any part of the deal which said, "We'll see you right on planning"?

Ms Wallace: Sorry?

Q159 Mr Mitchell: Was there any part of the deal with EDF to take over that they would be given an easier road on planning permission? That is one of a number of obstacles on pages 16 and 17 which face the commissioning of any new nuclear power stations.

Ms Wallace: There were no secret deals. That would be quite inappropriate.

Q160 Mr Mitchell: No, so the publication of the White Paper concurrent to these negotiations was just an accident or coincidence?

Ms Wallace: I have no idea. There are no secret deals.

Mr Higson: By "the publication of the White Paper", you mean the January 2008 Nuclear White Paper? I do not think it was a coincidence in the sense that the board of BE wanted to be sure what government policy was before they determined it was right to launch the process, so they were waiting to see what the Government produced by way of its White Paper in January 2008.

Q161 Mr Mitchell: Well, in December 2007, they had high-level discussions with British Energy with parties who were interested in acquiring the company. They must have found out then that the problems to acquiring the company would have been to do with planning permission.

Mr Higson: Well, they would have known at that stage that the Government had issued a consultation paper in May of 2007 which set out the proposed policy by Government on nuclear, so it would have been reasonable for them to start some discussions with a view to waiting to see what the Government's final decision was in January before launching the formal process, and I am not surprised that the discussions took place before the formal publication of the White Paper.

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Q162 Mr Bacon: Ms Wallace, can you just tell me what investment approach has the Government proposed for decommissioning funds for new nuclear build?

Ms Wallace: I think I am going to hand this one to you, Mr Lovegrove.

Mr Lovegrove: This is one of those moments where, I suspect, it would be best if I offered to write a note on this, but I believe that the new nuclear builders are responsible for decommissioning the nuclear power plants.

Ms Wallace: I am sorry, I handed it in the wrong direction. I do apologise for that.

Q163 Mr Bacon: Just keep tossing the ball around and it will land somewhere eventually!

Ms Wallace: Well, this is probably a matter for the Nuclear Liabilities Financing Advisory Board (NLFAB), is it not?

Mr Higson: It will be a requirement, before proceeding with new nuclear power, that new operators have a funded decommissioning plan which sets out how they propose to decommission the power station and how they are going to fund the cost of decommissioning, and that plan needs to be approved by the Secretary of State. Now, this is enshrined in legislation, a fund is built up and there are legislative provisions in place to ensure that, were the company to fail, the funds built up are beyond the reach of any administrator.

Q164 Mr Bacon: When you say “a fund is built up”, going back to my question, what is the investment approach? Is that laid down?

Mr Higson: The investment approach is not laid down. It will need to be prudent and the investment approach will need to be approved by the Secretary of State and the Secretary of State will have advice from a specially constituted board, called the NLFAB, the Nuclear Liabilities Financing Advisory Board, who

will advise the Secretary of State on whether the appraised investment principles for the fund are suitably prudent or not.

Q165 Mr Bacon: It is correct though that the approach would be different from that for the existing decommissioning funds for nuclear liabilities?

Mr Higson: That is correct.

Q166 Mr Bacon: Perhaps you can send us a detailed a note on that.¹⁰ I was interested in this question of how it is priced at the beginning, that for existing nuclear decommissioning the money is going to get put into gilts, which I do not think is going to be adequate for the period involved, and that for new nuclear build there is going to be a different investment approach, and I am interested in that difference, so if you could send us a detailed note about the approach for new nuclear build, that would be very helpful.

Q167 Mr Davidson: As to the point I raised about energy prices and comparisons, just to confirm you are going to give us a note about that?

Ms Wallace: Yes.

Chairman: Lady and gentlemen, thank you very much. That concludes our hearing. Clearly, the Government got a good price, but it got a good price because energy prices have fallen because of the recession and it is not quite clear to me what would happen if energy prices start going up. I am also worried about the success fee which Mr Davidson was asking you about and whether UBS may have set an easy goal in order to get the fee, and I am also worried, as we all are, about the degree of pressure there is on EDF to actually build these nuclear power stations without any public subsidy, but all these matters we can refer to in our Report, and we are very grateful for your attendance. Thank you very much.

¹⁰ Ev 16

Supplementary memorandum from the Department for Energy and Climate Change

Questions 32–35 (Mr Bacon): *Investments of the Nuclear Liabilities Fund*

The Nuclear Liabilities Fund (NLF) is classified to the public sector. The government stands behind it in that it would make good its liabilities were its assets to prove insufficient.

In principle the assets of the NLF are among the many government holdings which are aggregated in the Exchequer overnight each day to minimise the need for government borrowing. The C&AG's report¹ of October 2009 advocated this approach as the most efficient way for the government to manage its daily cashflow requirements.

In practice a small proportion of the NLF's assets cannot be consolidated into the Exchequer because they are held in private sector form, as set out below.

NLF investments, £m, 31 March 2009

National Loans Fund	7,397	
index linked gilts	62	
cash	441	
	<i>public sector subtotal</i>	7,900
equities	347	

¹ *Government Cash Management*, 16 October 2009

property		39	
	<i>private sector subtotal</i>		386
accruals		3	
	total		8,289

In line with the C&AG's recommendation, the government's investment policy for the NLF is to maximise its holdings in public sector accounts. It has not been possible for the NLF to achieve this because conditions for selling the other holdings have been unfavourable. Disposal, as market conditions allow, is now planned.

As to scoring, all the NLF assets held in public sector form reduce public sector net debt (PSND). So would any other liquid assets, such as cash held in private sector bank accounts. NLF assets held in other private sector forms would raise PSND.

Questions 90–91 (Geraldine Smith): *Status of EDF Application for Life Extension to Heysham 1 Nuclear Power Station*

Heysham 1 nuclear power station was commissioned in 1984 and Heysham 2 nuclear power station was commissioned in 1988. The plants have a planned lifetime until 2014 and 2023 respectively.

EDF Energy have advised that they will continue to pursue life extension of existing nuclear plants where it is technically and financially viable to do so. Decisions on life extension are taken no later than three years before the end of the current planned life for accounting purposes.

As the decisions on life extension for both Heysham 1 and Hartlepool have to be made by 2011, the company has begun to investigate the financial and technical viability of pursuing a life extension for both of these stations which are of similar design, and will make a proposal to the company's Board in due course.

In autumn 2009, the nuclear regulator—the Nuclear Installations Inspectorate (NII)—approved the periodic safety review (PSR), for Heysham 1. This decision means that the NII are satisfied the PSR is adequate to justify continued operation of the station for up to 10 years—subject to continued satisfactory performance monitored through the station's regular test and inspection programmes. This is a pre-requisite before life extension—which is a commercial decision for the company—can be made.

Question 112 (Chairman): *Nuclear Power Stations which EDF has built without a subsidy*

We do not have information about the funding arrangements that EdF have used in the construction of nuclear power stations in the past. All the nuclear power stations that EDF has built (ie completed) are in France.

The White Paper on Nuclear Power (2008) states that “it will be for energy companies to fund, develop and build new nuclear power stations in the UK, including meeting the full costs of decommissioning and their full share of waste management costs”. Section 2 of the White Paper includes more detail on the Government's assessment of the economics of nuclear power. As announced in the 2009 Pre-Budget Report, the Department of Energy and Climate Change and HM Treasury are taking forward work to ensure the electricity market framework can most effectively deliver a fair deal for the consumer and the low-carbon investment needed in the long term. This work will report back with initial findings at Budget 2010.

Question 114 (Mr Davidson): *UK Electricity Price Levels and Increases compared to Europe*

In the first half of 2009, UK domestic electricity prices for medium consumers were the fourth lowest in the EU15, 22% below the EU15 median. UK prices between the first half of 2008 and the first half of 2009 increased more slowly than prices in the EU.

In the first half of 2009, UK prices for industrial electricity consumers were generally above the EU15 median. UK prices between the first half of 2008 and the first half of 2009 increased more quickly than prices in the EU.

Question 114 (Mr Davidson): *Whether or not EDF's Prices in the UK compare well or badly to EDF's Prices elsewhere in Europe*

We have no data on prices charged by individual companies in other EU countries.

Questions 162–166 (Mr Bacon): *Funding and Investment arrangements for Decommissioning British Energy's existing Nuclear Plant and for New Nuclear Power Stations*

British Energy's existing nuclear plant

The Nuclear Liabilities Fund (NLF) provides a segregated fund with a pool of assets to meet certain decommissioning costs and uncontracted liabilities at the British Energy (BE) sites. Following the restructuring of BE in 2005, the NLF is explicitly underwritten by the Government to the extent that its assets do not cover British Energy's liabilities. This is not the case for new nuclear power stations.

Based on BE's current estimates for the costs of meeting their decommissioning and uncontracted liabilities, the estimated value of the NLF's assets is significantly greater than the current estimated costs of discharging its obligations. Since the liabilities extend over a very long period (ie into the next century), there are inevitable uncertainties in quantifying them.

Government policy is for the NLF to be invested in public sector assets (ie gilts and deposits with the National Loans Fund).

New nuclear power stations

Through the Energy Act 2008 (the "Act") the Government seeks to ensure that the operator meets the full costs of decommissioning and full share of the waste management and disposal costs.

The Act requires the operator of a new nuclear power station to submit to the Secretary of State for approval a Funded Decommissioning Programme (FDP) before construction of the new nuclear power station begins.

The Act also creates a monitoring and review framework and provides the Secretary of State with a range of powers to ensure the FDP is complied with.

The FDP must contain:

- a Decommissioning and Waste Management Plan (DWMP) which must contain the estimated costs of the steps the operator will take to treat, store, manage and dispose of any hazardous material during the operation of the station and the steps to decommission the installation, clean up the site and manage and dispose of the waste (including spent fuel);
- a Funding Arrangement Plan (FAP) which must set out how the operator intends to meet those costs and the details of the financial security to be put in place to meet the costs identified.

In developing a FAP the Government will expect the following principles to be met:

- Independence of Fund: The arrangements relating to the accumulation, management and disbursement of moneys are to be independent of the operator and of the Government.
- Sufficiency of Fund: The Fund is to be structured, governed and operated so that it delivers sufficient moneys to discharge in full the operator's liabilities as and when they fall due.
- Restrictions on use of Fund assets: The structure and governance of the Fund must be such that moneys in the Fund can only be used for decommissioning, waste management and waste disposal.
- Insolvency remoteness: The operator must ensure that the Fund is structured to ensure the Fund is insolvency remote.
- Preventing recourse to public funds: The operator must ensure that the prospect of the operator's liabilities having to be met in whole or in part from public funds is remote at all times.
- Transparency: The process of accumulating, maintaining and managing funds sufficient to discharge the operator's liabilities is to be transparent and visible to the Secretary of State, stakeholders and the wider public.

8 March 2010