



National Accounts Sector Classification of British Energy

1. Summary Conclusions

1.1 This article explains the decision of the National Accounts Classification Committee (NACC) of the Office for National Statistics (ONS) on the National Accounts sector classification of British Energy. From 9 September 2002 British Energy will be reclassified in the public sector as a public non-financial corporation. Previously British Energy was classified in the private sector as a private non-financial corporation.

1.2 The decision is based on a judgement about the degree of control exercised by public sector entities over British Energy's activities. It reflects the powers the Government has acquired, first through a credit facility granted in September 2002 and then following the British Energy restructuring. This judgement acknowledges that, post-restructuring, no one factor constitutes the degree of control necessary for British Energy to be classified to the public sector. Rather, it takes the view that, taken together, a number of factors represent a high degree of public sector control. These include, sometimes in certain circumstances, control over British Energy's:

- (i) payments of a majority of profits to fund decommissioning;
- (ii) important business decisions leading to increases in nuclear liabilities;
- (iii) corporate restructuring and share issuance;
- (iv) borrowing;
- (v) disposal of assets;
- (vi) dividend policy;
- (vii) investment strategy for reserves;
- (viii) financial policy on maintaining reserves;
- (ix) potential role in running power stations following their acquisition by Government.

1.3 This article also announces decisions on related entities and transactions. The newly established Nuclear Liabilities Fund will be classified to the public sector as a central government unit.

1.4 These classifications are consistent with international guidelines on National Accounts. The ONS consulted Eurostat, the statistical office of the European Union, about the classification of the restructured British Energy. Eurostat agrees with ONS's decision.

2. ONS's Role

2.1 The ONS produces the United Kingdom's National Accounts. The National Accounts are an internationally comparable accounting framework that describes the activities in a national economy, including the transactions that take place between sectors of that economy. The United Kingdom National Accounts are compiled on a legal basis following a 1996 regulation from the Council of the European Union.

2.2 In its fiscal policy framework (see HM Treasury's June 1998 *Economic and Fiscal Strategy Report*), the United Kingdom Government uses key statistical indicators for the public sector. The Government chose to base these indicators on the National Accounts. It is therefore necessary to be clear as to what constitutes the public sector. That means defining it in terms of the institutions that belong to it. The ONS decides on the classifications of all entities and transactions for the purposes of producing the National Accounts. These classification decisions follow international standards. It is National Accounts criteria that are the basis of ONS judgements on classifications, although in practice

the judgements may be contrasted with explicit and implicit assumptions of the fiscal policy framework.

2.3 This reclassification will be incorporated into the Public Sector Finances and the National Accounts as soon as practically possible. The effect has not been quantified, but it is not expected to have a significant impact on the Government's fiscal measures.

2.4 Whenever the Government has an active role in the creation or restructuring of an institution, the ONS will review its sector classification due to the importance of the fiscal policy framework. The ONS pays particular attention to entities those that might be thought to be in the public sector. From time to time these classification decisions are reviewed, particularly when circumstances change. The ONS process involves the NACC, a committee of experts in national accounting, to formulate decisions on the classification of entities and transactions. An article about NACC is available on the National Statistics website at www.statistics.gov.uk/psa. The NACC is referred to hereafter in this article as 'the classification committee'.

2.5 On 8 June 2004 ONS received a letter from HM Treasury requesting classification advice on the restructured British Energy.

2.6 In investigating the case, the classification committee looked at a large volume of reference material. This material included the Articles of Association of the British Energy companies and the contractual agreements that the company will enter into. These include the Nuclear Liabilities Funding Agreement, the Historic Liabilities Funding Agreement, the Contribution Agreement, the Option Agreement, and the terms for its new bonds. Information on these agreements is summarised in British Energy's announcement on 1 October 2003 of the formal agreement on the proposed restructuring of the company. This is available from the British Energy website at www.british-energy.com/media/press/index.html. A copy is also available on the ONS website at www.statistics.gov.uk/britishenergy. As the restructuring process is not complete, it is possible that some of the detail may change, so this classification decision is provisional and based on the information supplied at the time the decision was made.

2.7 The British Energy sector classification decision was authorised by the National Statistician, Len Cook, under standard classification committee procedures. The British Energy decision was communicated to HM Treasury on 23 September 2004. Copies of ONS's correspondence with HM Treasury are available on the National Statistics website at www.statistics.gov.uk/britishenergy.

2.8 Where the sector classification for National Accounts purposes differs from Generally Accepted Accounting Practice, this can be a matter of public interest, and some debate. In its report on the classification of Network Rail (House of Commons paper No. 154), the Treasury Committee recommended that where the (National Accounts) statistical and accountancy practice differed "the onus is on the parties concerned to align their different positions and explain the rationale for them to the public".

2.9 In its response (House of Commons paper No. 550), the Government said that it agreed that "where these two processes produce apparently contradictory results as regards sector classification, it is appropriate that the parties concerned should explain to the public the rationale for their views. ... However, once this has been done, and the issues fully explained, it is inappropriate for the Government to attempt to 'align' the different positions."

2.10 In light of this it was necessary to establish the treatment of the restructured British Energy in other accounting systems. The Comptroller & Auditor General, in his capacity as auditor of the Department of Trade and Industry's resource accounts and the Whole of Government Accounts, has concluded, based upon circumstances extant on 21 September 2004 that, post-restructuring, British Energy should be accounted for as a quasi subsidiary of the Department of Trade and Industry. There is thus no apparent difference in the statistical and accounting positions.

2.11 The classification committee also consulted with Eurostat on statistical classification.

3. Classification summary

Entity	Previous classification	Proposed classification
BNFL	Public non-financial corporation	No change
British Energy:		
(a) 1.4.1996 – 14.7.1996	Public non-financial corporation	No change
(b) 15.7.1996 – 8.9.2002	Private non-financial corporation	No change
(c) 9.9.2002 – end of credit facility	Private non-financial corporation	Public non-financial corporation
(d) Post-restructuring	Not applicable	Public non-financial corporation
Nuclear Decommissioning Authority	Not applicable	Central government
Nuclear Generation Decommissioning Fund	Public financial corporation	No change
Nuclear Liabilities Fund	Not applicable	Central government
The Nuclear Trust	Central government	No change

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4. British Energy plc

4.1 Background

4.1.1 British Energy plc is one of the United Kingdom's largest electricity generation companies, with about twenty per cent of the market. It is the only privately owned nuclear power generator in the United Kingdom. It was formed on 1 April 1996 through merger and reorganisation of Nuclear Electric and Scottish Nuclear. Both of these were classified in the National Accounts to the public sector as public non-financial corporations at that time, as was British Energy initially.

4.1.2 On 15 July 1996 the company was privatised by flotation. Thus, with the exception of three special shares and residual shareholdings held by the United Kingdom Government, British Energy was owned by private sector investors after privatisation. It was reclassified in the National Accounts as a private non-financial corporation at this point.

4.1.3 At the time of privatisation British Energy owned and operated six nuclear power stations in England and two in Scotland. All of these power stations have continued to be owned and run by British Energy. Following privatisation, British Energy acquired assets in the USA and Canada, all of which have subsequently been disposed of. In the United Kingdom, British Energy acquired, in 1999, the retail supply business of South Wales Electricity (subsequently sold in 2000) and, in 2000, the Eggborough coal-fired power station. This latter acquisition was made to obtain flexibility and provide some security against any outage at its nuclear stations.

4.1.4 British Energy's principal United Kingdom subsidiaries are British Energy Generation Ltd and British Energy Generation (UK) Ltd. British Energy Generation Ltd owns and operates the six nuclear power stations in England: Dungeness B; Hartlepool; Heysham 1; Heysham 2; Hinkley Point B and Sizewell B. British Energy Generation (UK) Ltd owns and operates the two nuclear power stations in Scotland: Hunterston B and Torness. Other subsidiaries include Eggborough Power Ltd, which owns and operates the coal-fired power station, and British Energy Power and Energy Trading Ltd.

4.1.5 In 2002 British Energy experienced financial difficulties with declining income and approached the United Kingdom Government for assistance. British Energy had suffered from a fall in electricity prices in the market that it operated within and output had also been adversely effected by unplanned outages. The adverse effect of this decreased income was compounded by the fact that nuclear power production incurs unique unavoidable costs: nuclear liabilities are unrelated to output; and the costs of reprocessing, storage and final disposal of spent fuel are unavoidable for fuel that has already been loaded into a reactor.

4.1.6 In addition to the deteriorating income position, the period from September 2002 showed an expected increase in payments; as well as contractual payments being due, significant capital expenditure was required for a North American subsidiary and repayment of a tranche of bonds was due in March 2003. British Energy unsuccessfully sought a bond offering in the summer of 2002.

4.2 Government Credit Facility

4.2.1 On 9 September 2002 the Government offered British Energy a credit facility of £410m against which it could borrow. The facility allowed British Energy to continue trading while it resolved longer-term issues. The facility was intended to be short-term, to be made available while analysis of British Energy's financial position was undertaken, and was initially made available until 27 September 2002. However, on 26 September 2002 it was extended to 29 November 2002, and raised to £650m. The facility was later extended until 9 March 2003, remaining at £650m. A further extension, until 30 September 2004, was obtained on 7 March 2003 but the credit facility was reduced to £200m. A very short-lived extension to the facility, to £275m, was granted in December 2003, although this was never used.

5. The Restructuring Proposals

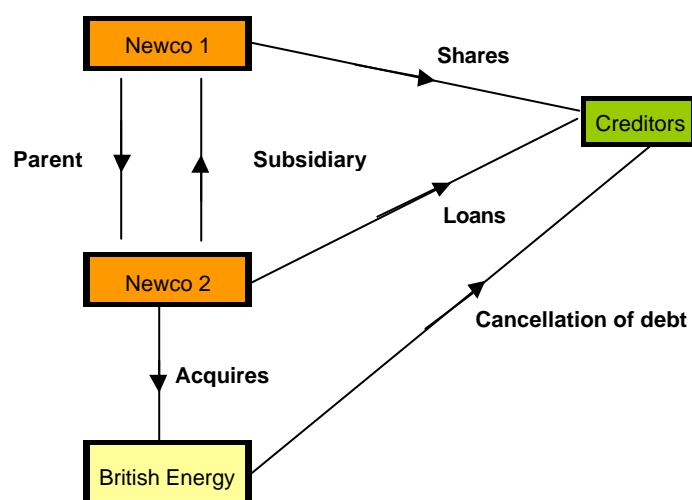
5.1 Agreements with creditors

5.1.1 In November 2002 British Energy announced a planned restructuring, which the Government was willing to support in principle. Together with other proposals to be agreed between British Energy and certain significant financial creditors, the plan was intended to lead to a solvent restructuring of British Energy. On 14 February 2003, the main creditors agreed with British Energy certain conditions and principles by which the rights of the creditors would be restructured. On 7 March 2003, the Government notified the European Commission of the proposed restructuring aid to British Energy. The restructuring deal was then agreed with the Government, the main creditors and the Nuclear Generation Decommissioning Fund on 1 October 2003.

5.1.2 The main creditors agreed to extinguish their existing claims against the British Energy Group in exchange for £275m of new bonds, £150m of special bonds for the Eggborough power station creditors and at least 97.5 per cent of the issued ordinary shares of the restructured group.

5.1.3 Existing shareholders have yet to vote on the restructuring. British Energy will propose a "Members' Scheme". If the shareholders approve it, they will receive the remaining 2.5 per cent of the new company's ordinary shares, as well as warrants to subscribe for a further five per cent of the new company's share capital. This represents a significant dilution of their existing holdings.

5.1.4 If the shareholders approve the Members' Scheme, then British Energy will cancel its existing shares and issue new shares to a new company¹, referred to as Newco 1. Newco 1 will be the parent company of Newco 2. British Energy would then be acquired by, and thus become a wholly owned subsidiary of, Newco 2, in exchange for Newco 2 issuing shares to Newco 1. The claims of the main creditors against British Energy would be discharged in return for shares in Newco 1 and bonds in Newco 2.



5.1.5 If the shareholders do not approve the Members' Scheme, or it does not proceed for other reasons, then shareholders would have to vote on whether to dispose of the assets and liabilities of British Energy or not. If this vote were in favour of disposal, the assets of British Energy would be acquired by Newco 2, in exchange for Newco 2 taking over British Energy's liabilities. The main creditors would again be discharged in return for new shares and bonds. In this scenario, the existing

¹ The company referred to as Newco 1 has now been registered as British Energy Group plc, similarly Newco 2 has been registered as British Energy Holdings plc.

shareholders would not receive any shares and their existing shares would be worthless. They would however still receive the warrants.

5.1.6 If the shareholders do not vote in favour of either of these options, then British Energy has announced its intention to delist the company, which would allow the disposal to proceed without a shareholder approval.

5.1.7 In addition, the proposed restructuring contains certain measures that may fall within the European Commission rules on State Aid. Completion of the restructuring is subject to the United Kingdom Government receiving a satisfactory notification from the Commission. A Commission decision is expected in autumn 2004². Following on from such approval, a variety of conditions need to be fulfilled. These include certain conditions which the Secretary of State for Trade and Industry must be satisfied have been fulfilled.

5.1.8 More details on the restructuring proposals can be found in British Energy's press notice of 1 October 2003 at www.british-energy.com/media/press/index.html. A copy is also available on the ONS website at www.statistics.gov.uk/britishenergy.

5.2 Nuclear liabilities

5.2.1 Definitions

5.2.1.1 Nuclear liabilities are the future costs of clearing out and decommissioning redundant nuclear facilities, storing and disposing of waste arising and returning the site to its original condition. Such work is complex and speculative in its costing. No major nuclear facility in the United Kingdom has been fully decommissioned, although there is relevant experience elsewhere, particularly in the United States of America.

5.2.1.2 Nuclear decommissioning is not explicitly mentioned in the statistical classification manuals. It is however common practice for activities such as nuclear decommissioning and dismantling oil rigs to be classified as capital formation in the National Accounts, recording the disposal of capital assets. Improvements to land, for example through reclamation or decontamination, are also classified as capital formation.

² State Aid approval was announced on 22 September 2004.

5.2.1.3 British Energy has three types of nuclear liabilities: (i) contracted back end fuel costs, (ii) decommissioning; and (iii) uncontracted back end fuel costs. British Energy's annual report and accounts, for the year ending 31 March 2004, gives the following presentation of nuclear liabilities.

Projected payment details				
Based on current estimates of station lives and lifetime output projections, the following table shows, in current prices, the likely undiscounted payments, the equivalent sums discounted at 3% per annum to the balance sheet date and the amounts accrued to date.				
	Back end fuel costs contracted £bn	Back end fuel costs uncontracted £bn	Decommissioning £bn	2004 Total £bn
Undiscounted	5.2	4.7	5.1	15.0
Discounted	3.5	1.1	1.1	5.7
Accrued to date	2.4	0.7	1.1	4.2

The differences between the undiscounted and discounted amounts reflect the fact that the costs concerned will not fall due for payment for a number of years. The differences between the discounted amounts and those accrued to date will be charged to the profit and loss account over the remaining station lives since they relate to future use of fuel.

Source: British Energy Annual Report & Accounts for the year ended 31 March 2004. Page 77.

5.2.2 Contracted back end fuel costs

5.2.2 There are contracts in place with BNFL, a public non-financial corporation, up to 2086 to deal with this type of liability. These liabilities are further sub-divided into historic costs and future costs. Historic costs cover spent Advanced Gas cooled Reactor fuel that was loaded into reactors by the completion date of the restructuring. Future costs cover future spent fuel that will be loaded into reactors after the restructuring is complete. The contracts were amended on 16 May 2003 as part of the negotiations associated with the British Energy rescue plan. The majority of historic costs will, as part of the rescue package, be paid either directly by Government to BNFL, or via British Energy. The future costs will be an ongoing cost for the restructured British Energy.

5.2.3 Decommissioning liabilities

5.2.3 These are the expected costs for de-fuelling, dismantling and decommissioning the reactor core and buildings etc.

5.2.4 Uncontracted back end fuel costs

5.2.4 This type of nuclear liability covers spent fuel not covered in existing contracts elsewhere, plus any waste arising from, for example, the decommissioning process.

5.3 Agreements with Government

5.3.1 The proposals agreed between the Government and British Energy for its restructuring included a change to the manner in which the decommissioning liabilities of British Energy are to be funded and a proposal for the funding of certain of its contracted and uncontracted nuclear liabilities. As such, Government involvement in the British Energy restructuring was designed to:

- (i) ensure British Energy can function as a successful private sector owned company, and
- (ii) clarify responsibility for funding nuclear liabilities and decommissioning costs and ensure appropriate financing is in place.

5.3.2 The Government recognises that if a nuclear power generator became insolvent the costs of decommissioning are likely to fall to the Government, for safety and environmental reasons. As a result of this, the Government is assuming financial responsibility for some nuclear liabilities from British Energy and guaranteeing the others. In return, British Energy agreed to issue £275m of bonds and will contractually be required to make contributions towards future decommissioning costs and uncontracted nuclear liabilities. The principle here is that British Energy is still paying for these costs, but Government is underwriting them.

5.3.3 There are three categories of British Energy's payments towards nuclear liabilities. The first is the "cash sweep", whereby the restructured group has to pay an annual contribution equal to a fixed percentage of its "adjusted cash flow". This percentage is initially set at 65 per cent. If necessary, the cash sweep can be converted into an equity shareholding in the restructured group equal to the same percentage of the thereby enlarged issued share capital. The second category covers a fixed annual contribution of an index-linked £20m (at March 2003 prices); the payments taper as nuclear power stations are scheduled to close. The third category is an index-linked £150,000 payable for every tonne of fuel loaded into the Sizewell B reactor.

6. Golden Shares

6.1 Golden shares are typically a type of share that gives the owner a right of veto over a company's charter. They have been used in privatisations where Government seeks to retain some control.

6.2 The three existing British Energy "golden shares" (in the parent company and its two main subsidiaries) will be retained, but powers under them will be reduced in line with a European Court of Justice judgement in 2003. The golden shares will just retain the requirement for Government consent for: (a) anyone to purchase more than 15 per cent of British Energy's shares; and (b) disposal of a nuclear power station by British Energy or relevant subsidiary. Government consent may only be refused on grounds of national security. In addition the creation, variation or disposal of any voting shares requires Government consent but only where the action is contrary to national security. The golden shares give the right to speak but not vote at general meetings.

7. Nuclear Generation Decommissioning Fund

7.1 To facilitate the privatisation of British Energy in 1996, a segregated fund was established to secure funding for the decommissioning of British Energy's stations and to make payments for decommissioning and approved costs. Prior to privatisation there was no need for a separate fund as the obligations were in the public sector. To this end the Nuclear Trust and the Nuclear Generation Decommissioning Fund Limited were set up, and an agreement between them and British Energy put in place (the Nuclear Decommissioning Agreement). This agreement will be terminated as part of the British Energy restructuring arrangements.

7.2 The Department of Trade and Industry appointed actuarial advisers to determine the funding strategy. Decommissioning costs were station specific and each of British Energy's eight nuclear power stations was considered according to its commissioning date and the anticipated profile of its

decommissioning costs arising. Payments into the fund to cover each station's costs would be spread across the operating life of that station, paid annually and level (in real terms) for every year of that station's operation. The last station was estimated to close in 2035. Final costs, and thus the last payments out of the fund, are expected to arise about 115 years after starting the fund (i.e., in 2111). The fund was expected to have an average real rate of return over the whole period of about 3.5 per cent.

7.3 Once all stations had been decommissioned, any assets of the fund would have been converted into cash and used to provide for any remaining liabilities and costs of winding up. Payment of any surplus would have been distributed in the following proportions:

- (i) 95 per cent to the Licensees (British Energy);
- (ii) 4.99 per cent to HM Treasury; and
- (iii) 0.01 per cent to the Trustees, for the purposes of the Nuclear Trust.

7.4 The Nuclear Generation Decommissioning Fund covered only part of the nuclear liabilities. It did not cover defuelling costs, contracted spent fuel and uncontracted liabilities.

8. Nuclear Liabilities Fund

8.1 The Nuclear Generation Decommissioning Fund will be enlarged into, and renamed as, the Nuclear Liabilities Fund at the point when British Energy restructuring occurs. The Nuclear Liabilities Fund will cover all the types of nuclear liabilities except for the contracted historic spent fuel liabilities, which will be taken on by Government directly, and the contracted future spent fuel liabilities, which continue to be borne by British Energy. The contributions to pay future decommissioning costs will be managed and invested by the Nuclear Liabilities Fund. The Nuclear Liabilities Fund will then pay British Energy agreed amounts to fund the decommissioning and uncontracted spent fuel liabilities, as verified by the Nuclear Decommissioning Authority. The Nuclear Decommissioning Authority will ensure that amounts are properly spent.

8.2 Any deficit in the Nuclear Liabilities Fund's ability to meet these costs will be met by Government, so the Government is underwriting the fund. Without these undertakings by Government it is unlikely that British Energy would have survived. Any surplus in the fund will be retained by Government.

8.3 As part of the rescue package it was also announced that the Government would contribute around £150m-£200m a year over the next decade to help pay for historic spent fuel liabilities. This money will go directly to the contractor, BNFL, rather than via the Nuclear Liabilities Fund.

9. National Accounts classification

9.1 UK National Accounts classification decisions are consistent with the principles of the international statistical manuals, the *European System of Accounts 1995* (ESA95) and the *System of National Accounts 1993* (SNA93), and supporting manuals and case law.

9.2 Paragraph 2.18 of ESA95 defines how units acting in the economy are grouped into institutional sectors:

Each of the sectors and sub-sectors groups together the institutional units which have a similar type of economic behaviour.

The institutional units are grouped into sectors on the basis of the type of producer they are and depending on of their principal activity and function, which are considered to be indicative of their economic behaviour. A sector is divided into sub-sectors according to the criteria relevant to that sector; this permits a more precise description of the economic behaviour of the units.

The accounts for sectors and sub-sectors record all the activities, whether principal or secondary, of the institutional units covered.

Each institutional unit belongs to only one sector or sub-sector.

9.3 The first sector classification issue is to determine whether an entity is public or private sector. Care should be taken here with terminology. National Accounts explain the economy based on the activities of groups of institutions or entities within it. These groupings are called sectors. The international statistical manuals define what should be included in the public or private sectors. These terms are often used elsewhere in different contexts, for example public schools, public transport. There is a distinction between public ownership and public control and also to public funding. Any references to public or private in this article refer to National Accounts definitions.

9.4 Chapter 2 of ESA95, which defines the institutional sectors in the National Accounting system, concentrates on control rather than ownership. For example, paragraph 2.28, which defines public non-financial corporations, states:

The sub-sector public non-financial corporations consists of all non-financial corporations and quasi-corporations that are subject to control (see paragraph 2.26) by government units.

9.5 The key paragraph in ESA95 for determining control is 2.26. Although this refers to corporations, it sets out general standards to follow. It is reproduced below:

Control over a corporation is defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary.

A single institutional unit (another corporation, a household or a government unit) secures control over a corporation by owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power. In addition, government secures control over a corporation as a result of special legislation decree or regulation which empowers the government to determine corporate policy or to appoint the directors.

9.6 Having decided whether an entity is part of the public or private sectors, the second important aspect for classification is to determine whether it is a market or non-market entity. Public sector market entities are classified as public corporations, public sector non-market entities as general government. General government is then sub-divided into sub-sectors, such as central government, state government and local government. Private sector market entities are classified as private corporations, and private sector non-market entities are classified to a sector known as Non Profit Institutions Serving Households.

9.7 The borderline between market and non-market classification is defined in ESA95 by whether more than fifty per cent of production costs are covered by sales (ESA95 paragraph 3.32).

10. Testing for Control using ESA95 Principles

10.1 The classification committee's approach to such cases is to consider whether there:

- (i) is control or influence over an entity's directors through the appointment process; or
- (ii) any special factors that enable any part of the public sector to determine general corporate policy, either individually or collectively.

10.2 In addition to securing control through power of appointment, ESA95 recognises that control over a corporation can result from legislation, decree or regulation. The classification committee examines the situation to see whether any of these apply. The following sections examine the controls and powers present for all the relevant entities and give the classification committee's views on whether they are deemed to be controlling or not.

10.3 The borderline between regulation and control can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatised utilities, but regulatory involvement itself is not necessarily control. Therefore, it is possible for there to be regulatory involvement in important areas, such as setting prices, without the entity ceding control of general corporate policy. However, when the regulation is so tight as to effectively dictate how the entity performs its business, then this is recognised as a form of control.

11. Classification of The Nuclear Trust

11.1 The Nuclear Trust was set up on 27 March 1996, prior to British Energy's privatisation. Its primary purpose was to "protect and preserve for the benefit of the nation the environment of the United Kingdom, ... to receive and hold monies and investments ... so as to secure funding for decommissioning of the nuclear power stations ... and to make payments for such decommissioning in approved cases".

11.2 Prior to privatisation there was no need for a separate fund as the nuclear liability obligations were in the public sector. Thus for privatisation, The Nuclear Trust and the Nuclear Generation Decommissioning Fund Limited were set up, and the Nuclear Decommissioning Agreement, an agreement between them and British Energy, was put in place.

11.3 The Nuclear Trust has five trustees. Two trustees were appointed by British Energy, three by Government. This was a deliberate design to make the fund independent from British Energy. As the majority of trustees are appointed by public sector entities, The Nuclear Trust is classified to the public sector in line with ESA95 paragraph 2.26. It is a non-market entity and hence is classified as part of the central government sub-sector in the National Accounts. There is no change to the sector classification of The Nuclear Trust.

12. Classification of Nuclear Generation Decommissioning Fund

12.1 Before privatisation, a segregated fund, the Nuclear Generation Decommissioning Fund, was established for the purpose of providing funds for nuclear decommissioning. The objectives of the Nuclear Generation Decommissioning Fund were wholly consistent with the purposes of The Nuclear Trust. The fund was established with a corporate structure, the Nuclear Generation Decommissioning Fund Limited being incorporated on 28 March 1996, although it is generally referred to as "the fund" rather than "the company".

12.2 The five trustees of The Nuclear Trust are the ordinary shareholders of the Nuclear Generation Decommissioning Fund Limited. As the trustees are bound by the objectives of the trust, it is more appropriate to view the Nuclear Trust as the owner of the shares. The shares will only have a value if the fund has a surplus after the completion of decommissioning, and even then 95 per cent of the surplus would be distributed to British Energy. The trustees are also the directors of the company and hence for National Accounts purposes the Nuclear Generation Decommissioning Fund is majority controlled by public sector appointees, and therefore classified in National Accounts to the public sector.

12.3 The Nuclear Generation Decommissioning Fund charges fees for its work. An analysis of these fees, according to the ESA95 test to determine whether an entity is market or non-market, determined that the Nuclear Generation Decommissioning Fund was a market entity.

12.4 ESA95 paragraph 2.37, reproduced below, provides details of the borderline of the market sectors between financial and non-financial corporations. The Nuclear Generation Decommissioning Fund was effectively providing treasury services to British Energy, which was largely the beneficial owner of the funds, but was legally a separate entity and not controlled by British Energy. Hence, its activities went beyond simply performing a treasury service for a company group. The classification committee determined that the Nuclear Generation Decommissioning Fund was classified in National Accounts as a public financial corporation. There is no change to the sector classification of the Nuclear Generation Decommissioning Fund.

Financial intermediation, generally, is limited to financial transactions on the market. In other words, acquiring assets and incurring liabilities should be with the general public or specified and relatively large sub-groups thereof. Where the activity is limited to small groups of persons or families, generally, no financial intermediation takes place. In particular, financial intermediation does not include institutional units providing treasury services to a company group. These institutional units are allocated to a sector according to the predominant function of the company group within the economic territory. However, in cases

where the institutional unit providing the treasury services is subject to financial supervision, it is classified in the financial corporations sector by convention.

13. Classification of Nuclear Liabilities Fund

13.1 The Nuclear Generation Decommissioning Fund will be enlarged into, and renamed as the Nuclear Liabilities Fund at the point when British Energy restructuring occurs. The Nuclear Liabilities Fund will cover all the types of nuclear liabilities except for the contracted historic spent fuel liabilities, which will be taken on by Government directly.

13.2 The Nuclear Liabilities Fund Ltd's structure is very similar to the Nuclear Generation Decommissioning Fund. The Nuclear Decommissioning Agreement, which governed the contributions to and investment strategy for the Nuclear Generation Decommissioning Fund, will be terminated and replaced with the Nuclear Liabilities Funding Agreement. This sets out the agreed monies into and out of the Nuclear Liabilities Fund and its investment policy.

13.3 The Nuclear Liabilities Fund will be classified to the public sector in National Accounts, again due to the appointment process for the trustees.

13.4 The main difference between the Nuclear Liabilities Fund and the Nuclear Generation Decommissioning Fund is that the beneficial owner of the fund changes to Government.

13.5 The Nuclear Liabilities Fund will receive fees from British Energy but remaining administrative costs will be covered from the fund. As Government is now the beneficial owner of the fund, such contributions are effectively from Government, so are not considered as sales when considering the ESA95 test for determining whether an entity is market or non-market.

13.6 Although the Nuclear Liabilities Fund is not operating yet, the Nuclear Generation Decommissioning Fund's costs are a good guide to its future costs. The Department of Trade and Industry have confirmed that they should be lower, but not enough to change the analysis. Applying the ESA95 paragraph 3.32 test indicates that the Nuclear Liabilities Fund is a non-market entity, and hence it will be classified as a central government entity in the National Accounts.

14. Classification of Nuclear Decommissioning Authority

14.1 The Nuclear Decommissioning Authority will be set up by the Government to deal with the nuclear liabilities. It will be funded directly by Government through grant in aid. It will be classified to the public sector, as a central government entity, in the National Accounts.

15. Classification of British Energy during time of credit facility

15.1 British Energy remains owned by its shareholders during the time that the credit facility is in place, but control is a different issue to ownership. Control of a corporation is defined (ESA95 paragraph 2.26) as the ability to determine general corporate policy. The most common examples are through control by appointing a majority of directors, or having more than half the voting rights. Neither of these conditions is applicable here.

15.2 However, ONS concluded that Government has sufficient control over British Energy through the credit facility that it should be reclassified to the public sector for National Accounts for the duration of the facility. More details on these controls are provided later in this section.

15.3 The borderline between market and non-market is defined in ESA95 by whether more than fifty per cent of production costs are covered by sales (ESA95 paragraph 3.32). In the case of British Energy this test determines that it is clearly a market entity, in both 2002/3 and 2003/4 sales accounted for more than 100 per cent of costs. Therefore British Energy has been reclassified to the public sector as a public non-financial corporation whilst the facility is in place.

15.4 The credit facility itself is classified for National Accounts purposes as a contingent liability of the Government. ESA95 paragraph 5.05 defines contingent assets and includes lines of credit, and is reproduced below. Contingent assets and liabilities are not included in the National Accounts since its focus is on economic transactions in the economy and the resulting matched assets and liabilities. Any amounts drawn on the facility are classified as Government lending to British Energy (F.4 lending in the financial account).

Contingent assets are contractual arrangements between institutional units, and between them and the rest of the world, which specify one or more conditions which must be fulfilled before a financial transaction takes place. Examples are guarantees of payment by third parties, letters of credit, lines of credit, underwritten note issuance facilities (NIFs) and many of the derivative instruments. In the system, a contingent asset is a financial asset in cases where the contractual arrangement itself has a market value because it is tradable or can be offset on the market. Otherwise, a contingent asset is not recorded in the system.

15.5 The ONS's analysis of the credit facility agreement relates to the re-signed 7 March 2003 agreement. The September 2002 agreement is slightly more onerous in one respect, but the only main changes introduced in March 2003 were to the size of the facility and the introduction of a charge on British Energy for it.

15.6 As part of the agreement, British Energy has certain obligations to the Government. The relevant elements are:

- (i) there will be no disposals, other than at arms length in the ordinary course of business, without the written consent of the Government;
- (ii) there will be no material change to the nature of the business undertaken by British Energy;
- (iii) no new contracts over £5million will be entered into without the prior written consent of the Government, unless the contract is in line with British Energy's trading manual and guidelines;
- (iv) no money will be borrowed (other than swaps or other arrangements which are in accordance with British Energy's treasury policy) without the prior written consent of the Government;
- (v) no dividend will be paid without the prior written consent of the Government; and
- (vi) there will be no acquisitions without the prior written consent of the Government.

15.7 ONS classification case law, in determining whether one entity controls another, includes amongst others the following indicators: authority to decide what sort of financial transactions the body can undertake, or limit them; and authority to prevent the body from receiving certain types of income from other sources; and control of dividend policy. ONS has judged that the above powers were sufficient to view the Government as effectively determining British Energy's general corporate policy.

15.8 It may be noted that the British Energy facility has similarities with bank credit facilities for companies in distress. In such similar cases ONS would conclude that control has moved from one part of the private sectors (the shareholders) to another (the bank) and so the company would still be classified as private sector. When Government takes the place of the bank in this example, the control has moved from a private sector entity to a public sector entity, resulting in public sector classification.

15.9 This reclassification will be incorporated into the Public Sector Finances and the National Accounts as soon as practically possible. It is not expected to have a significant impact on the Government's fiscal measures.

15.10 The accounting treatment of the transactions relating to the Government's support for British Energy during the period of the credit facility is reflected in the Department of Trade and Industry Consolidated Resource Accounts 2002-03 (HC14 26 November 2003, also available at www.dti.gov.uk). The National Accounts classification of British Energy as public sector or otherwise does not affect the accounting treatment in Resource Accounts.

16. Classification of a restructured British Energy

16.1 Direct Control

16.1.1 Following restructuring British Energy will continue to be majority owned by private sector shareholders but, in National Accounts, ownership is recognised as being different from control. In National Accounts, control of a corporation is defined (ESA95 paragraph 2.26) as the ability to determine general corporate policy. The most common examples are through control by appointing a majority of directors, or having more than half the voting rights. Neither is applicable here. ESA95 also acknowledges that control over a corporation can also result from special legislation, decree or regulation, which empowers determination of corporate policy.

16.1.2 ONS also recognise that control can arise via contracts or a mixture of the items mentioned earlier. As a result, the agreements between British Energy and any relevant public sector entities have to be examined when considering the nature and extent of public sector controls over the restructured group. The relevant public sector entities here are the Department of Trade and Industry, the Nuclear Liabilities Fund, the Nuclear Decommissioning Authority and BNFL. It is the totality of the powers inferred by these contracts that determine the statistical classification of the restructured group as public or private sector.

16.1.3 Before looking at a list of Government influences on the restructured group, obtained from analysing detailed legal documents, it is worth highlighting that British Energy has agreed to contractual limitations upon its decision making rights as part of the restructuring. When making classification decisions ONS normally determines that such agreements are everyday contracts rather than control contracts. However, before doing so the classification committee felt it was important to reflect on whether that would be appropriate in this case, since British Energy was negotiating with the Government over a rescue plan from a position of extreme weakness. Without Government agreeing to assume responsibility for certain of British Energy's nuclear liabilities and decommissioning costs, it is likely that British Energy would have had to commence insolvency proceedings.

16.2 Rights under golden shares

16.2.1 The Government's special shares ("golden shares") in British Energy and its two main subsidiaries will be retained in the restructured company. They require Government consent for: (a) anyone to purchase more than 15 per cent of the restructured group's shares; and (b) disposal of a nuclear power station by the restructured group or relevant subsidiary. Government consent will only be refused on grounds of national security. In addition the creation, variation or disposal of any voting shares requires Government consent but only where the action is contrary to national security. The shares give the right to speak but not vote at general meetings.

16.2.2 Powers under golden shares are, for National Accounts classification purposes, usually considered as remote or contingent, and thus ignored unless those powers are utilised. The classification committee concluded that the Government powers under the Golden Shares are not indicators of control; however the Government's veto over disposal of power stations was taken into account when the classification committee formed its overall view.

16.3 Rights under the Nuclear Liabilities Funding Agreement

16.3.1 The Nuclear Liabilities Funding Agreement is an agreement between the Government, the Nuclear Liabilities Fund and British Energy. It defines which of British Energy's nuclear liabilities the Government is underwriting and gives British Energy obligations to manage them.

16.3.2 For example the agreement describes how the Nuclear Liabilities Fund's funds will be used in the decommissioning of nuclear liabilities and that the Government undertakes to make payments on

behalf of the Nuclear Liabilities Fund if there are insufficient funds. In return British Energy has a number of covenants and obligations. The main factors analysed for classification purposes have been listed below.

16.3.3 The first factor in the Nuclear Liabilities Funding Agreement is Government's right to approve, through the Nuclear Decommissioning Authority, British Energy's decommissioning plan, other uncontracted liabilities discharge plan, and approve decommissioning strategy, e.g., if British Energy want to change the closure date of a station they need approval.

16.3.4 In practice these contractual rights would not change the situation much: the nuclear industry is heavily regulated and there is already a requirement that decommissioning strategy is reviewed by Government.

16.3.5 The classification committee concluded that this was not Government control by itself, but was a factor that should be taken into consideration when considering the totality of the case.

16.3.6 The second factor in the Nuclear Liabilities Funding Agreement is that British Energy has to meet Minimum Performance Standards at each of its nuclear power stations.

16.3.7 These are not specifically defined, but are described as "the application of practices, methods and activities in good faith, in compliance with all Applicable Law and Accepted Standards". So, British Energy has agreed with Government and the Nuclear Liabilities Fund that it will abide by the law and accepted standards. The classification committee concluded that this was just a standard legal clause in most such agreements and not representative of any additional control.

16.3.8 The third factor in the Nuclear Liabilities Funding Agreement is that British Energy retains economic responsibility for nuclear liabilities and seeks approval for key operational changes.

16.3.9 This clause was required to ensure that, even though the Government is underwriting the nuclear liabilities, British Energy retains responsibility for its actions.

16.3.10 A key operational change is defined as one that results in an increase of nuclear liabilities above £10 million at net present value. British Energy advised that this level was chosen to ensure that the amount was material but would not require frequent contact or interference. ONS discussed with relevant parties the likelihood of Government involvement.

16.3.11 There are various types of 'key operational change' defined. The most significant, from a classification perspective, is where Government or the Nuclear Decommissioning Authority sees a way in which British Energy may reduce their nuclear liabilities. They may propose that British Energy makes such a change. The change may include a request for British Energy to continue operating a power station beyond its scheduled or actual closure date, but for no more than twelve months. Broadly, British Energy is required to implement the change if it is approved by a regulator, reduces the net present value of costs of discharging liabilities by more than £10 million on a net present value basis, and a "reasonable and prudent" operator would implement it. Beyond that there are "no limitations on the nature of such a change".

16.3.12 If British Energy disagrees with the implementation (e.g., doesn't regard the change as "reasonable and prudent" or considers the reduction in liabilities to be less than £10 million net present value) it can refer the matter to an Expert for resolution. Theoretically, having exhausted all rights to appeal on the above grounds, if British Energy still doesn't implement the change, it would effectively have to cover the amounts that would have been saved itself. In practice, it is debatable whether British Energy is in the financial position to refuse such changes.

16.3.13 The classification committee concluded that the public sector, through the Government and the Nuclear Decommissioning Authority, appears to have the right to instruct British Energy on business decisions in such circumstances. The classification committee concluded that this was not Government control by itself, but was a strong factor that should be taken into consideration when judging the totality of the case.

16.3.14 The fourth factor in the Nuclear Liabilities Funding Agreement concerns any surpluses generated by the “cash sweep”. British Energy has to pay an annual fixed percentage (initially 65 per cent) of its “adjusted cash flow” as a contribution to meeting nuclear liabilities. It pays this to the Nuclear Liabilities Fund. The Nuclear Liabilities Funding Agreement gives the Government the rights to any Nuclear Liabilities Fund surpluses if contributions to the fund exceed the eventual nuclear liabilities.

16.3.15 The classification committee concluded that this was not Government control by itself, but was a factor that should be taken into consideration when considering the totality of the case. This factor is perhaps more about ownership than control, recognition that Government has an “other equity” type of stake in the success of the restructured group.

16.3.16 The fifth factor in the Nuclear Liabilities Funding Agreement is that British Energy is restricted from certain activities through covenants. The most important two of these are that:

(i) British Energy will not enter into any agreement that has the effect of conferring security (e.g., mortgaging or otherwise borrowing against assets) other than some specified exceptions, without the consent of the Nuclear Liabilities Fund, unless British Energy grants security equally to the Nuclear Liabilities Fund. This appears to be a restriction on certain borrowing without the Nuclear Liabilities Fund’s consent.

(ii) British Energy needs the consent of two Government departments (Department of Trade and Industry and HM Treasury) to undertake any corporate restructuring, amalgamation, merger or demerger if it could result in a material increase in the cost of discharging liabilities. This appears to be a restriction on amending corporate structure without Government approval.

16.3.17 Although such restrictions are very unusual in a private sector corporation, the classification committee concluded that they were not by themselves sufficient to be considered Government control. They were however a strong factor that should be taken into consideration when considering the totality of the case.

16.4 Rights under the Contribution Agreement

16.4.1 The Contributions Agreement details British Energy’s payment obligations to the Nuclear Liabilities Fund. Broadly, British Energy will pay the Nuclear Liabilities Fund up to 65 per cent of its free cash. The obligations, and clauses in covenants supporting them, include:

- (i) the issue of £700 million of new bonds, of which £275 million will be issued to the Nuclear Liabilities Fund;
- (ii) the definition and application of cash reserves (these need to be maintained until a certain credit rating is achieved and maintained);
- (iii) details of the Nuclear Liabilities Fund’s conversion and voting rights if it elects to receive shares instead of cash.

16.4.2 At the time of the classification committee’s analysis the Contribution Agreement was being redrafted to ensure that the Nuclear Liabilities Fund’s conversion rights on shares will have voting rights restricted to 29.9 per cent while they are in the Nuclear Liabilities Fund’s ownership. The classification committee worked on the assumption that this change would be completed.³

16.4.3 The first classification factor in the Contribution Agreement is the Nuclear Liabilities Fund’s right to receive 65 per cent of British Energy’s free cash.

³ ONS has since seen a version of the documents that includes a change restricting the voting rights. The exact wording used was “... so that they remain below the amount required to trigger a mandatory offer for the company under the City Code on Takeovers and Mergers (being 29.9% at the time of restructuring.”)

16.4.4 The Nuclear Liabilities Fund has a contractual right to a percentage of British Energy's free cash. This is initially 65 per cent, can go up and down but is subject to a cap of 65 per cent. A simplified description of free cash is amounts available after tax, financing charges and capital expenditure.

16.4.5 The cash sweep proposition was originally put forward by Government during negotiations, as an alternative to British Energy's proposal that Government take a significant equity stake in the company. The Government would not have agreed the deal unless this factor, or an alternative way for the Nuclear Liabilities Fund to recover value from British Energy, was present.

16.4.6 The classification committee had to decide whether the contractual acceptance of paying out 65 per cent of free cash equated to surrender of general corporate policy, or whether it was just a contractual arrangement. For example, it could be argued that Government does not need to have directors on the board of British Energy, as it has already contractually pre-determined the financial policy of the cashflow for decommissioning, resulting in the effective control of the dividend policy. Additionally, it is Government that retains any Nuclear Liabilities Fund surplus. This indicates that British Energy is not simply outsourcing the liabilities and paying a fee for their management, but that there is a dividend element akin to Government being, in substance if not in form, a majority shareholder.

16.4.7 The classification committee concluded that this was not Government control by itself. It was however a strong factor that should be taken into consideration when considering the totality of the case.

16.4.8 The second factor in the Contribution Agreement is the requirement that British Energy must maintain minimum cash reserves.

16.4.9 The amounts of these reserves can only be reduced if a specified credit rating is achieved or alternative finance is available, although even then not to the extent that reducing the reserves would lead to that rating being lost. The proposal for a minimum cash reserve was originally put forward by British Energy, but the detailed arrangements were negotiated and agreed between British Energy, the Government and creditors.

16.4.10 British Energy needs to maintain cash reserves in order to be a viable business post restructuring because in the absence of these reserves it would not have access to alternative financing. The cash reserves are a key element of the restructuring. They will provide collateral for trading and liquidity for outages, seasonal fluctuations and working capital requirements.

16.4.11 Although it is good business practice to maintain these reserves, the classification committee questioned whether an uncontrolled private sector company would just unilaterally maintain such reserves, rather than enter into a contractual agreement with others to do so.

16.4.12 The classification committee concluded that this factor was not Government control by itself. It was however a factor that should be taken into consideration when considering the totality of the case.

16.4.13 The third factor in the Contribution Agreement is the restrictions on the restructured group over the use of its cash reserves.

16.4.14 The cash reserve can only be used for agreed purposes. British Energy's 'trading principles framework' was developed by the company following lengthy negotiations with Government. The agreement requires that British Energy has, and acts in line with, a 'prudent' trading policy, although approval of the policy is clearly with the board of British Energy. Within the framework there is only a commitment to provide the Government with annual information on the performance of the policy.

16.4.15 The cash reserves can only be applied in line with covenants. These covenants require that:

- (i) there are restrictions on cash or capital distributions in respect of ordinary shares; and that
- (ii) there will be no distributions or acquisitions unless there is enough cash and collateral to fulfil the reserve requirements and pay the Nuclear Liabilities Fund cash sweep.

16.4.16 The cash reserves may only be invested in accordance with British Energy's treasury policy. British Energy's treasury policy remains as defined by the British Energy board prior to the restructuring and the Department for Trade and Industry have stated to ONS that they have not influenced it. However, if British Energy wants to invest outside of this policy, then prior written consent of the Government is necessary. Any changes to the Treasury policy that are not "reasonable and prudent" have to be agreed by the Government.

16.4.17 The classification committee concluded that, although these restrictions were very unusual in a private sector corporation, such restrictions were not Government control by themselves. It was noted that they only apply to the financial policies for part of the company's finances, although control of 65 per cent of cashflow was considered a significant proportion. The classification committee judged it a strong factor that should be taken into consideration when considering the totality of the case.

16.4.18 The fourth factor in the Contribution Agreement is the restrictions on the restructured group issuing any new shares, other than ordinary shares, without the approval of the Nuclear Liabilities Fund.

16.4.19 The Nuclear Liabilities Fund has the option to convert the cash sweep payment into convertible shares, although as mentioned earlier there were plans to restrict the voting rights on these shares. If the Nuclear Liabilities Fund is to receive equity rather than cash, then the restructured group is prevented from diluting the value of this equity when issuing more shares.

16.4.20 The classification committee concluded that this was not Government control by itself. It was however a factor that should be taken into consideration when considering the totality of the case.

16.5 Rights under the Option Agreement

16.5.1 This is an agreement between the Government and British Energy, which grants irrevocably an option for the Government to purchase its nuclear power stations for a nominal sum (£1). The option can be exercised to either decommission or to operate the stations. British Energy can remove capital assets, for use at other power stations, prior to a sale for decommissioning.

16.5.2 Under this agreement Government may purchase a nuclear power station at its closure date to operate it. The Government may instruct British Energy to operate it on its behalf, for a period of up to five years, with payments made under contract. The completion of the purchase will take place:

- (i) on the scheduled closure date, if British Energy decides to maintain that date; or
- (ii) on an "early closure date", if British Energy chooses to move the scheduled closure date forward and gives more than 30 months notice; or
- (iii) within three years of the exercise of the option in any other eventuality.

16.5.3 Under the agreement, Government may purchase a station for decommissioning. The completion date will be the latest of:

- (i) three years after exercising the option;
- (ii) the scheduled closure date, if British Energy decides to maintain that date;
- (iii) the "early closure date", if British Energy chooses to move the scheduled closure date forward.

16.5.4 The classification committee took note of Government's right, following exercise of the option, to require British Energy to operate a power station after it wanted to close it, but noted that any profit/loss from such operations would be for Government.

16.5.5 The classification committee concluded that this was not Government control by itself, although it was a strong factor that should be taken into consideration when judging the totality of the case.

16.6 Terms imposed under issuance of new bonds

16.6.1 As part of the restructuring, the restructured group will issue new bonds to British Energy's main creditors. The bondholder with the largest proportion of the issued bonds will be the Nuclear Liabilities Fund, although it will not own the majority of the bonds.

16.6.2 Under the covenants included in the terms of the bonds, the restructured group is restricted from some activities. Some of these restrictions apply until the restructured company attains a particular credit rating. If it subsequently loses this rating, the restrictions return. ONS sought advice from relevant parties on how long it would take to achieve this rating, although they found it difficult to predict. In the list in the following paragraph (v), (vi) and (vii) are not dependent on the credit rating.

16.6.3 The covenants are similar to those in the Nuclear Liabilities Funding Agreement. They include:

- (i) a limitation on the restructured company's financial indebtedness (based on an interest cover ratio). It excludes any financial indebtedness covered by the other contractual agreements that are to be signed as part of the agreed restructuring arrangements;
- (ii) restrictions on business diversification;
- (iii) if a target amount of cash reserves is not met there is a restriction on dividend payments, buy-backs etc;
- (iv) British Energy will not enter into any material transactions with any affiliate that is not at arms length (save for benefits, advances, expenses etc. to employees, transactions with other members of the group, transactions with BNFL and 'permitted payments');
- (v) British Energy will not enter into any agreement that has the effect of conferring security (e.g., mortgaging or otherwise borrowing against assets);
- (vi) limitations on transactions with the Nuclear Liabilities Fund and the Secretary of State. Transactions (except those under the Nuclear Liabilities documentation) are required to be on fair and reasonable terms. Transactions over £5million must be found by British Energy directors to be "in the interests of the relevant British Energy company". For transactions over £25million, British Energy directors must deliver to the Nuclear Liabilities Fund an "independent expert opinion" that states the transaction is on fair and reasonable terms;
- (vii) limitations on transactions with BNFL. These must be determined by the British Energy board to be on arms-length terms if over £2million.

16.6.4 The classification committee considered that none of the bond terms were control in their own right, but that the first three listed above were relevant when considering the totality of the case. The first was a restriction on types of borrowing, the second a restriction on dividend policy, and the third a restriction on business diversification.

16.6.5 The terms are applied by all the bondholders as part of the agreement, not just by the Nuclear Liabilities Fund. However, they do restrict what the corporation can do, and are thus relevant to any discussion about Government controls on the restructured corporation.

16.6.6 One argument put forward in the classification committee discussion was that these restrictions could be ignored, as there were similar cases for private sector companies that have issued

bonds. A counter-argument to this is that these are not conventional bond issues; at the time of the restructuring agreement British Energy was in no position to issue bonds to the market.

16.7 Totality

16.7.1 The classification committee concluded that there was no individual factor that, by itself, conclusively demonstrated control. However, when looking at the entire picture, public sector bodies would have influence, sometimes in certain circumstances, over: British Energy's

- (i) payments of a majority of profits to fund decommissioning;
- (ii) important business decisions leading to increases in nuclear liabilities;
- (iii) corporate restructuring and share issuance;
- (iv) borrowing;
- (v) disposal of assets;
- (vi) dividend policy;
- (vii) investment strategy for reserves;
- (viii) financial policy on maintaining reserves;
- (x) potential role in running power stations following their acquisition by Government.

16.7.2 Additionally, British Energy recognises, in its own documents that "under the terms of the Proposed Restructuring, there are certain restrictions on the Board's ability to pay dividends".

16.7.3 These influences do not apply in all circumstances, but when combined with the limitations on British Energy's activities imposed through the terms of the bonds, such as the limit on diversification, the classification committee concluded that British Energy does not have the freedom that a normal private sector corporation has.

16.7.4 Although recognising that British Energy was operating in a specialised industry that requires strong regulation, the classification committee judged that, taking all these factors into account, there was sufficient public sector control over British Energy to classify it to the public sector.

16.8 Market or non-market

16.8.1 The second aspect to any National Accounts sector classification decision is whether an entity is market or non-market. The borderline between them is defined in ESA95 paragraph 3.32 by whether more than fifty per cent of production costs are covered by sales. In the case of British Energy this test determines that it is clearly a market entity. Therefore the restructured British Energy will continue to be classified as a public non-financial corporation once the credit facility ends and the restructuring proposals have been completed.

17. Classification of associated transactions

17.1 Regular British Energy payments to the Nuclear Liabilities Fund

17.1.1 In the Nuclear Liabilities Funding Agreement, Government underwrites the future nuclear liabilities in return for the restructured group contributing towards these future costs. The on-going payments will be:

- (i) an annual cash-flow related payment.
- (ii) £20m per annum (inflation-linked from March 2003, but tapers when stations are scheduled to close);
- (iii) £150,000 per tonne of fuel loaded into the Sizewell B reactor;

17.1.2 The cash-flow payment gives the Nuclear Liabilities Fund a contractual right to a percentage (initially 65 per cent) of the restructured company's "free cash". To protect the value of this payment (e.g., if the company has a potential future cash-flow shortage, it might not be wise to extract the cash owed) the Nuclear Liabilities Fund has the option to convert this payment into shares.

17.1.3 Free cash is calculated after capital expenditure, tax and financing costs, but before certain payments to the Nuclear Liabilities Fund, dividends and other adjustments. It has a floor value of £0, otherwise the Nuclear Liabilities Fund would end up funding British Energy if the free cash was negative.

17.1.4 The £20m per annum is similar to the contributions that British Energy previously made to the Nuclear Generation Decommissioning Fund.

17.1.5 The classification committee concluded that the payments should be classified as capital transfers, after considering the following four options:

- (a) tax;
- (b) capital transfer;
- (c) dividend distribution/withdrawal of equity;
- (d) sale of service.

17.1.6 The first option is a tax, akin to Government requiring a polluter to pay. ESA95 defines taxes as compulsory and unrequited payments. The payments cannot be described as compulsory, as they are a contractual arrangement voluntarily entered into, nor unrequited as they fund the clean-up costs of British Energy assets. Classification of tax would have been the only option that requires a detailed look at the three types of payments, as they fit into different types of tax classification. In all the other options the separate payments are simply components of an overall figure.

17.1.7 The second option is a capital transfer. ESA95 paragraph 4.145 defines capital transfers as:

Capital transfers are different from current transfers by the fact that they involve the acquisition or disposal of an asset, or assets, by at least one of the parties to the transaction. Whether made in cash or in kind, they should result in a commensurate change in the financial, or non-financial, assets shown in the balance sheets of one or both parties to the transaction.

17.1.8 As these are payments to fund the disposal of an asset in the future, then the capital transfer option fits well. Although in this case the capital formation is more about destruction than creation, it is classified as formation as it returns value to an asset. A non-polluted site is more valuable than a polluted site. ESA95 allows the actual capital expenditure work to take place at a different time to the transactions that fund it. The classification committee decided this was the best option.

17.1.9 The third option, dividend or withdrawal of equity, is only possible if one views Government having an effective "other equity" stake in British Energy and withdrawing money from it. ESA95 paragraph 4.53 defines a dividend as:

Dividends (D.421) are a form of property income received by owners of shares (AF.5) to which they become entitled as a result of placing funds at the disposal of corporations. Raising equity capital through the issue of shares is an alternative way of raising funds to borrowing. In contrast to loan capital, however, equity capital does not give rise to a liability that is fixed in monetary terms and it does not entitle the holders of shares of a corporation to a fixed or predetermined income.

17.1.10 The last sentence of the paragraph defines a situation that is different from the British Energy arrangements. Withdrawal of equity, where Government would be extracting the share value from the company, also does not work well as an option because there is no equity available to withdraw.

17.1.11 The fourth option is a sale of service receipt, effectively viewing the situation as British Energy making pre-payments for the service of cleaning up nuclear waste. This option does not work well, as it would involve pre-payments of possibly 150 years, and the cost of the service provided is likely to differ from the flow of money.

17.2 Payments from the fund for decommissioning work

17.2.1 There are two possible treatments of payments made from the fund to finance the decommissioning work. They depend on who the owner of the assets being decommissioned is. This

could be either the restructured British Energy or the Government, which has options to acquire the nuclear power stations.

(i) British Energy ownership

17.2.2 When the Nuclear Liabilities Fund pays British Energy to fund decommissioning work this will be classified as an investment grant (D.92). This is because the decommissioning work is classified as capital formation and the payments from the fund are a grant to finance this work. If the decommissioning work is contracted and the contractor is paid directly from the fund, then the transaction is imputation via British Energy to reflect the economic reality of what is happening. ESA95 paragraph 4.152 defines investment grants. It is reproduced below.

Investment grants (D.92) consist of capital transfers in cash or in kind made by governments or by the rest of the world to other resident or non-resident institutional units to finance all or part of the costs of their acquiring fixed assets.

(ii) Government ownership

17.2.3 The payments would be classified as gross capital formation (P.51) by central government. The flow of funds within the central government sub-sector would be consolidated out of the National Accounts.

17.3 Government assumption of British Energy liabilities

17.3.1 In return for assuming certain nuclear liabilities the Nuclear Liability Funds will be issued with £275m of the restructured company's bonds.

17.3.2 As nuclear liabilities are not recognised by themselves in National Accounts there are no descriptions of transactions featuring their transfer in the international manuals. However a recent decision by the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) has relevance here.

17.3.3 The CMFB assists the European Commission in drawing up and implementing economic statistics work programmes. In 2003, it consulted its members about a case involving the transfer from public corporations to governments of unfunded pension scheme obligations. These are similar types of liabilities, in that they are not included in National Accounts; the consultation case involved the transfer of contingent liabilities from corporations to governments. In the pensions case the government receives a cash lump-sum payment in return for assuming the liabilities, usually reflecting the additional costs they have taken on. The objective of the exercise was to improve the balance sheet of the corporations in the run-up to privatisation. A counterpart transaction was needed to balance the cash payment. The CMFB case vote was in favour of a D.99 capital transfer being recorded.

17.3.4 In return for taking on the nuclear liabilities, the Nuclear Liabilities Fund will be issued with £275m of bonds. The bond issuance (F.332) needs to be balanced with a counterpart transaction in the National Accounts. The classification committee decided that the CMFB case gave precedence that the counterpart transaction was a capital transfer from the restructured British Energy to central government.

17.4 Government assumption of British Energy assets

17.4.1 The beneficial owner of virtually all of the Nuclear Generation Decommissioning Fund's assets was British Energy. As part of the restructuring agreements, the Nuclear Liabilities Fund will take over the Nuclear Generation Decommissioning Fund's assets when it replaces it. In National Accounts this will be classified as an asset assumption. British Energy will make a notional D.99 capital transfer to central government (the Nuclear Liabilities Fund), which will then use the proceeds to buy the assets of the Nuclear Generation Decommissioning Fund. The purchase will be recorded as financial transactions in the appropriate financial investments.

17.4.2 ESA95 paragraph 4.165f, reproduced below, covers debt assumption when defining D.99 capital transfers. Asset assumption is treated consistently with debt assumption.

4.165. *Other capital transfers include the following transactions: ...*

f) *the counterpart transaction of cancellation of debts by agreement between institutional units belonging to different sectors or sub-sectors (for example, the cancellation by the government of a debt owed to it by a foreign country; payments in fulfilment of guarantees which free defaulting debtors from their obligations). Such cancellations by mutual agreement are treated as a capital transfer from the creditor to the debtor equal to the value of the outstanding debt at the time of cancellation. Likewise the counterpart transaction of debt assumption is another capital transfer. However, excluded are: ...*

(2) Debt cancellation against and debt assumption from a public corporation by government which disappears as an institutional unit in the system. This case is recorded in the other changes in the volume of assets account (see paragraphs 5.16., 6.29. and 6.30.);

(3) Debt cancellation against and debt assumption from a public corporation by government as a part of an ongoing process of privatisation to be achieved in a short term perspective. This case is treated as a transaction in shares and other equity (see paragraph 5.16.);

17.4.3 The second exception paragraph here is inappropriate since British Energy is just being restructured, it is not going to disappear. The third exception is also inappropriate. Government does not own the shares in British Energy (apart from the special shares and a residual holding left over from the 1996 privatisation), so this can't be a transaction in shares. Similarly, the transaction can not be in "other equity" as although Government has a controlling influence it does not have the necessary share or other equity. This exception can therefore be seen as referring to privatisation, where equity is transferred and hence does not apply in this circumstance.

18. Eurostat

18.1 ONS consulted Eurostat before the decision on the sector classification of the restructured British Energy was announced. Eurostat agreed with ONS that the restructured company should be classified as a public non-financial corporation. Copies of ONS's correspondence with Eurostat are available on the National Statistics website at www.statistics.gov.uk/britishenergy.

18.2 Eurostat noted that "there is a substantial list of cases in which the corporation would not be free to act according to the wishes of the shareholders/management. As a matter of example there are significant restrictions on an important factor which is the ability to incur new liabilities. Moreover, there seems to be an 'implicit' equity held by government shown by the obligation by British Energy to pay the Nuclear Liability Fund a pre-agreed part of its profits".

19. Classification of Network Rail

19.1 The classification of British Energy as public sector differs from that of Network Rail, which was classified as private sector. British Energy and Network Rail are different types of corporations. British Energy is a conventional equity-based company and distributes profits to shareholders. Network Rail is a company limited by guarantee and does not have shareholders. The shareholder function of holding the directors to account is performed in companies limited by guarantee by its members. Companies limited by guarantee usually have constitutions that prevent the distribution of profits.

19.2 As a result it is misleading to make direct comparisons between British Energy and Network Rail. For example, a dividend policy could not be compared. However, if a comparison were made on the main points of Government influence, it would yield the results in the following table.

Control Factor	British Energy	Network Rail
Payment of the majority of profits	Yes	No, prevented by constitution
Say in important business decisions	Yes, if resulting in increases in nuclear liabilities	Minority representation on board and membership.
Corporate restructuring and share issuance	Yes, under certain circumstances	Not applicable, prevented by constitution
Financial policy on borrowing	Yes, certain types	No, although in practice any major borrowing has needed Government support
Disposal of assets	Yes, through option to purchase	No, although there are restrictions through the constitution
Dividend policy	Yes, through cash reserves, Nuclear Liability Fund payments and limitation through bond terms	Not applicable, prevented by constitution
Investment strategy for reserves	Yes, consent needed to amend	No

20. National Accounts and the public sector fiscal measures

20.1 The ONS decides on classification issues for the National Accounts, using internationally agreed standards. In Europe these standards are contained in the *European System of Accounts 1995* (ESA95). ESA95 is based on the *System of National Accounts 1993* (SNA93). SNA93 was produced by five international organisations. It was approved by the Statistical Commission of the United Nations. ESA95 was adopted into European Union law by *Council Regulation (EC) No. 2223/96* of 25 June 1996. National Accounts statistics supplied to the European Commission must comply with it. The ONS decided in 1998 to have one version of the United Kingdom National Accounts, consistent with ESA95. It has produced the National Accounts on this basis since September 1998.

20.2 National Accounts classification decisions are consistent with the principles of these international statistical manuals and supporting manuals and case law.

20.3 In the June 1998 *Economic and Fiscal Strategy Report*, the Government introduced the current policy framework for monitoring and controlling the public finances. The three main measures are the public sector surplus on current budget, public sector net borrowing (PSNB) and the ratio of public sector net debt to GDP. The first two of these measures of the Chancellor's fiscal rules either directly use or are closely based on National Accounts' concepts. ONS has responsibility for measuring the fiscal rules, but not defining them or determining the relevance of their application in specific circumstances. HM Treasury accepts ONS decisions on sector classifications in National Accounts to establish which units are within the public sector.

20.4 The National Accounts' measures are based on accruals principles. Before 1998 the public finances were presented on a cash basis, the main measure being the public sector borrowing requirement (PSBR). The PSBR was renamed the public sector net cash requirement (PSNCR) to avoid confusion with PSNB. The cash measure is affected by the sometimes erratic nature of cash receipts and payments and by one-off financial transactions. The National Accounts accruals-based measures exclude such factors and are viewed by Government as providing a better guide to the underlying fiscal position. The National Accounts' definitions also allow for international comparability and consistency with other sectors of the economy. The PSNCR continues to be produced, although it is no longer one of the preferred fiscal measures.

20.5 The European Union also uses a version of net borrowing; in the Growth and Stability Pact and the Excessive Deficit Procedure under the Maastricht Treaty. The European Union measure's definition covers only general government, whereas in the UK the focus is on the public sector, which is defined as general government plus public corporations. Therefore, the reclassification of British

Energy as a public corporation has no impact on the European Union fiscal measures for the general government sector.

21. National accounting and GAAP accounting

21.1 National Accounts and GAAP accounting

21.1.1 ESA95 is designed as an integrated system of economic statistics for the whole economy. It is not used to account for individual entities. It will record each entity only once, otherwise there will be errors in arriving at an aggregated view of the whole economy through double-counting or omission. It also measures relevant assets and liabilities just once, for the same reason.

21.1.2 In the 2002 case of Network Rail there was a lack of understanding as to how two accounting approaches arrived at seemingly contradictory conclusions. The conclusions reached were not alternative ways of looking at the same issue. Rather they were fundamentally different activities undertaken for different purposes using different criteria.

21.1.3 For completeness it is worth recording how these different systems, with their different purposes, judge such cases even though these judgements have no bearing on the National Accounts classification. In the British Energy case there are no apparent differences.

21.1.4 The Financial Reporting Standards that form UK Generally Accepted Accounting Practice (UK GAAP) are based on a private sector model of governance. They are not always directly applicable to public sector entities.

21.2 Whole of Government Accounts

21.2.1 HM Treasury is in the process of developing “Whole of Government Accounts”. These will be commercial-style accounts on an accruals basis covering the whole of the public sector. They are required by the *Government Resources and Accounts Act 2000* to use Generally Accepted Accounting Practice, adapted where necessary for government.

21.2.2 HM Treasury has developed a series of tests of control to assist in determining which bodies should be included in Whole of Government Accounts. These tests have been approved by the independent Financial Reporting Advisory Board. These tests are considered by ONS as consistent with the approach to National Accounts classification. The paper describing them defines the boundary for public sector used in Whole of Government Accounts consistently with that used by National Accounts.

21.2.3 After examining the available evidence and considering the views of the Office for National Statistics and the National Audit Office, the Treasury has concluded that, if it were to prepare Whole of Government Accounts at the current time, they would include a restructured British Energy.

21.3 National Audit Office

21.3.1 The Comptroller and Auditor General has concluded, based upon circumstances extant on 21 September 2004 that, post restructuring, British Energy should be accounted for as a quasi subsidiary of the Department of Trade and Industry. This conclusion is based upon an analysis of the restructuring agreements as currently drafted and relevant accounting standards. In arriving at this conclusion, the Comptroller and Auditor General has focussed on the substance of the proposed restructuring and the underlying commercial effect, as well as its legal form.

21.4 Resource Accounts

21.4.1 Resource accounting is the accrual-based methodology by which individual central government departments produce accounts and budgets. Some other public sector entities, such as Non-departmental Public Bodies, produce accounts based on similar manuals. The boundary for entities that have to produce Resource Accounts will differ from that for the National Accounts central government sub-sector because they fulfil different purposes. It is important to remember here that the

National Accounts sub-sector “central government” covers more than just government departments and ministries, it also covers other central agencies. The Resource Accounts boundary is based on in-year budgetary control. Public corporations are not consolidated into departmental Resource Accounts, although they are included in notes to the accounts, which include lists of entities not consolidated.

21.4.2 It is for individual departments to prepare Resource Accounts in accordance with the *Resource Accounting Manual*. Resource Accounts are subsequently audited by the National Audit Office.

22. Release of information

22.1 Under the National Statistics Code of Practice, all important methodological decisions, and the reasons for them, are to be made publicly available in advance of the release of statistics based upon them. ONS places all sector classification committee decisions on the National Statistics website as soon as possible after any confidentiality implications have been cleared.

23. Contacts

23.1 If you have any questions on statistical classification please contact psa@ons.gov.uk. Any questions on the Government’s policy on British Energy should be referred to the Department of Trade and Industry. The ONS acknowledges the Department of Trade and Industry and the National Audit Office’s assistance in producing this article.

Abbreviations used in the article

BNFL	British Nuclear Fuels
CMFB	Committee on Monetary, Financial and Balance of Payments Statistics
ESA95	European System of Accounts (1995)
GAAP	Generally accepted accounting practice
GDP	Gross domestic product
HM	Her Majesty’s
Ltd	Limited
NACC	National Accounts Classification Committee
NLF	Nuclear Liabilities Fund
NLFA	Nuclear Liabilities Funding Agreement
No.	Number
ONS	Office for National Statistics
PSBR	Public Sector Borrowing Requirement
PSNB	Public Sector Net Borrowing
PSNCR	Public Sector Net Cash Requirement
SNA93	System of National Accounts (1993)
UK	United Kingdom
USA	United States of America