

COMPLAINT¹
TO THE COMMISSION OF THE EUROPEAN COMMUNITIES
CONCERNING FAILURE TO COMPLY WITH COMMUNITY LAW

1. Surname and forename of complainant: Woods, John

2. Where appropriate, represented by:

3. Nationality: British and Irish

4. Address or Registered Office²:
John Woods
Director (Northern Ireland)
Friends of the Earth
7 Donegall Street Place
Belfast BT1 2FN
United Kingdom

5. Telephone/fax/e-mail address:
Tel : 00 44 28 9023 3488
Fax : 00 44 28 9024 7556
Email : johnw@foe.co.uk

6. Field and place(s) of activity: Northern Ireland

7. Member State or public body alleged by the complainant not to have complied with Community law: Department of Enterprise, Trade and Investment (Northern Ireland), a United Kingdom Government Department.

¹ You are not obliged to use this form. You may also submit a complaint by ordinary letter, but it is in your interest to include as much relevant information as possible. You can send this form by ordinary mail to the following address:
Commission of the European Communities
(Attn: Secretary-General)
Rue de la Loi 200,
B-1049 Brussels
BELGIUM

You may also hand in the form at any of the Commission's representative offices in the Member States. The form is accessible on the European Union's Internet server (<http://europa.eu.int/comm/sg/lexcomm>).

² To be admissible, your complaint has to relate to an infringement of Community law by a Member State. You should inform the Commission of any change of address and of any event likely to affect the handling of your complaint.

8. Fullest possible account of facts giving rise to complaint

Introduction

- a. The electricity market in Northern Ireland is dominated by vesting contracts put in place when the industry was privatised in 1992. The market has three features that lead to breaches of European law. First, customers are obliged to pay for the availability of electricity whether or not they choose to purchase it. Secondly, the contracts enable the cost of compliance with changes in law (which primarily means environmental legislation) to be passed directly to customers. Thirdly, the entire Northern Ireland market is tied to these contracts (the formal counter party is Northern Ireland Electricity – NIE – which is entitled to recover any shortfall between the cost of the contracts and the market value of the electricity produced under the contract through a Public Service Obligation levy). This complaint describes how possession of the contracts causes the environmental objectives of the EU Emissions Trading Directive to be frustrated and favours certain undertakings by subsidising the cost of compliance with environmental legislation, constituting a form of State aid and breaching Article 87 of the Treaty of Rome.

The EU Emissions Trading Scheme

- b. The EU Emissions Trading Scheme (EUETS) established by Directive 2003/87/EC is designed to reduce greenhouse gas emissions across Europe. It sets caps on emissions that are less than current emissions in order to create the scarcity necessary for a market in allowances to develop. Companies are given a free allocation of allowances. “Those facing difficulty in remaining within their emissions limit have a choice between taking measures to reduce their emissions, such as investing in more efficient technology or using a less carbon-intensive energy source, buying the extra allowances they need at the market rate, or a combination of the two, whichever is cheapest. This ensures that emissions are reduced in the most cost-effective way.” (European Commission. Emissions Trading: An open scheme promoting global innovation to combat climate change. 2005)

The Northern Ireland Electricity Market

- c. The electricity market in Northern Ireland differs from other electricity markets but in particular from the Great Britain (England, Wales and Scotland) market in that it is dominated by vesting contracts put in place at privatisation in 1992. In Great Britain the EU Emissions Trading Scheme (EUETS) causes the cost of carbon to be fed into the price of electricity but customers do have the option of buying from other power stations and over time the expectation is that generators will be compelled by market pressure to move from more polluting to less polluting forms of generation. Electricity generators in Northern Ireland who were contracted to Northern Ireland Electricity (NIE) at privatisation and who remain so contracted are protected from this market pressure, thus nullifying the EUETS. Two elements of the contracts are responsible for this.

Availability payments

- d. First, the contracts which the generators hold oblige customers to pay them for being available irrespective of whether or not they sell any electricity. The 'availability payment' under the contract is therefore a sunk cost as far as customers are concerned. This has two consequences. The first is that customers have little choice but to buy electricity from the contracted plant since they have already had to pay for its capacity. The second is that because the contracted plant is there and has customers who are in effect captive, there is a barrier to another generator entering the market. A new (and presumably cleaner) generator would not enter the market because to compete successfully his total costs would have to be below the marginal costs of the contracted generator.

Environmental compliance costs

- e. Secondly, the privatisation contract allows the cost of compliance with post privatisation environmental legislation to be passed directly to the consumer. This includes the cost of purchasing carbon permits under the EU Emissions Trading Scheme. Generators are therefore not faced with the choice which lies at the core of the EUETS as described at (b) above.
- f. Furthermore, it appears that the nature of the contract means that penalties associated with infringements of the EUETS cannot be applied to a contracted generator.

Effect of market structure on EUETS

- g. This market structure clearly nullifies the EUETS mechanism and frustrates the environmental objectives of the Directive because it blocks the orderly evolution to cleaner generation which EUETS was intended to promote. Consumers are not in a position to change to a cleaner generator except at significant extra cost; cleaner competitors are prevented from entering the market; and generators are not incentivised to take measures to reduce their emissions.

Article 87 issues

- h. The availability payment element of the contracts represents a breach of Article 87 (State aid) of the Treaty of Rome. As described above the sunk cost of an availability payment prevents other generators from entering the market unless they can offer prices that are less than the marginal cost to consumers of purchasing electricity from an existing generator to whom an availability payment has already been made. This is clearly a barrier to competition.
- i. The provision of the contract that allows the cost of compliance with environmental legislation to be passed directly to customers also leads to breaches of Articles 87. The Large Combustion Plant Directive obliges generators to install pollution abatement technology by specific dates or wind down their operations. In a normal electricity market, the cost of compliance with the environmental objectives of the Directive is born by the generator and may or may not be reflected in the price charged for electricity. In the Northern Ireland market the full cost of compliance is born by the customer and this places generators not in possession of such contracts at a distinct disadvantage. There is no restriction on selling electricity from contracted plants into the rest of the UK market, the Republic of Ireland market or further afield. They will be doing so not having had to bear the costs of installing Flue Gas Desulphurisation equipment, for example, unlike their competitors. From 2007 a single electricity market (SEM) for the island of Ireland will be established and contracted Northern Ireland generators will enjoy this advantage over their competitors across the island.

- j. The contracts in question were drawn up under the Electricity (NI) Order 1992. The power stations were sold by the State under contracts which have proved to be inviolable. The State, therefore, has been and remains fully complicit in ensuring that generators are fully protected from the consequences of a liberalised generation market. The provision that allows the direct pass through of environmental compliance costs to customers is a form of State aid that gives contracted generators an unfair advantage over competitors both within the UK and between Member States.

- k. This situation described above is particularly serious because much of the contracted generation in Northern Ireland comes from a highly polluting coal fired power station, Kilroot, of below average efficiency.

THE CASE OF AES KILROOT

- l. Annex 1 of Directive 2003/87/EC (the Directive) lists combustion installations with a rated thermal input exceeding 20MW as coming into the scope of the Directive (Article 2(1)) for emissions of carbon dioxide. Such an installation is Kilroot Power Station owned and operated by AES Kilroot Power Ltd, Larne Road, Carrickfergus BT38 7LX.

- m. Kilroot is a coal fired power station that supplies electricity to the Northern Ireland grid under a Power Purchase Agreement (PPA) with Northern Ireland Electricity (NIE), which supply about two thirds of the electricity consumed in Northern Ireland. The Kilroot PPA comprises two main elements: (1) an 'availability payment' that the generator receives for making the 520 MW facility available to NIE; and (2) a payment for the direct cost of fuel necessary to generate the electricity that is actually used. The latter element is variable in that it is directly linked to market prices for coal. Thus AES Kilroot is insulated from the market price of fuel in that costs are passed on to the consumer. Should fuel prices be high, NIE can theoretically choose not to purchase power from Kilroot but given that the availability payment constitutes approximately £60m per annum or in excess of 2 pence per kw/h even when the plant is operating as base load, it is difficult to imagine circumstances where it would make sense to write

off the availability payment and purchase from another generator that does not enjoy such favourable contract terms instead.

- n. The result is that Kilroot operates as a baseload station for the Northern Ireland grid supplying approximately 37% of electricity consumed and producing 2.8mtCO₂ per annum which is approximately 20% of Northern Ireland's CO₂ emissions and is the largest single source of CO₂ emissions in Northern Ireland.
- o. In terms of European law the result is (1) that the EUETS is nullified and the environmental objectives of the Emissions Trading Directive are frustrated by the fact that it is financially prohibitive for customers to change to a cleaner supplier and (2) cleaner generators are prevented from entering the market because to compete successfully their total costs would have to be below the marginal costs of Kilroot, breaching Article 87 of the Treaty.
- p. A key element of the PPA is that it allows additional costs such as the cost of compliance with environmental legislation to be passed to the consumer. This includes the cost of purchasing carbon permits in order to comply with the rules of the EUETS. Thus in the same way that Kilroot is insulated from the price of fuel as a result of the PPA, it is also insulated from the price of carbon.
- q. Kilroot's allocation for Phase I of the ETS is 2.05mtCO₂. The installation's historic annual emissions averaged 2.84mtCO₂ from 1998-2002. Under current UK proposals its allocation for 2008/12 will be much lower but even under Phase 1 in 2005 Kilroot required additional allowances. If NIE asks Kilroot to generate electricity which will take it above its allocation, customers will be required to pay for additional allowances. The overall result will be electricity which is dearer without creating a pathway to cleaner electricity because Northern Ireland consumers have to pay for the station anyway and it is simply not a cost-effective option not to continue to use Kilroot as a baseload station.

Breaches of Emissions Trading Directive

- r. Article 1 of the Emissions Trading Directive states that the purpose of the ETS is "to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner." It has been shown above that not only does the

ETS as it has been applied to Northern Ireland's largest generators fail to reduce emissions in the manner described, but it ensures that any attempts to reduce emissions by not purchasing electricity from Kilroot would be very likely to drive up the cost to the consumer. The environmental objectives of the Directive are therefore undermined.

- s. Article 16(1) of the Directive states that in relation to "penalties applicable to infringements of the national provisions", "the penalties provided for must be effective, proportionate and dissuasive." The terms of AES Kilroot's Power Purchase Agreement mean that no such penalties can be applied to it causing a breach of this article.

Breaches of Article 87 of the Treaty of Rome

- t. The Large Combustion Plant (LCP) Directive required Kilroot either to reduce its SO₂ emissions substantially by 2008 or to wind down its operations. Kilroot chose to 'opt in' to the Directive and install Flue Gas Desulphurisation (FGD) equipment (estimated at circa £40m capital and £5m per annum running costs). But due to the nature of the PPA, these costs are being passed directly to NIE shielding the plant from having to make a normal commercial decision about investing in FGD and giving it an unfair advantage over its competitors both in the UK and the Republic of Ireland, particularly in the context of the Single Electricity Market for Ireland - see (w) below. Kilroot will not have to recover the cost of installing FGD in the market price of electricity whereas Ireland's other coal-fired power stations' owners will have to recover that cost in the market place as will owners of coal-fired power stations in Great Britain who could be in competition with Kilroot.
- u. Kilroot's contract runs from 1992 to 2024 but may be, subject to certain conditions, cancelled in 2010. Even if cancelled in 2010 the full capital cost of the plant including FGD will have been paid by 2010. The LCP Directive also requires the installation of Selective Catalytic Reduction (SCR) equipment for the abatement of NO_x emissions by 2015. It appears that Kilroot will be able to recover the cost of this in the same manner as it is doing with FGD with a similar impact on competitors.

- v. Annex III(5) of the Emissions Trading Directive states “The [national allocation] plan shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities in accordance with the requirements of the treaty, in particular Articles 87 and 88 thereof.” The status of AES Kilroot is such that while the allocations do not discriminate directly in its favour the market structure in which it is located means that the EUETS is neutralised. By having no regard to the different market structure which pertains in NI the UK is discriminating in the way in which it is allocating the UK’s carbon permits.

Future market scenarios

- w. A Single Wholesale Electricity market (SEM) for the island of Ireland is expected to come into existence in 2007. This complaint should be considered in this context. As referred to above, the contract with Kilroot may be cancelled in 2010 or it may continue until 2024. In either case because the full capital costs including the cost of FGD will have been recovered by the owners by that date, Kilroot will remain in a privileged market position since it will have been endowed through the action of the State with FGD without having had to recover that cost in the market place. This is true whether or not the contract is cancelled in 2010 although should it not be cancelled, the position of Kilroot would be even stronger since its fixed operating costs, as well as large profits, would remain guaranteed by customers.

9. As far as possible, specify the provisions of Community law (treaties, regulations, directives, decisions, etc.) which the complainant considers to have been infringed by the Member State concerned:

Directive 2003/87/EC
Article 87 of the Treaty of Rome

10. Where appropriate, mention the involvement of a Community funding scheme (with references if possible) from which the Member State concerned benefits or stands to benefit, in relation to the facts giving rise to the complaint:

Not known

- 11.** Details of any approaches already made to the Commission's services (if possible, attach copies of correspondence):

None

- 12.** Details of any approaches already made to other Community bodies or authorities (e.g. European Parliament Committee on Petitions, European Ombudsman). If possible, give the reference assigned to the complainant's approach by the body concerned:

None

- 13.** Approaches already made to national authorities, whether central, regional or local (if possible, attach copies of correspondence):

- 13.1** Administrative approaches (e.g. complaint to the relevant national administrative authorities, whether central, regional or local, and/or to a national or regional ombudsman):

Submission to DETI Inquiry under Article 39 of Electricity (NI) Order 1992
– attached.

- 13.2** Recourse to national courts or other procedures (e.g. arbitration or conciliation). (State whether there has already been a decision or award and attach a copy if appropriate):

None

- 14.** Specify any documents or evidence which may be submitted in support of the complaint, including the national measures concerned (attach copies):

None. Kilroot's Power Purchase Agreement is not publicly available.

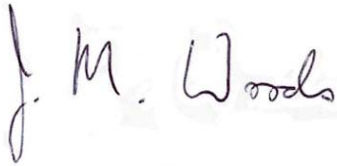
- 15.** Confidentiality (tick one box)³:

- "I authorise the Commission to disclose my identity in its contacts with the authorities of the Member State against which the complaint is made."

³ Please note that the disclosure of your identity by the Commission's services may, in some cases, be indispensable to the handling of the complaint.

- "I request the Commission not to disclose my identity in its contacts with the authorities of the Member State against which the complaint is made."

16. Place, date and signature of complainant/representative:

A handwritten signature in black ink that reads "J. M. Woods". The signature is written in a cursive style with a large initial 'J'.

April 2006

(Explanatory note to appear on back of complaint form)

Each Member State is responsible for the implementation of Community law (adoption of implementing measures before a specified deadline, conformity and correct application) within its own legal system. Under the Treaties, the Commission of the European Communities is responsible for ensuring that Community law is correctly applied. Consequently, where a Member State fails to comply with Community law, the Commission has powers of its own (action for non-compliance) to try to bring the infringement to an end and, if necessary, may refer the case to the Court of Justice of the European Communities. The Commission takes whatever action it deems appropriate in response to either a complaint or indications of infringements which it detects itself.

Non-compliance means failure by a Member State to fulfil its obligations under Community law, whether by action or by omission. The term State is taken to mean the Member State which infringes Community law, irrespective of the authority - central, regional or local - to which the non-compliance is attributable.

Anyone may lodge a complaint with the Commission against a Member State about any measure (law, regulation or administrative action) or practice which they consider incompatible with a provision or a principle of Community law. Complainants do not have to demonstrate a formal interest in bringing proceedings. Neither do they have to prove that they are principally and directly concerned by the infringement complained of. To be admissible, a complaint has to relate to an infringement of Community law by a Member State. It should be borne in mind that the Commission's services may decide whether or not further action should be taken on a complaint in the light of the rules and priorities laid down by the Commission for opening and pursuing infringement procedures.

Anyone who considers a measure (law, regulation or administrative action) or administrative practice to be incompatible with Community law is invited, before or at the same time as lodging a complaint with the Commission, to seek redress from the national administrative or judicial authorities (including the national or regional ombudsman and/or arbitration and conciliation procedures available). The Commission advises the prior use of such national means of redress, whether administrative, judicial or other, before lodging a complaint with the Commission, because of the advantages they may offer for complainants.

By using the means of redress available at national level, complainants should, as a rule, be able to assert their rights more directly and more personally (e.g. a court order to an administrative body, repeal of a national decision and/or damages) than they would following an infringement procedure successfully brought by the Commission which may take some time. Indeed, before referring a case to the Court of Justice, the Commission is obliged to hold a series of contacts with the Member State concerned to try to terminate the infringement.

Furthermore, any finding of an infringement by the Court of Justice has no impact on the rights of the complainant, since it does not serve to resolve individual cases. It merely obliges the Member State to comply with Community law. More specifically, any individual claims for damages would have to be brought by complainants before the national courts.

The following administrative guarantees exist for the benefit of the complainant:

- (a) Once it has been registered with the Commission's Secretariat-General, any complaint found admissible will be assigned an official reference number. An acknowledgment bearing the reference number, which should be quoted in any correspondence, will immediately be sent to the complainant. However, the assignment of an official reference number to a complaint does not necessarily mean that an infringement procedure will be opened against the Member State in question.
- (b) Where the Commission's services make representations to the authorities of the Member State against which the complaint has been made, they will abide by the choice made by the complainant in Section 15 of this form.
- (c) The Commission will endeavour to take a decision on the substance (either to open infringement proceedings or to close the case) within twelve months of registration of the complaint with its Secretariat-General.
- (d) The complainant will be notified in advance by the relevant department if it plans to propose that the Commission close the case. The Commission's services will keep the complainant informed of the course of any infringement procedure.
