

## Certification of transmission system operators under the Third Package - consultation

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**Target audience:**

Consumers and their representatives, electricity and gas transmission and distribution companies, generators and offshore producers, gas shippers, energy suppliers, government, the city and other interested parties.

**Overview:**

Ofgem seeks views on the new requirement under the European Third Package of energy legislation for Great Britain's gas and electricity transmission networks to unbundle from gas production, electricity generation and supply interests.

The objective of the Third Package, which entered into force in September 2009, is to further liberalise European energy markets. The Department of Energy and Climate Change (DECC) is primarily responsible for transposition of the Third Package provisions into national law. Ofgem, assuming we will be designated as the national regulatory authority by DECC, will be required to certify transmission system operators as being in compliance with the full ownership unbundling requirements or one of the alternative unbundling models set out in the Third Package. This is the focus of this consultation.

The unbundling requirements apply to the electricity and gas transmission system operators. For the purposes of licensees in Great Britain, we understand this to mean transmission licensees (including future offshore transmission licensees) and electricity and gas interconnector licensees. The Authority must have certified all transmission system operators as being in compliance by March 2012 (or March 2013 in certain limited circumstances).

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## Context

The term "Third Package" refers to a package of EU legislation on European electricity and gas markets. It entered into force on 3 September 2009. The purpose of the Third Package is to liberalise further European energy markets. DECC is primarily responsible for its transposition in Great Britain and must do this by 3 March 2011.

A key aspect of the Third Package is the requirement for a greater separation of transmission interests from generation, production and supply interests. It sets out three models for ownership unbundling, with a further derogation allowed provided certain criteria are satisfied. Member States must implement the requirements to allow transmission system operators to be ownership unbundled. However, they may choose which of the additional options they will transpose. National regulatory authorities are required to certify transmission system operators as compliant with one of the options available.

Ofgem's role will be to certify Great Britain's transmission system operators. This consultation seeks views on the arrangements of the transmission system operators and their compliance with the unbundling requirements. We committed to consult on unbundling under our Corporate Plan in March. TSOs are obliged to be certified as compliant with the unbundling requirements by 3 March 2012, with an additional 12 months in certain circumstances.

## Associated Documents

- The Third Package legislation, available at:  
[http://ec.europa.eu/energy/gas\\_electricity/third\\_legislative\\_package\\_en.htm](http://ec.europa.eu/energy/gas_electricity/third_legislative_package_en.htm)
- European Commission staff working paper on Notes for the implementation of the Electricity Directive 2009/72/EC and the Gas Directive 2009/73/EC, 22 January 2010. Available at:  
[http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/interpretative\\_note\\_en.htm](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm)
- Department of Energy and Climate Change, Consultation on the Implementation of the EU Third Internal Energy Package, 27 July 2010. Available at:  
[http://www.decc.gov.uk/en/content/cms/consultations/imp\\_eu\\_third/imp\\_eu\\_third.aspx](http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx)
- Department of Enterprise, Trade and Investment (NI) Consultation on Implementation of unbundling provisions of the 2009 Electricity Directive (2009/72/EC) and Consultation on Implementation of unbundling provisions of the 2009 Gas Directive (2009/73/EC), December 2009. Available at:  
[http://www.detini.gov.uk/consultations\\_on\\_the\\_implementation\\_of\\_unbundling\\_provisions\\_of\\_the\\_2009\\_electricity\\_directive\\_2009\\_72\\_ec\\_and\\_the\\_2009\\_gas\\_directive\\_2009\\_73\\_ec\\_3](http://www.detini.gov.uk/consultations_on_the_implementation_of_unbundling_provisions_of_the_2009_electricity_directive_2009_72_ec_and_the_2009_gas_directive_2009_73_ec_3)

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## Summary

The purpose of the Third Package, which entered into force on 3 September 2009, is to liberalise further European energy markets. DECC is primarily responsible for transposition of the Third Package in Great Britain by 3 March 2011.

It requires transmission systems and transmission system operators to be unbundled from generation, production and/or supply undertakings. This must either be achieved through full ownership unbundling, an independent system operator model, an independent transmission operator model, or an Article 9(9) derogation from ownership unbundling.

The regulatory authority is required to certify transmission system operators as compliant with the unbundling arrangements implemented in that Member State. We understand that DECC is minded to make all the unbundling options available, though it is considering the case for not making the independent transmission system operator model (as it consider that it may not be compatible with the market framework). However, for the Authority to certify a transmission system operator as compliant with one of these unbundling options, it must establish whether the arrangements meet the relevant requirements provided for in the Third Package. This consultation therefore seeks to solicit views from stakeholders on the transmission system operators' compliance with the unbundling requirements. To do this, we set out the arrangements relating to the transmission system operators we anticipate having to consider and provide, where appropriate, our initial assessment of compliance with the Third Package. Specifically, we consider the ownership arrangements of:

- National Grid plc, including National Grid Electricity Transmission plc, National Grid Gas plc and National Grid Interconnector Limited, and BritNed Development Limited, the electricity interconnector owner between GB and the Netherlands. They have indicated that they wish to be considered for certification under the full ownership unbundling model;
- The gas interconnectors, specifically the BBL Company Limited and Interconnector (UK) Limited, who have some shareholders that have shipping interests and/or are vertically integrated. The European Commission has indicated that interconnectors with an Article 22 exemption under the Second Gas Directive<sup>1</sup> are exempt from the unbundling provisions for the duration of the exemption. As such, our initial view is that the BBL Company Limited is exempt from the unbundling provisions for the duration of its exemption. While Interconnector (UK) Limited does not have a formal exemption under the Second

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<sup>1</sup> The term "Second Gas Directive" refers to Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

Gas Directive, we consider that a comfort letter it received in 1995 from the European Commission is akin to a Second Gas Directive exemption and, as such, it should therefore be treated in the same manner as other exempt interconnectors. We also set out our proposed approach to the operators of transmission lines linking GB with Northern Ireland and the Republic of Ireland;

- Offshore Transmission Owners. Our current view is that Offshore Transmission Owners will be covered by the Third Package and therefore subject to the unbundling requirements. This means that any new Offshore Transmission Owners must be fully ownership unbundled. Successful bidders in the current transitional round and any future rounds, which are awarded offshore transmission owner licences, will subsequently be required to comply with the unbundling provisions in order for the Authority to certify them by 3 March 2012; and
- The Scottish electricity transmission companies, Scottish Hydro Electric Transmission Limited and SP Transmission Limited, which have both indicated that they wish to be considered for certification under the Article 9(9) derogation. For the purpose of the consultation, we summarise the main provisions of the independent transmission operator model. We then set out the arrangements with respect to the separation of tasks between the Scottish electricity transmission companies and the independent system operator, National Grid, and the obligations for ring-fencing arrangements within the vertically integrated undertaking. We do not set out a minded-to decision but instead welcome views on whether the Scottish transmission arrangements satisfy the test for an Article 9(9) derogation.

## Next steps

We strongly encourage industry participants and others to respond to the questions this document raises and the options proposed. We will continue to develop our thinking regarding the appropriate certification of transmission system operators, in coordination with the undertakings concerned and, where appropriate, with other regulatory authorities and the European Commission. Depending on these developments, we reserve the right to consult again on these matters if appropriate. Subject to transposition of the Third Package as anticipated, we envisage reaching decisions in early 2011, which we would notify to the European Commission as required. As required by the Third Package, our final certification decisions and the European Commission's opinions will be published together.

## 1. Introduction and background

### Chapter Summary

This chapter provides an overview of the Third Package and Ofgem's role in the certification process.

### The Third Package - overview

1.1. The term "Third Package" refers to a package of EU legislation on European electricity and gas markets. This consists of the following pieces of legislation:

- Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, herein referred to as the "Electricity Directive";
- Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003, herein referred to as the "Electricity Regulation";
- Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, herein referred to as the "Gas Directive";
- Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, herein referred to as the "Gas Regulation"; and
- Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, herein referred to as the "Agency Regulation"<sup>2</sup>.

1.2. The purpose of the Third Package is to further liberalise European energy markets. It entered into force on 3 September 2009 and Member States have a period of 18 months (until 3 March 2011, with an additional 12 months (3 March

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<sup>2</sup> The Electricity Directive and the Gas Directive are together referred to as "the Directives". The Electricity Regulation, the Gas Regulation and the Agency Regulation are together referred to as "the Regulations".

2012) for the unbundling provisions<sup>3</sup>) to implement the provisions of the Third Package into national law. In Great Britain (GB), DECC is primarily responsible for this.

1.3. A key aspect of the Third Package is the requirement for a greater separation of transmission interests from generation, production and/or supply interests. In the European Commission's view, without effective separation of transmission networks from the activities of generation, production and supply, there is an inherent risk of discrimination not only in the operation of the network but also in the incentives for vertically integrated undertakings to invest adequately in their networks. DECC is required to ensure transmission system operators (TSOs)<sup>4</sup> in GB are unbundled in compliance with the provisions of the Third Package. Prior to designating TSOs, Ofgem, assuming we will be designated as the national regulatory authority in GB, will be required to certify them as compliant with one of the unbundling models (or with the "derogation" discussed below)<sup>5</sup>.

1.4. DECC is responsible for transposing the unbundling provisions into national legislation. In addition to the ownership unbundling model, DECC is minded to make both the independent system operator model and the Article 9(9) derogation available. However, it has stated that it is considering the case for not making the independent transmission operator model available on the grounds that it may not be compatible with the market framework. The process for certification, including relevant information gathering powers, and the provision of the necessary vires for certification in national law is also a matter for DECC. It is currently considering this as part of its consultation on the implementation of the Third Package. We are liaising closely with DECC on these matters.

1.5. This consultation solicits views from stakeholders on GB TSOs' compliance with the unbundling requirements provided in the Third Package. To do this, we set out the arrangements relating to the TSOs we intend considering and provide, where appropriate, our initial assessment of compliance with the Third Package unbundling provisions. Specifically, we address the ownership arrangements of:

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<sup>3</sup> Or 24 months (3 March 2013) if, as provided for under Article 9(4) of the Directives, Member States approve and the transmission system operator is not part of a vertically integrated undertaking.

<sup>4</sup> Under Article 1 of the Electricity Directive, "transmission system operator" means a natural or legal person who carries out the function of transmission and is responsible for operating, ensuring the maintenance of and, if necessary, developing the transmission system in a given area and, where applicable, its interconnection with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity. Under Article 1 of the Gas Directive, "transmission system operator" means a natural or legal person who carries out the function of transmission and is responsible for operating, ensuring the maintenance of and, if necessary, developing the transmission system in a given area and, where applicable, its interconnection with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transport of gas.

<sup>5</sup> In accordance with Article 10 of the Directives and Article 3 of the Regulations. We understand that DECC intend designating Ofgem as the national regulatory authority for the purpose of the Third Package - this is addressed as part of DECC's consultation. Should Ofgem be designated as the national regulatory authority, it will be responsible for certification.

- National Grid plc, including National Grid Electricity Transmission plc, National Grid Gas plc, National Grid Interconnectors Limited and BritNed Development Limited, the joint venture between National Grid International Limited, a wholly owned subsidiary of National Grid plc and NLink International B.V., a wholly owned subsidiary of TenneT Holding B.V.;
- the BBL Company Limited (which operates the gas interconnector between GB and the Netherlands, BBL) and Interconnector (UK) Limited (which operates the gas interconnector between GB and Belgium, Interconnector (UK)). We also set out our proposed approach to the operators of electricity transmission lines and interconnectors connecting GB with Northern Ireland and the Republic of Ireland;
- Offshore Transmission Owners (OFTOs)<sup>6</sup>; and
- Scottish Hydro-Electric Transmission Limited (SHETL) and SP Transmission Limited (SPTL), the electricity transmission companies in Scotland.

1.6. With respect to certification of TSOs in Northern Ireland, the Northern Irish authorities are responsible for this<sup>7</sup>.

1.7. This consultation does not address the unbundling provisions regarding distribution system operators or storage system operators as it is concerned with the unbundling provisions GB TSOs are subject to.

## Unbundling provisions

### The unbundling models and the Article 9(9) derogation

1.8. The unbundling provisions seek to achieve greater separation of transmission interests (ownership and operation of transmission systems) from generation, production and/or supply activities<sup>8</sup>. As such, it requires that any system for unbundling should be effective in removing any conflict of interests between generators, gas producers, suppliers and transmission owners/TSOs, in order to create incentives for the necessary investment, guarantee the access of new market entrants under a transparent and efficient regulatory regime and not create an overly onerous regulatory regime for the regulatory authorities.

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<sup>6</sup> Offshore gas networks are not covered by the Third Package as Article 2(3) of the Gas Directive defines transmission as "the transport of natural gas through a network, which mainly contains high-pressure pipelines, other than an upstream pipeline network".

<sup>7</sup> Under Article 35(3) of the Electricity Directive and Article 39(3) of the Gas Directive, by way of derogation to the requirement to designate a single national regulatory authority, a Member State may designate regulatory authorities for small systems on a geographically separate region. We understand that DECC intend designating the Northern Ireland Authority for Utility Regulation (NIAUR) as the regulatory authority for Northern Ireland.

<sup>8</sup> The Third Package uses the term "gas production" but this is not defined. In GB, the term gas shipper refers to a person who arranges with a gas transporter for gas to be introduced into, conveyed by means of or taken out of a pipe-line system operated by that transporter (Gas Act 1986, Section 5(1)(c)). We understand the term "gas production" to encompass also the activity of gas shipping.

1.9. To address this, the Third Package sets out three models for ownership unbundling - the full ownership unbundling model (OU model); the independent system operator model (ISO model); and the independent transmission operator model (ITO model). The Third Package also allows for a derogation from the OU model provided certain criteria are satisfied. The ISO, ITO and derogation are available only to transmission systems which belonged to a vertically integrated undertaking on 3 September 2009<sup>9</sup>. It is for the Member State to decide whether the ISO and ITO models and the Article 9(9) derogation are available to TSOs. DECC is currently consulting on which models to implement into national legislation.

1.10. An overview of the main elements of each of the unbundling models is set out in summary form below.

#### *OU model*

1.11. The intention behind this model is that the transmission system is required to be owned and operated by an undertaking that is completely independent from generation, gas production and/or supply interests. The legal test requires that:

- The transmission owner acts as a TSO of the transmission system; and
- The same person or person cannot:
  - directly or indirectly exercise control over an undertaking performing any of the functions of generation, production and/or supply, and directly or indirectly exercise control or exercise any right over a TSO or over a transmission system; or
  - directly or indirectly exercise control over a TSO or over a transmission system, and directly or indirectly exercise control or exercise any right over an undertaking performing any of the functions of generation, production and/or supply<sup>10</sup>.

1.12. Exercising rights includes:

- the power to exercise voting rights;
- the power to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking; or
- the holding of a majority share<sup>11</sup>.

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<sup>9</sup> This is the date the Directives came into force.

<sup>10</sup> Article 9(1) of the Directives.

<sup>11</sup> Article 9(2) of the Directives.

1.13. This requirement is applicable across both the electricity and gas industries so that, for example, a person with voting rights in an electricity generation or a supply undertaking cannot exercise control over a gas transmission system<sup>12</sup>.

1.14. The requirements of the OU model are deemed to be fulfilled where two or more undertakings which own transmission systems have created a joint venture which acts as a TSO in two or more Member States for the transmission systems concerned<sup>13</sup>.

1.15. We have concerns that, read literally, the lack of qualifications in these prohibitions could render them unworkable and unenforceable. For example, an individual shareholder owning a small generator (even in another Member State) who holds a single share in a TSO could preclude the TSO being considered ownership unbundled. This appears disproportionate. We are working with DECC and, as appropriate, other national regulatory authorities and the European Commission, to seek a pragmatic interpretation which preserves the desire for a strict application but which is workable in practice.

#### *ISO model*

1.16. Where the transmission system belonged to a vertically integrated undertaking on 3 September 2009, a Member State may decide not to apply the OU model and, once the TSO has been certified by the regulatory authority as compliant with the ISO model, designate it as an ISO<sup>14</sup>.

1.17. Under the ISO model, the independent system operator is responsible for:

- granting and managing third-party access, including the collection of access charges, congestion charges and payments under the inter-transmission system operator compensation mechanism<sup>15</sup>;
- operating, maintaining and developing the transmission system;
- ensuring the long-term ability of the system to meet reasonable demand through investment planning; and
- planning, construction and commissioning of new infrastructure.

1.18. The transmission system owner is responsible for:

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<sup>12</sup> Article 9(3) of the Directives.

<sup>13</sup> Article 9(5) of the Directives.

<sup>14</sup> Article 9(8) of the Directives.

<sup>15</sup> The inter-transmission compensation (ITC) mechanism refers to an EU-wide payment system to compensate TSOs for hosting cross-border electricity flows.

- providing all the relevant cooperation and support to the ISO for the fulfilment of its tasks;
- financing the investments decided by the ISO and approved by the regulatory authority;
- providing for the coverage of liability relating to the network assets; and
- providing guarantees to facilitate financing of any network expansions, excluding those investments where it has given its agreement to have financed by any interested party.

1.19. Where an ISO has been appointed, the transmission system owner, which is part of a vertically integrated undertaking, is required to be independent at least in terms of its legal form, organisation and decision-making from other activities not relating to transmission<sup>16</sup>.

#### *The ITO model*

1.20. Where the transmission system belonged to a vertically integrated undertaking on 3 September 2009, a Member State may decide not to apply the OU model but apply the ITO model instead, if the regulatory authority certifies the TSO as being in compliance with that model<sup>17</sup>. Under the ITO model, the ITO's responsibilities include granting and managing third-party access, collection of all transmission system related charges, the operation, maintenance and development of a secure, efficient and economic transmission system and investment planning<sup>18</sup>. In doing this, the ITO is required to have appropriate ring-fencing requirements. The ITO may remain part of the vertically integrated undertaking, provided effective unbundling is achieved through the effective separation of the ITO from the vertically integrated undertaking. Both the ITO's responsibilities and the ring-fencing requirements are addressed in further detail in Chapter 3.

#### *The Article 9(9) derogation*

1.21. The Third Package also provides for a derogation from these models in the event that, on 3 September 2009, the transmission system belonged to a vertically integrated undertaking and the arrangements in place at that time guarantee more effective independence of the TSO than the ITO model<sup>19</sup>. This is also addressed in further detail in Chapter 3.

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<sup>16</sup> Article 14(1) of the Electricity Directive and Article 15(1) of the Gas Directive. The Gas Directive is in fact broader and requires such independence from activities not relating to transmission, distribution and storage.

<sup>17</sup> As set out in Chapter V of the Electricity Directive and Chapter IV of the Gas Directive.

<sup>18</sup> These are set out in full in Articles 12 and Article 17 of the Electricity Directive and Article 13 and Articles 17 of the Gas Directive.

<sup>19</sup> As provided for under Article 9(9) of the Electricity and Gas Directives.

## Certification process

1.22. The regulatory authority is required to notify the European Commission of its explicit or tacit decision on the certification of a TSO. The European Commission then has two months in which to examine the decision and to deliver an opinion as to the compatibility of the decision with the unbundling requirements and the certification requirements to the regulatory authority. During this period, it may also request the European Agency for the Cooperation of Energy Regulators (the European Agency or ACER), which will have formal powers from March 2011, to provide an opinion on the regulatory authority's decision. This would extend the timeline by a further two months. Within two months of receiving an opinion from the European Commission, the regulatory authority shall adopt a final decision regarding certification, taking utmost account of the European Commission's opinion. In the absence of an opinion, the European Commission is deemed not to raise objections to the regulatory authority's decision and the Member State approves and designates the TSO according to the unbundling model it has been certified under by the regulatory authority. With respect to certification under the Article 9(9) derogation, the European Commission's opinion on the regulatory authority's decision is binding and, as such, the regulatory authority is obliged to comply with it; essentially, the European Commission may exercise a power of veto over the regulatory authority's decision regarding the Article 9(9) derogation<sup>20</sup>.

1.23. The regulatory authority is obliged to notify the European Commission if certification is requested by a TSO or transmission system owner which is controlled by a person or persons from a third country/countries<sup>21</sup>. Further notification is required without delay if any circumstances arise which would result in such a person/s acquiring control of a transmission system/TSO. In addition to ensuring that the entity complies with the unbundling requirements, the regulatory authority must only certify the TSO if it has been demonstrated to the regulatory authority or otherwise to the Member State that granting certification would not put at risk the security of supply of the Member State and the Community. The European Commission is also obliged to consider the specific facts of the case and the third country or countries. It may request the views of the European Agency, the Member State concerned and interested parties in considering its opinion<sup>22</sup>.

1.24. Assuming we will be designated as the regulatory authority for GB, the Authority is required to certify GB TSOs as being in compliance with one of the unbundling models provided for by DECC<sup>23</sup>. TSOs must be compliant with the

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20 For a full explanation of the process for certification, see Article 10 of the Directives and Article 3 of the Electricity and Gas Regulations.

21 A third country refers to any country that is not a Member State of the EU.

22 For a full explanation of the certification process in relation to third countries, see Articles 11 of the Directives.

23 The certification process is set out in Article 10 of the Directives and Article 3 of the Regulations.

relevant unbundling model by 3 March 2012<sup>24</sup>. The deadline for implementation of the Third Package provisions (including those relating to certification) is 3 March 2011; the Regulations do not apply until 3 March 2011, from which point the European Commission will be able to engage formally in the certification process.

1.25. It is our view that the Third Package requires all TSOs - whether designated under the Second Package or otherwise - to be assessed with respect to their compliance with the unbundling arrangements<sup>25</sup>. This is the only reading which permits an assessment by the regulatory authority and the European Commission and ultimate designation by the Member State, as envisaged by the Third Package. For the purpose of a new TSO, we consider that it should be certified before it commences the activity of transmission - it is not necessary that certification is required during the construction phase.

1.26. In Section 2 below we set out our preliminary view on the compliance of GB TSOs which will require certification under the Third Package unbundling provisions.

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24 Or by 3 March 2013 for those which have been allowed a derogation for a further year, provided for under Article 9(4) of the Directives.

25 This is supported by the European Commission's Interpretative note which states that "These rules must be applied to all TSOs for their initial certification"; Commission staff working paper, Interpretative note on The Unbundling Regime, p22.

## 2. Unbundling models for GB TSOs

### Chapter Summary

This chapter addresses the ownership arrangements of National Grid plc, GB gas interconnectors, BBL and Interconnector (UK), and the future OFTOs and discusses how they may be able to comply with the ownership unbundling models set out in Chapter 1.

### Question box

Question 1: Have we correctly identified the GB TSOs that require certification? Are there other TSOs that would require certification?

Question 2: Are there reasons why the subsidiaries of National Grid plc that act as TSOs should not be certified according to the OU model? What are these?

Question 3: What do you think of our proposed approach to certifying the various interconnectors?

Question 4: Do you agree that OFTOs should require certification with respect to the unbundling provisions and be obliged to comply with the ownership unbundling model (with possible exceptions noted below)?

## National Grid

2.1. National Grid plc ("National Grid") is an international electricity and gas company. In GB, it has gas and electricity transmission, gas distribution, LNG re-gasification and storage interests and some generation interests. It also provides energy as part of its property interests. National Grid also has some generation and supply interests in the United States (US).

### *Transmission interests*

2.2. In GB, National Grid has electricity transmission, gas transmission and electricity interconnector interests. These activities are regulated and relate to the following entities which are licensed in GB:

- National Grid Electricity Transmission plc (NGET), which holds an electricity transmission licence permitting it to develop, maintain and operate the high voltage electricity transmission system within the specific transmission area of England and Wales. NGET is also permitted under the electricity transmission licence to carry out System Operator (SO) activities across the national electricity transmission system of GB, which includes onshore high voltage electricity wires and offshore high voltage wires;
- National Grid Gas plc (NGG), which holds a gas transmission licence permitting it to develop, maintain and operate the gas transmission system across GB. This includes system operation activities across GB; and

- National Grid Interconnector Limited (NGIL), which holds an electricity interconnector licence permitting it to own and operate the 2,000MW high voltage direct current link between the French and GB transmission systems, Interconnexion France Angleterre (IFA).

2.3. NGIL shares ownership and operation of the IFA with RTE, the French electricity TSO. As NGIL is the licensed entity in GB, we will be required to certify NGIL. The French authorities shall be responsible for certifying RTE.

2.4. National Grid International Limited, a wholly owned subsidiary of National Grid, has a joint venture with NLink International B.V., a wholly owned subsidiary of TenneT Holding B.V., the electricity TSO in the Netherlands, to construct and operate BritNed, the electricity interconnector connecting the electricity transmission systems in the Netherlands and GB. This is expected to become operational by 2011. Assuming that the joint venture company remains the relevant entity (i.e. the licensed undertaking in respect of the interconnector in both GB and the Netherlands), we will seek to jointly certify BritNed with the Dutch authorities.

2.5. National Grid and BritNed have indicated they wish to be considered for certification under the OU model.

2.6. In considering our approach to certification, we are conscious of the purpose of the OU model<sup>26</sup>. The aim of ownership unbundling is to resolve an inherent conflict of interest, to ensure non-discriminatory access to the network and to promote investments in infrastructure in a non-discriminatory way. The strictest literal reading of the Directives may require a TSO to divest all of its generation, production and supply interests to achieve independence from these activities, whatever their purpose. However, in order for National Grid to comply with its obligation in the Directives to maintain and develop under economic conditions secure, reliable and efficient transmission systems, it may need to carry out certain ancillary supply and generation activities, provided the purpose behind ownership unbundling is achieved.

2.7. National Grid, in its role as TSO, is involved in the provision of electricity to its own transmission sub-stations and has stand-by generation in case of electricity supply failure at its own sites. We consider that these activities are ancillary to its function as TSO and do not give rise to any difficulties with regard to certification.

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<sup>26</sup> This is set out in Recital (11) of the Electricity Directive and Recital (8) of the Gas Directive, which states that "Only the removal of the incentive for vertically integrated undertakings to discriminate against competitors as regards network access and investment can ensure effective unbundling. Ownership unbundling, which implies the appointment of the network owner as the system operator and its independence from any supply or production interests, is clearly an effective and stable way to solve the inherent conflict of interests and to ensure security of supply. For that reason, the European Parliament (...) referred to ownership unbundling at transmission level as the most effective tool by which to promote investments in infrastructure in a non-discriminatory way, fair access to the network for new entrants and transparency in the market".

### *Other activities*

2.8. However, there are three areas where National Grid has activities relating to generation and/or supply that are more distinct:

- its business in the US;
- its joint venture Blue-NG Limited; and
- provision of electricity to third parties on National Grid sites.

### *Interests outside the EU*

2.9. National Grid has a number of interests in the US, including electricity transmission, gas distribution, LNG and storage and electricity generation. It is also responsible for the purchase and sale of electricity and the supply of the electricity it produces as part of its agreement with the Long Island Power Authority<sup>27</sup>.

2.10. DECC has indicated that any restriction it intends placing on licensees, through national legislation, from engaging in activities that would contravene the unbundling provisions would not apply to involvement in undertakings outside the EU. On that basis, we do not consider these activities to be relevant to the test for ownership unbundling. Furthermore, we note that the electricity transmission systems in the US have little scope to be physically connected to the electricity transmission systems in the EU and, as such, National Grid's interests in generation and supply of electricity would not appear to frustrate the objective of ownership unbundling.

### *Generation interests in GB*

2.11. NGG has a joint venture with 2OC, Blue-NG Limited (Blue-NG), to operate power stations generating renewable electricity produced from rape seed oil at certain NGG gas distribution pressure reduction sites<sup>28</sup>. There are plans to test this at up to 8 NGG distribution sites, with potential to extend further if this is successful. The first two sites are at Beckton and Southall. The generation capacity of each will be around 18MW and will be connected to the distribution network at relatively low voltages (11kV and 33KV respectively). The power will be sold under a Power Purchase Agreement to a third-party electricity supplier.

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<sup>27</sup> See <http://www.nationalgrid.com/>.

<sup>28</sup> See <http://www.blue-ng.com/blueng/home/how-do-blue-ng-do-it>.

2.12. In April 2008, we consulted on National Grid's proposal to commence generating electricity at gas distribution sites<sup>29</sup>. In our response, published in October 2008, we highlighted the potential ownership unbundling requirements of the Third Package, which was being drafted and was under discussion at the time. We stated that the Third Package, should it come into force, would supersede national law, which does not currently prohibit TSOs from having affiliates with generation interests<sup>30</sup>.

2.13. Irrespective of the potential benefits of Blue-NG, our initial view is that National Grid will have to divest of it in order to comply with the OU model. This is on the basis that it may represent scope for a conflict of interest for National Grid's transmission business which could thus frustrate the objective of the OU model. Furthermore, it is not technically necessary that National Grid undertake this activity. We invite views on our assessment of the compatibility of Blue-NG against the OU model.

2.14. National Grid has suggested that it may request a derogation pursuant to Article 9(4) of the Electricity Directive, which allows Member States to approve a derogation from full ownership unbundling until 3 March 2013. This derogation is only available if the TSO is not part of a vertically integrated undertaking. The choice to allow National Grid the Article 9(4) derogation is a matter for DECC; it has indicated that it intends to implement this derogation into national legislation. Ofgem will need to know the result of this decision prior to taking decisions on certification of the relevant National Grid companies.

#### *Provision of electricity*

2.15. NGET is prohibited from purchasing or otherwise acquiring electricity for the purpose of sale or other disposition to third parties<sup>31</sup>. However, it has some interests which we have consented to, including the purchase or acquisition of electricity for the purpose of selling or other disposition to third parties.

2.16. Energis Communications Limited (Energis) is a provider of commercial telecommunications services. National Grid is one of its customers to which it

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29 Specifically, we considered whether the Authority should issue consent under NGG's gas transmission licence with respect to disposal of assets (Standard Special Condition A27) and Indebtedness (Standard Special Condition A39). See

<http://www.ofgem.gov.uk/Networks/GasDistr/otherwork/Documents1/NGG%20Blueng%20Open%20letter.pdf>.

30 Specifically, we stated that "A number of respondents highlighted in their responses the impact of the proposed 3rd Electricity Directive, which if implemented as currently drafted clearly prohibit Transmission System Operators (TSOs) from being involved in generation activities either directly or indirectly. With regards to the way National Grid Electricity Transmission's licence is currently worded there is no prohibition on the proposed arrangement, however, this may be superseded if a European Directive is passed which is subsequently passed into UK law." Available at:

<http://www.ofgem.gov.uk/Networks/GasDistr/otherwork/Documents1/Blue-ng%20decision%20doc%2020081031.pdf>.

31 Standard Licence Condition (SLC) C2 of the transmission licence.

provides operational telecoms and protection signalling for transmission circuits using fibre-optic cables installed at 66 of NGET's substations. In turn, National Grid provides electricity to Energis at these substations. In 2007, at the time of consent<sup>32</sup>, the electricity supplied amounted to under 4GWh, worth less than £200,000<sup>33</sup>. Our initial view is that this activity is compatible with the OU model on the grounds that the service provided by Energis is part of system operation and the costs of installing independent supplies would be both uneconomic and inefficient. The purpose behind the OU model is not jeopardised, as there is no actual or potential conflict of interest. We invite views on our assessment of the compatibility of this activity against the OU model.

2.17. National Grid also provides electricity to tenants or sub-tenants at its own non-operational sites amounting to £250,000 for 2008/09<sup>34</sup>. This is in line with normal commercial practice for landlords. Our initial view is that this activity is not necessary in order for National Grid to undertake its role as a TSO. However, we also recognise that this activity is unlikely to represent scope for a conflict of interest. As such, we invite views on how we should address this activity.

## Interconnectors

2.18. In addition to IFA and BritNed, GB has other electricity and gas interconnectors which connect the GB transmission system to the transmission systems in Northern Ireland, the Republic of Ireland, the Netherlands and Belgium<sup>35</sup>. There is also potential for future links to at least Ireland, Belgium, Norway and France<sup>36</sup>. Interconnectors are captured by the definition of a TSO, which includes natural or legal persons responsible for the interconnection of the transmission system with other systems. Besides NGIL (which is addressed above), TSOs that currently connect GB to another Member State or to a geographically separate region within the UK include:

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32 The consent relating to Energis Communications is available at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=5&refer=Licensing/Work/Notices/Decisions>.

33 National Grid has indicated that these amounts have not materially changed since this date.

34 The consent relating to National Grid's property arrangements is available at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=5&refer=Licensing/Work/Notices/Decisions>.

35 We refer to the transmission lines that connect the transmission system in GB to the transmission system in Northern Ireland as interconnectors. However, under the Gas Directive, interconnectors refer to "a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States" (Article 1(17) of the Gas Directive). Under the Electricity Directive, interconnector means "equipment used to link electricity systems" (Article 1(13)). Whilst Moyle and SNIP are sub-sea interconnectors, they do not cross or span the border between Member States; they connect two geographical regions within the same Member State and as such, fall within the definition of transmission rather than interconnection under the Directives (Article 2(3) and (14) of the Electricity Directive and Article 2(3) and (17) of the Gas Directive).

36 For a full description of existing, planned and future interconnection see Table 1 of our Electricity interconnector policy consultation paper. Available at: <http://www.ofgem.gov.uk/Europe/Documents1/Interconnector%20policy%20consultation.pdf>.

- Moyle Interconnector Limited and Premier Transmission Limited, which are licensed to participate in the operation of, respectively, the Moyle electricity interconnector and the SNIP gas interconnector between GB and Northern Ireland;
- BGE (UK) Limited, which is licensed to participate in the operation of IC 1 and IC 2 ("Moffat interconnectors"), the gas interconnectors between GB and Ireland;
- BBL Company Limited, which is licensed to participate in the operation of the BBL gas interconnector between GB and the Netherlands; and
- Interconnector (UK) Limited, which is licensed to participate in the operation of the Interconnector (UK) gas interconnector between GB and Belgium.

#### *Interconnection with Ireland*

2.19. With respect to the TSOs in Northern Ireland, including those that operate the transmission lines connecting Northern Ireland with GB, DECC has confirmed that the Northern Irish authorities will be responsible for their certification.

2.20. Regarding IC 1 and IC 2, BGE (UK) Limited is owned by Bord Gáis Networks, which in turn is owned by Bord Gáis Éireann (BGE). As BGE will need to be certified by the authorities in the Republic of Ireland regarding its transmission system in Ireland, we anticipate these authorities leading on the certification of BGE. However, as BGE (UK) also has a GB interconnector licence, we anticipate cooperating with the authorities in the Republic of Ireland in the certification relating to IC 1 and IC 2, where necessary and appropriate.

2.21. East West Cable One Limited, Eirgrid plc and Imera Hydragrid Limited (now Imera Limited) also hold GB electricity interconnector licences. We anticipate considering their certification, in cooperation with the authorities in the Republic of Ireland, prior to any entering into operation.

#### *BBL Company and Interconnector (UK)*

2.22. In our view, the BBL Company Limited (BBL Company) and Interconnector (UK) Limited (Interconnector (UK)) are both captured by the definition of a TSO under the Third Package and will therefore potentially fall within the scope of the unbundling provisions. We are cooperating with the Dutch authorities regarding the certification of BBL Company and with the Belgian authorities regarding the certification of Interconnector (UK), and discussing these issues with the European Commission.

2.23. We do not at this stage have a firm position on the certification of these entities as discussions are continuing. However, to allow respondents to give their views on potential outcomes of this process, we summarise briefly here the

ownership position of the two entities and some of the key considerations as we now see them.

2.24. BBL Company is a joint venture of three undertakings<sup>37</sup>:

- Gasunie BBL B.V., which is part of a corporate group which has gas transmission interests in the Netherlands and Germany, with a 60 per cent share;
- Fluxys BBL B.V., which is part of a corporate group which has gas transmission interests in Belgium, with a 20 per cent share; and
- E.On Ruhrgas BBL B.V., which is part of a group which has transmission, shipping, generation and supply interests, with a 20 per cent share.

2.25. Interconnector (UK) is jointly owned by eight shareholders<sup>38</sup>, including:

- La Caisse de dépôt et placement du Québec, a Canadian fund management company, with a 23.5 per cent share;
- CDP Investissements, a subsidiary of the above, with a 10 per cent share;
- E.On Ruhrgas, which has transmission, generation, shipping and supply interests, with a 15.09 per cent share;
- Distrigas, which has supply interests, with a 11.41 per cent share;
- ConocoPhillips, which has gas storage interests, with a 10 per cent share;
- Fluxys, which has transmission interests, with a 15 per cent share;
- Gazprom, which has transmission, shipping and supply interests, with a 10 per cent share; and
- ENI, which has transmission and supply interests, with a 5 per cent share.

2.26. In each case, we understand that the shareholders exercise voting rights and can appoint directors to the Board. As such, these shareholders exercise a right over a TSO (the interconnector) and some exercise control of a generation, production and/or supply business.

2.27. In 2005, BBL Company was granted an exemption under Article 22 of the Second Gas Directive, which allows for major new infrastructure to be exempted from the provisions relating to third-party access and approval of charging methodologies provided that certain criteria are met. A similar provision on new infrastructure is contained in Article 36 of the Gas Directive which provides for an exemption from the ownership unbundling arrangements.

2.28. Following a COREPER<sup>39</sup> meeting in June 2009, the European Commission stated that, "Exemptions from the regulatory regime granted under the existing Directive

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<sup>37</sup> [www.bblcompany.com/](http://www.bblcompany.com/), as of July 2010.

<sup>38</sup> [www.interconnector.com/company/shareholders.htm](http://www.interconnector.com/company/shareholders.htm), as of July 2010.

2003/55/EC (...) for new cross-border infrastructure continue to apply until the expiry date foreseen in the granted exemption decision also after entry into force of the Directive repealing Directive 2003/55/EC (...). Unless provided otherwise in the exemption decisions themselves, such exemptions shall therefore not be altered by application of the provisions on new infrastructure provided for in Article 35 of the amended Gas Directive (...)"<sup>40</sup>.

2.29. We understand that the European Commission's intention behind this declaration was that by not requiring existing exemption decisions to be altered, holders of these exemptions need not re-request an exemption under the Gas Directive for an exemption from the requirements of Article 9 to apply, as long as the existing exemption decision is valid.

2.30. As such, our initial view, subject to further discussions with the European Commission, is that BBL Company is exempt from the unbundling provisions for the duration of its exemption and, as such, Ofgem does not need to certify the BBL Company. While it does not have an exemption for all of its capacity<sup>41</sup>, we consider that the unbundling exemption can only meaningfully apply to the whole of the infrastructure<sup>42</sup>. We are currently in the process of discussing this with the Dutch authorities and the European Commission.

2.31. With respect to Interconnector (UK), it was constructed prior to the introduction of the exemption regime of the Second Gas Directive. However, in 1995, Interconnector (UK) notified the European Commission of its arrangements and received a "comfort letter" in accordance with the practice at that time<sup>43</sup>.

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39 The Permanent Representatives Committee or "COREPER" is responsible for preparing the work of the Council of the European Union.

40 Declaration 2007/0198 (COD). Note that the provision on new infrastructure was under Article 35 in draft versions of the Gas Directive. This is Article 36 under the final version of the Gas Directive.

41 The exemption does not cover non-physical reverse flows and only covers the forward flow capacity provided under the initial long-term contracts. The exemption is until 2016 in respect of a specified proportion of the capacity and until 2022 in respect of a specified proportion of the capacity.

42 The Commission has stated that the exemptions granted under the Second Gas Directive continue to apply and are not altered by the application of the provisions on new infrastructure provided for in the new Gas Directive. Article 22 of the Second Gas Directive allows exemptions to cover part of the infrastructure. It provides that "the exemption may cover all or parts of, respectively, the new infrastructure, [or] the existing infrastructure with significantly increased capacity." Therefore, it would appear that the principle of the draft declaration is that exemption decisions are to remain unaltered unless the exemption decision itself provided for this.

43 Specifically, DG Comp states in its letter dated 25 May 1995 that, "(T)he arrangements appear to contain restrictions of competition falling under the prohibition in Article 85(1) of the EC Treaty and Article 53(1) of the EEA Agreement, especially where Interconnector (UK) Limited markets capacity of gas transport through the pipe for its own account, joint selling by the joint venture partners occurs. However, the Director General for Competition takes the view that you have provided sufficient justification for an exemption to be granted by the Commission". Interconnector (UK) ownership arrangements were also

2.32. Our initial view is that the circumstances of Interconnector (UK), while unique to that entity, are broadly equivalent to those applying to interconnectors exempted under the Second Package<sup>44</sup>. We therefore consider that, in principle, similar treatment should apply. We are currently in the process of discussing these issues with the European Commission and the Belgian Authorities.

2.33. We recognise that our approach to certification of BBL Company and Interconnector (UK) is still subject to further developments in light of on-going discussions. However, we would welcome respondents' views regarding our intended approach as outlined above.

## Offshore Transmission Owners

2.34. The UK Government expects the development of offshore renewable electricity generation to make a major contribution to the achievement of the UK's emission targets. Under this approach, licences to own and operate offshore electricity transmission assets will be granted on a competitive, non-exclusive basis. A competitive tender process, administered by Ofgem E-Serve, is being used to select offshore transmission licensees. The competitive tender process will result in the granting of an offshore transmission licence to the successful bidder from the tender process. Offshore transmission licences include a number of special conditions which set out the specific obligations and rights of the licensee. These define, among other things, the revenue stream that the OFTO will receive.

2.35. Whilst the details of the offshore regulatory regime were consulted on, the Government and Ofgem announced in July 2007 that there would be a set of transitional arrangements (for a limited number of projects that had met certain pre-conditions by the "Go Live" date). These were put in place to ensure continued delivery of offshore renewable projects and to provide certainty to developers and funders of offshore investments. Enduring arrangements would take effect for all other projects.

2.36. Our initial view is that offshore electricity transmission systems are caught by the definition of "transmission system" under the Third Package and that OFTOs are therefore subject to the unbundling requirements set out in the Electricity Directive. This is supported by the fact that such lines are classified as transmission lines under domestic legislation, that the definitions of transmission and TSO would appear to

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considered as part of the sector enquiry into the gas and electricity markets by the Commission in 2005 but no concerns were raised in its conclusions regarding the matter. The forward and reverse capacity of Interconnector (UK) is fully contracted with major energy and utility companies on 20 year contracts expiring 2018.

<sup>44</sup> For example, the test for granting an exemption from Article 85 (now 101) to Interconnector UK corresponds to the test later developed for an exemption under the Second Gas Directive.

include offshore transmission<sup>45</sup> and that there is no specific exclusion in the Electricity Directive or Regulation for offshore transmission (unlike in gas, for example, where there is a specific exclusion set out for upstream pipeline networks which makes it clear that offshore gas pipelines are outside of the transmission network<sup>46</sup>). Furthermore, it would not appear that offshore transmission could fall within the definitions of micro isolated systems<sup>47</sup> or direct lines<sup>48</sup> provided for under the Electricity Directive. Finally, it is our view that any purposive interpretation of the Directive would capture offshore transmission, particularly in light of discussions on future "supergrids" in Europe. We invite views regarding our proposed approach to the application of the Third Package unbundling provisions to OFTOs.

2.37. However, for TSOs which existed on 3 September 2009, our initial view is that it is doubtful that any acquisition it makes of a physically discrete offshore transmission asset which did not connect to that TSO's existing network could be considered as part of an existing TSO's network. Rather, the specific offshore transmission system would have to be considered new and separate and would therefore have to comply with the OU model.

#### *Current tender rounds*

2.38. To introduce the offshore transmission regime there will also be transitional tender rounds for generator developers that have either partly or completely built their own transmission assets. Potential OFTOs will bid to purchase the transmission assets from the developer and then finance and maintain the assets over 20 years. The tender process for the first transitional round commenced in July 2009 and successful bidders are expected to be licensed from October/November 2010. Undertakings that are granted OFTO licences through the current transitional tender round will subsequently be required to demonstrate compliance with the unbundling provisions in order for the Authority to certify them by 3 March 2012. Subject to the approval of Member States and provided the OFTO is not part of a vertically integrated undertaking, a further year (until 3 March 2013) may be available to OFTOs in which to become compliant<sup>49</sup>.

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45 Under Article 1 of the Electricity Directive, transmission means the transport of electricity on the extra high-voltage and high-voltage interconnected system with a view to its delivery to final consumers or to distributors, but does not include supply. The definition of a TSO means a natural or legal person responsible for operating, ensuring the maintenance of and, if necessary, developing the transmission system in a given area and, where applicable, its interconnection with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity.

46 Article 34 of the Gas Directive.

47 Article 2 of the Electricity Directive defines "micro isolated system" to mean any system with consumption less than 500GWh in the year 1996, where there is no connection with other systems. Article 44 provides a derogation from the unbundling provisions (Chapter IV).

48 Article 34 of the Electricity Directive.

49 As provided for under Article 9(4) of the Electricity Directives.

2.39. Where the offshore transmission system was operational by 3 September 2009 and belonged to a vertically integrated undertaking, other options may be available to the TSO. However, this will depend on how DECC transposes the relevant provisions. We will keep this under review.

2.40. Where the offshore transmission systems had not been constructed by 3 September 2009, they may be considered to be "new transmission systems". The European Commission has stated that "new transmission systems", in particular those systems which did not yet exist on 3 September 2009, will have to comply with the full ownership unbundling model<sup>50</sup>.

#### *Future tender rounds*

2.41. For future offshore transmission systems, it is our understanding that all OFTOs will be required to be ownership unbundled before being licensed and commencing the activity of transmission. This is based on our understanding that each offshore transmission cable is a separate transmission system.

2.42. The Third Package requires TSOs to, among other things, develop their own system<sup>51</sup>. It may be possible, therefore, that the requirements of the Directive do not preclude a certified TSO, which existed on 3 September 2009 and is not ownership unbundled, to own and operate an offshore line without having to comply with the OU model provided that the transmission line is physically connected to its existing network.

2.43. This may be clarified by DECC's transposition or otherwise by national law. We are still considering this position and would welcome any views.

2.44. For future transitional and enduring tender rounds, the tender process will need to be amended to include a certification stage.

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<sup>50</sup> Commission staff working paper, Interpretative note on The Unbundling Regime, p5.

<sup>51</sup> Article 12(a) of the Electricity Directive.

## 3. Scottish transmission arrangements

### Chapter Summary

The Scottish electricity transmission companies, SHETL and SPTL, have indicated they wish to be certified in accordance with the Article 9(9) derogation. DECC has indicated it intends implementing this option into national law. Assuming this is the case, it could therefore decide not to apply the provisions of the OU model in respect of the Scottish electricity transmission companies, if the Authority certifies each company individually (and the European Commission agrees) on the basis that the arrangements in place on 3 September 2009 guarantee more effective independence of such licensees than the ITO model. As the Authority must certify TSOs as having complied with one of the unbundling models (or with the derogation) by 3 March 2012, the Scottish electricity transmission companies have provided some initial evidence to us as to why they consider that the arrangements they had in place on 3 September 2009 guarantee more effective independence than the ITO model. The Authority has not yet formed a view on this question and the purpose of this section of the consultation is to seek your views on this issue. This chapter presents an overview of the ITO model. It also provides a summary of certain legal and regulatory requirements on SHETL and SPTL.

### Question box

Question 5: Do you consider that the arrangements relating to the Scottish electricity transmission companies guarantee more effective independence of such licensees from the vertically integrated undertakings of which they are part of than the provisions of the ITO model? Why?

Question 6: Are there further areas of investigation or clarification we could consider?

Question 7: Do you consider our overall approach to the assessment of the Scottish electricity transmission companies against the Article 9(9) derogation appropriate?

## The Scottish transmission arrangements and the derogation

3.1. Article 9(9) of the Directives allows Member States not to apply the provisions of the OU model if, on 3 September 2009, the transmission system belongs to a vertically integrated undertaking and there are arrangements in place which guarantee more effective independence of the TSO than the provisions of the ITO model<sup>52</sup>.

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<sup>52</sup> "Member States can derogate from the specific rules concerning ownership unbundling, ISOs and ITOs, where on 3 September 2009 the transmission system belonged to a vertically integrated undertaking and at that date arrangements were in place which

3.2. DECC has indicated that it is minded to implement the Article 9(9) derogation into national law. We understand that it will consider this matter as part of overall implementation of the Third Package, in cooperation with respondents to their consultation and with the European Commission. The Authority may only certify TSOs as compliant with one of the Third Package unbundling options which have been made available by DECC.

3.3. SHETL holds the electricity transmission licence in respect of the transmission system in northern Scotland. It is a wholly owned subsidiary of Scottish and Southern Energy plc (SSE). SPTL holds the electricity transmission licence in respect of the transmission system in central and southern Scotland. It is a wholly owned subsidiary of SP Limited (SP) which itself is a wholly owned subsidiary of Iberdrola S.A. (Iberdrola). Both SSE and Iberdrola have generation and supply interests in GB and elsewhere in the EU. Therefore, our understanding is that the transmission systems in respect of which SHETL and SPTL are licensed belong to vertically integrated undertakings<sup>53</sup> which control both transmission and supply/generation undertakings.

3.4. SHETL and SPTL have indicated that they wish to be certified in accordance with the Article 9(9) derogation.

3.5. Given that DECC is minded to make the Article 9(9) derogation available, we consider it appropriate to assess, at this stage, the Scottish transmission arrangements against the Article 9(9) derogation in order to provide clarity to SHETL and SPTL and to allow respondents to give their views on the compatibility of the Scottish transmission arrangements against the Third Package unbundling provisions.

3.6. Assuming DECC do make the Article 9(9) derogation available, the Authority will need to reach a view on whether the arrangements SHETL and SPTL had in place on 3 September 2009 meet the test for the Article 9(9) derogation; that is, whether they guarantee more effective independence of the TSO than the ITO provisions<sup>54</sup>. In considering this matter, we do not set out a line by line analysis of the Scottish electricity transmission companies' compliance against these ITO provisions as we are not assessing the compliance of the Scottish electricity transmission companies with the ITO model itself. Rather, we summarise the main provisions of the ITO model. We then set out in summary the arrangements with respect to the separation of tasks between SHETL and SPTL and the independent SO, NGET, and the licence requirements on SHETL and SPTL to have certain ring-fencing arrangements in place.

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guarantee more effective independence of the TSO than the specific provisions concerning the ITO model". Commission staff working paper, Interpretive note on The Unbundling Regime, p6.

53 For further details of SSE's and Iberdrola's supply and generation interests, see their websites, <http://www.scottish-southern.co.uk/SSEInternet/default.aspx> and <http://www.iberdrola.es/webibd/corporativa/iberdrola?cambioIdioma=ESWEBINICIO> respectively.

54 The ITO model is set out in Annex 2.

Both undertakings have provided us with initial evidence to support their views that the arrangements in place on 3 September 2009 meet this test. This is supplemented with information on certain conditions of SHETL's and SPTL's licences. We welcome views on whether our approach to the assessment of the Scottish electricity transmission companies' arrangements on 3 September 2009 is appropriate and whether these arrangements satisfy the test for an Article 9(9) derogation.

3.7. We have not yet reached a view on whether or not the Scottish electricity transmission companies meet the test for the derogation. However it is important to be aware that, in accordance with the procedure explained in Chapter 1, the Authority or the European Commission may reach the view that the arrangements the Scottish electricity transmission companies had in place on 3 September 2009 do not guarantee more effective independence than the ITO provisions. Similarly, DECC may choose not to implement the Article 9(9) derogation. In such an event, SHETL and SPTL would need to unbundle in accordance with the models implemented in GB in order for the Authority to be able to certify them as compliant with the unbundling provisions.

## **The test for a derogation**

### **Provisions of the ITO model**

3.8. As explained in Chapter 1, the ITO model allows the ownership and operation of the transmission system to remain within a vertically integrated undertaking, subject to detailed ring-fencing requirements. The purpose of these requirements (as with the other unbundling models) is to remove the incentive for vertically integrated undertakings to discriminate against competitors as regards access to the network and to promote investments in infrastructure in a non-discriminatory way. The text of the ITO model is provided in Appendix 2.

3.9. In broad terms, the ITO model requires the TSO to have:

- technical, physical and financial resources, assets and personnel, which are necessary for fulfilling its obligations under the Electricity Directive and carrying out electricity transmission activities;
- effective decision-making rights independent from the vertically integrated undertaking with respect to the assets necessary to operate, maintain and develop the transmission system, and the power to raise money on the capital market;
- independence of staff and management;
- a supervisory board; and
- a compliance programme and a compliance officer.

3.10. Under the ITO model, the TSO is required to carry out all of the activities relating to the operation and investment in the network<sup>55</sup>. In summary, the main obligations of the TSO are:

- ensuring the long-term ability of the system to meet reasonable demand for electricity transmission, including through investment planning and also operation, maintenance and development of a secure, reliable and efficient transmission system<sup>56</sup>;
- managing electricity flows on the system, taking into account exchanges with other interconnected systems<sup>57</sup>;
- providing to the operator of any other system with which its system is interconnected sufficient information to ensure secure and efficient operation and interoperability of the interconnected system<sup>58</sup>;
- providing users with the information they need for efficient access to the system and granting third-party access on a non-discriminatory basis as between users<sup>59</sup>;
- collecting congestion rents, payments under the ITC mechanism, system related charges including access charges and balancing charges<sup>60</sup>;
- representing the TSO and contacts to third parties and the regulatory authorities and within the European network of TSOs for Electricity (ENTSO-E)<sup>61</sup>; and
- facilitating market integration<sup>62</sup>.

### **Separation of tasks between NGET as the SO and the Scottish electricity transmission companies**

3.11. In considering whether the specific arrangements which were applicable to SHETL and SPTL on 3 September 2009 guarantee more effective independence than the ITO model, the Authority will consider all relevant factors. These include whether the separation of transmission ownership from system operation removes any potential conflicts of interest and (to the extent it is relevant given the role of the SO) whether the ring-fencing arrangements of SHETL and SPTL ensure their independence within the vertically integrated undertaking.

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<sup>55</sup> These are set out in full in Articles 12 and 17(2) of the Electricity Directive.

<sup>56</sup> Article 12(a), (b) and (c) and 17(2)(e), 17(2)(f) and Article 22 of the Electricity Directive.

<sup>57</sup> Article 12(d) of the Electricity Directive.

<sup>58</sup> Article 12(e) of the Electricity Directive.

<sup>59</sup> Article 12(f), 12(g), Article 17(2)(c) and Article 23 of the Electricity Directive.

<sup>60</sup> Article 12(h) and 17(2) (d) of the Electricity Directive.

<sup>61</sup> Article 17(2)(a) and (b) of the Electricity Directive.

<sup>62</sup> Article 12(h) and 17(2)(g) of the Electricity Directive.

3.12. BETTA provides for a single SO, NGET, to operate the electricity transmission systems in GB<sup>63</sup> as a single transmission system<sup>64</sup>. As such, NGET rather than SHETL or SPTL is responsible for certain TSO tasks outlined above relating to system operation, such as daily operation and providing access to the system. SHETL and SPTL consider that because system operation is undertaken by NGET, these arrangements guarantee greater independence than the ITO model provisions because there is a reduced scope for conflict of interest arising between SHETL or SPTL and the rest of the vertically integrated business. Furthermore, SHETL and SPTL consider that where they have responsibility for the TSO tasks outlined above, such as the development of the transmission system, they must adhere to the conditions set out in the relevant legislation and/or the relevant licence. The Authority has powers to enforce these conditions by imposing an order to require compliance or to impose a penalty of up to 10 per cent of the turnover of the licensee for a breach of a relevant condition or requirement<sup>65</sup>.

3.13. The remainder of this section sets out a brief summary of the role of NGET in system operation and the role of SHETL and SPTL in investment, development and maintenance of the system. In the following section, we consider the provisions for ring-fencing SHETL and SPTL within the vertically integrated groups.

*Long-term ability of the system and maintenance and development of the transmission system*

3.14. The ITO model requires the TSO to submit to the regulatory authority, following consultation with stakeholders, a ten-year network development plan which contains all investments already decided and identifies new investments required, including the timeframe for investment<sup>66</sup>. The TSO is also required to inform the regulatory authority of the financial resources available for future investment projects and/or the replacement of existing assets<sup>67</sup>. The regulatory authority is required to examine whether the network development plan covers all investment needed<sup>68</sup>. It is also required to monitor and evaluate implementation of the network development plan. In the event that the TSO does not undertake the investment in the following 3 years, the regulatory authority is required to ensure that the investment is made, provided it is still relevant on the basis of the most recent ten-

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63 The electricity transmission systems in GB consist of those owned by SHETL and SPTL in Scotland and that owned by NGET in England and Wales.

64 The BETTA arrangements and the corresponding obligations on market players have been provided for in the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the transmission licence (standard and special licence conditions) and codes (such as the Grid Code, the SO-Transmission Owner Code (SO-TO) Code, the Balancing and Settlement Code (BSC) and the Connection and Use of System Code (CUSC)).

65 We do this through, for example, imposing orders to secure compliance, imposing penalties for any breach of these conditions (up to 10 per cent of turnover of the licence holder) or, ultimately, the licence may be revoked if the licensee fails to comply with a final or provisional enforcement order (section 25 of the Electricity Act 1989).

66 Article 22 of the Electricity Directive.

67 Article 18(8) of the Electricity Directive.

68 Article 22 of the Electricity Directive.

year network development plan. To this end, the regulatory authority must have the powers to require the TSO to execute the investment or to organise a tender procedure open to any investors for the investment in question. It can also oblige the TSO to accept a capital increase to finance the necessary investment and allow independent investors to participate in the capital.

3.15. SHETL and SPTL have a duty to "develop and maintain an efficient, coordinated and economical system of electricity transmission"<sup>69</sup>. If they fail to undertake an investment necessary to comply with this duty, the Authority can impose an order to secure compliance with this requirement or impose a penalty of up to ten per cent of the licence holder's (transmission owner's) turnover<sup>70</sup>.

3.16. With respect to transmission planning and transmission investment plans, under the STC, SHETL and SPTL are required to produce their own transmission investment plans and to cooperate with NGET as the SO in developing such plans<sup>71</sup>. In preparing annual investment plans, SHETL and SPTL are required to take into account planning assumptions provided by NGET<sup>72</sup> and ensure that their transmission systems comply with the relevant transmission system security standard<sup>73</sup>. The transmission investment plans are required to provide a timeframe for all investment projects<sup>74</sup>. NGET has the opportunity to comment on the investment plans of the Scottish electricity transmission businesses and, if required, can ask for additional work to be undertaken<sup>75</sup>. Furthermore, NGET can also require the Scottish electricity transmission companies not to undertake investment until it has been agreed with the affected users. If concerns persist regarding the investment plans that cannot be resolved between NGET and the Scottish electricity transmission company, the matter may be referred to the Authority for a final determination<sup>76</sup>. SHETL and SPTL also have an obligation to notify the Authority as to whether they have sufficient resources to carry out the transmission business activities<sup>77</sup> and the Authority has certain options open to it in the event that insufficient resources, which amount to a contravention of the relevant licence condition, are reported. For example, it may make an order requiring the licensee to ensure it has sufficient resources to carry out its business<sup>78</sup> and, in the event that a contravention of the relevant licence condition

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69 Section 9(2)(a) and (b) of the Electricity Act 1989 and SLC B7 of the transmission licence. They are also required by the licence to comply with the terms of the CUSC (pursuant to SLC B12 of the transmission licence), which relates to the development, maintenance and operation of an economic and efficient system.

70 Section 25, section 26 and section 27A of the Electricity Act 1989.

71 Section D of the STC.

72 Section D of the STC. A planning assumption is essentially NGET's forecasts of power flows onto and off SHETL's and SPTL's transmission systems.

73 SHETL and SPTL are required under SLC D3 of their transmission licences to comply with the National Electricity Transmission System Security and Quality of Supply Standard (SQSS).

74 Section D of the STC.

75 Section D of the STC. This is done through the Joint Planning Committee (JPC), which consists of representatives from NGET and each TO.

76 Section D of the STC.

77 SLC B7 of the transmission licence.

78 Section 25 of the Electricity Act 1989.

continues, it may impose a penalty of up to ten per cent of the licence holder's (transmission owner's) turnover<sup>79</sup>.

3.17. There is also a coordinated plan for the whole GB transmission network. NGET is responsible for the coordination of the Seven Year Statement<sup>80</sup> that sets out projections for investment in the GB transmission network and for ensuring that the transmission system security standard and quality of service standards are met<sup>81</sup>. NGET is also responsible for producing a network output measures methodology<sup>82</sup>. In the event that NGET or the Scottish electricity transmission companies wish to change any parts of their respective investment plans, they may agree to do so at any time, provided that the relevant party provides an updated version to other parties<sup>83</sup>.

3.18. With respect to maintenance, SHETL and SPTL are required to maintain their respective systems<sup>84</sup> and, as such, are responsible for determining and implementing their own maintenance policies. In facilitating the outage planning process for maintenance, they are required to exchange certain data with NGET. NGET has the right to determine the dates of outages necessary to undertake maintenance<sup>85</sup>.

#### *Managing electricity flows*

3.19. The ITO model requires the TSO to manage electricity flows taking into account exchanges with other interconnected systems. To that end the TSO is required to be responsible for the operation of a secure, efficient and economic transmission system<sup>86</sup>. The TSO is also responsible for ensuring adequate means to meet service obligations and for ensuring the availability of all necessary ancillary services<sup>87</sup>.

3.20. NGET is responsible for real-time operation of the Scottish electricity transmission systems on behalf of SHETL and SPTL<sup>88</sup>. It is obliged to have resources which enable it to carry on its business in an "efficient, economic and coordinated manner"<sup>89</sup>. It is also required to have in force and comply with the BSC<sup>90</sup> and it is prohibited from discriminating between "any person or classes of persons in its

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79 Section 27A of the Electricity Act 1989.

80 SLC C11 of the transmission licence.

81 SLC C17 of the transmission licence.

82 The network output measures methodology produced under SLC B17 of the transmission licence evaluates various factors, such as the current condition of the network assets, the reliability of the transmission system and its technical performance.

83 Section D of the STC.

84 Section 9(2)(a) and (b) of the Electricity Act 1989 and SLC B6 of the transmission licence.

85 STCP11-1 of the STC.

86 Article 12(d) and 17(2)(e) of the Electricity Directive.

87 Articles 12(b) and 12(d) of the Electricity Directive.

88 SLC C2 of the transmission licence.

89 SLC B7 of transmission licence.

90 SLC C3 of the transmission licence.

procurement or use of balancing services"<sup>91</sup>. In relation to the obligation to ensure the availability of all necessary ancillary services, NGET is required not to discriminate in its procurement or use of balancing services (which is defined to include ancillary services)<sup>92</sup>. It is required to have in place the STC, which is designed to permit the development, maintenance and operation of an efficient, coordinated and economical system for the transmission of electricity<sup>93</sup>. Further, one of the objectives of the STC is the "development, maintenance and operation of an efficient, economical and coordinated system of electricity transmission"<sup>94</sup>. In providing transmission services to NGET, SHETL and SPTL are required to make information and assets available<sup>95</sup>. Furthermore, SHETL and SPTL are required to treat any information relating to the management or operation of the transmission business as confidential<sup>96</sup>.

#### *Providing sufficient information to ensure interoperability*

3.21. The TSO under the ITO model is required to provide to the operator of other systems with which it is interconnected sufficient information to ensure the secure and efficient operation, coordinated development and interoperability of the interconnected system<sup>97</sup>.

3.22. For interconnectors or other TSOs which seek to interconnect with the GB transmission system, NGET is obliged to provide relevant information<sup>98</sup>. In doing this, it may determine that one of the Scottish electricity transmission companies is an "affected TO" and require it to submit a connection offer for the interconnector or TSO, which would include any relevant information relating to the connection offer<sup>99</sup>. For ongoing operation and development of the system, the Scottish electricity transmission companies are required to provide NGET with the information it requires to enable it to coordinate flows over the system, which could reflect flows onto and over the interconnector<sup>100</sup>. Interconnectors, in turn, are required to furnish information to "any relevant licensee" concerning its operational and technical

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91 SLC C3 and C16 of the transmission licence.

92 SLC C16 of the transmission licence.

93 SLC B12 of the transmission licence.

94 SLC B12 of the transmission licence.

95 SLC D2 of the transmission licence.

96 Special Licence Condition C of SHETL's and SPTL's licence.

97 Article 12(e) of the Electricity Directive.

98 SCL C11 of the transmission licence. Furthermore, the introduction to the SQSS (Section 1.4) notes that external interconnections between the onshore transmission system and external systems (e.g. in Ireland and France) are covered by separate agreements, which will normally be consistent with the SQSS. The licensee is required to have available ancillary services pursuant to the Grid Code (Section CC.8). These include those to ensure the stable operation of the national electricity transmission system or any system linked by an interconnector.

99 STCP 18.1 of the STC. There is also a requirement under SLC D2 of the transmission licence for SHETL and SPTL to provide transmission services to the SO, which includes providing to the SO information in relation to SHETL's and SPTL's transmission systems which is needed by the SO to enable it to coordinate and direct the flow of electricity onto and over the national electricity transmission system.

100 SLC D2 of the transmission licence.

specifications or any information the relevant licensee requires to fulfil its own licence<sup>101</sup>.

### *Third party access*

3.23. The ITO model requires the TSO to establish and publish transparent and efficient procedures, to be approved by the regulatory authority, for non-discriminatory connection of new power plants to the transmission system<sup>102</sup>. There is also a requirement for reasoned explanations to be given where access is denied<sup>103</sup>. Furthermore, the TSO is not entitled to refuse connection of a new power plant on the grounds of possible future limitations to available network capacities or on the grounds that it will lead to additional costs linked with necessary capacity increase. In addition the TSO is to ensure non-discrimination between system users and provide users with the information they need for efficient access to the system<sup>104</sup>.

3.24. The procedures for new power plants, including those owned by SSE and SP, to connect to the electricity transmission system are provided for under the transmission licence and established in the CUSC and the Grid Code. Both of these are public documents. Changes to these are approved by the Authority. Under this, NGET has overall responsibility for managing requests from any party (power plants or users)<sup>105</sup>, including those affiliated to SSE or SP. In doing this, NGET is prohibited from discriminating against users<sup>106</sup>. The specific reasons for why access may not be granted are set out in NGET's licence<sup>107</sup>. SHETL and SPTL must enter into an agreement with NGET to provide dates and costs for the work involved in facilitating the connection<sup>108</sup>. SHETL and SPTL are also prohibited from unduly discriminating against any person in its offers for connection which might include offers for interconnection to other transmission systems<sup>109</sup>. The charging methodology relating to SHETL's or SPTL's connection offer is determined by all the transmission companies, which is then consulted upon and approved by the Authority<sup>110</sup>. The Authority has the power to make a binding determination in the event of a dispute between the parties<sup>111</sup>.

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101 SLC 5 of the Electricity interconnector licence.

102 Article 23 of the Electricity Directive.

103 Article 12(h) of the Electricity Directive.

104 Article 12(f) and (g) of the Electricity Directive.

105 SLC C8, C10 and C14 of the transmission licence.

106 SLC C7 of the transmission licence.

107 SCL C8 of the transmission licence.

108 SLC D4A of the transmission licence.

109 SLC D5 of the transmission licence.

110 Special Licence Condition J10 of SHETL's and STPT's licence. Schedule 8 and 9 of the STC and STCP 18.1-18.6. Connection charges are developed on a yearly basis by the Charging Users Group.

111 SLC C9 of the transmission licence.

*Charges for use of system and balancing services*

3.25. Under the ITO model, the TSO is required to collect all transmission system related charges including access charges and balancing charges for ancillary services<sup>112</sup>.

3.26. Under BETTA, NGET has responsibility for the methodology which determines the use of system charges owed by system users<sup>113</sup>. In doing this, there is a general requirement on NGET not to restrict, distort or prevent competition. It is also obliged to keep the methodology for use of system charges under review and to consult on it and seek final approval of modifications to it from the Authority<sup>114</sup>. NGET also collects the charges from users of the system on behalf of SHETL and SPTL. SHETL and SPTL are not directly involved in determining the charging methodology or collecting the charges from users<sup>115</sup>.

3.27. NGET is obliged to maintain the BSC detailing how generators will act in providing balancing services, and how NGET will use and remunerate these services<sup>116</sup>. Under this, NGET is obliged to do this in an efficient, economic and coordinated manner whilst promoting effective competition and efficiency. The charges it earns for balancing services must be consulted upon with users and approved by the Authority<sup>117</sup>.

*Representation of the TSO*

3.28. The ITO model requires that the TSO represents itself to third parties and regulatory authorities<sup>118</sup>. It also requires it to be represented within ENTSO-E<sup>119</sup> (which was not a requirement on 3 September 2009).

3.29. In GB, transmission is established as a separate licensable activity distinct from other activities<sup>120</sup>. Any contact with Ofgem and/or the Authority on issues directly related to the transmission companies is required to be on behalf of the transmission business<sup>121</sup>. The management of the Scottish electricity transmission companies is

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112 Article 12(h) of the Electricity Directive.

113 SLC C5 of the transmission licence.

114 SLC C5 of the transmission licence.

115 Given that that transmission businesses are not signatories to the CUSC.

116 SLC C3 of the transmission licence.

117 SLC C5 of the transmission licence. Charges relating to balancing services are set out in the BSC.

118 Article 17(2)(a) of the Electricity Directive.

119 Article 17(2)(b) of the Electricity Directive.

120 Section 6(1)(b) of the Electricity Act 1989.

121 Special Licence Condition D of SHETL's and SPTL's licence.

addressed in some further detail below. NGET and the Scottish companies are represented within the ENTSO-E<sup>122</sup>.

### **Independence of the TSO within the vertically integrated undertaking**

3.30. While certain TSO responsibilities, as set out in the Electricity Directive, are undertaken by SHETL and SPTL under BETTA, many of them lie with NGET. This may reduce the scope for a conflict of interest. It remains necessary, however, to consider their independence from the rest of the vertically integrated undertakings of which they are part.

3.31. The ITO model addresses in some detail the independence and ring-fencing requirements between the TSO and the vertically integrated undertaking<sup>123</sup>. In order to consider whether the Scottish transmission arrangements meet the test of guaranteeing more effective independence of the TSO than the provisions of the ITO model, we do not consider it appropriate to rely on the actual practice of the Scottish electricity transmission companies as part of this stage of the assessment. Rather, it is necessary for us to address what general legal requirements and regulatory ring-fencing arrangements SHETL and SPTL are subject to under their respective transmission licences<sup>124</sup> and to then consider all relevant factors, including those received from respondents to this consultation, in assessing whether to grant the derogation.

#### *Scottish electricity transmission companies' assets and equipments*

3.32. The ITO model imposes a general obligation on the TSO to be autonomous<sup>125</sup>. In summary, it requires the TSO to be equipped with all human, technical, physical and financial resources necessary for fulfilling the activities of electricity transmission. It prohibits leasing of personnel and rendering of services to and from other parts of the vertically integrated undertaking (save in certain specific circumstances). The TSO is obliged not to share IT systems or equipment, physical premises and security access systems (nor use the same consultants/external contractors for same) with any part of the vertically integrated undertaking. There is also a requirement that accounts must be audited by an auditor other than the one auditing the accounts of the vertically integrated undertaking. The TSO is also obliged to have its own corporate services including legal, accountancy and IT services.

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122 See <https://www.entsoe.eu/index.php?id=15>.

123 Articles 17 to 21 of the Electricity Directive.

124 Indeed, the European Commission states that the test for an Article 9(9) derogation is whether the arrangements in place "guarantee more effective independence of the TSO than the *specific* provisions concerning the ITO model of Article 17-23 of the Electricity Directive" (emphasis added); Commission staff working paper, Interpretative note on The Unbundling Regime, p6.

125 The full detail of the requirements is set out in Article 17 of the Electricity Directive.

3.33. With respect to the Scottish transmission arrangements, SHETL and SPTL are obliged to have all resources to ensure that they are able to properly and efficiently carry out the transmission business and to comply with their obligation under the transmission licence<sup>126</sup> and are prohibited from trading with affiliates/related undertakings for goods, services or assets other than on normal commercial conditions<sup>127</sup>. There are also certain confidentiality requirements on SHETL and SPTL. They are required to treat any information relating to or deriving from the management or operation of the transmission business as confidential and, as such, are only allowed to disclose this information to other parties only in specific circumstances<sup>128</sup>. They are also prohibited from trading with affiliates and related undertakings for goods, services or assets other than on normal commercial conditions<sup>129</sup>.

#### *Independence of the TSO*

3.34. Under the ITO model, the TSO must have effective decision-making rights, independent from other parts of the vertically integrated undertaking with respect to assets necessary to operate, maintain or develop the transmission system<sup>130</sup>. In summary, generation and supply subsidiaries of the vertically integrated undertaking cannot have direct or indirect shareholdings in the TSO nor can the TSO have direct or indirect shareholdings in any generation or supply subsidiary of the vertically integrated undertaking, nor receive dividends or other financial benefit from that subsidiary. Any commercial and financial relations between the TSO and other parts of the vertically integrated undertaking must comply with market conditions and be approved by the regulatory authority. Other parts of the vertically integrated undertaking must refrain from determining the behaviour of the TSO in relation to day to day activities and must refrain from any action impeding or prejudicing the TSO from complying with its obligations. It must not require the TSO to seek permission in fulfilling these obligations. The TSO is also obliged to have the power to raise money on the capital market. It is also required not to discriminate against different persons and not to restrict, distort or prevent competition in generation or supply.

3.35. With respect to independence of SHETL and SPTL, there is an obligation for the Scottish electricity transmission companies to maintain full managerial and

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126 SLC B7 of the transmission licence.

127 SLC B9 of the transmission licence. Note, however, that SHETL and SPTL are permitted to manage and operate their electricity transmission companies along with their related distribution businesses. For example, SPTL is managed and operated along with SP Distribution Limited and SP Manweb Limited as SP Energy Networks. In granting permission for this activity, the Authority noted the obligations the Scottish electricity transmission businesses are subject to in ensuring that, amongst other things, the use of premises, systems, equipment, facilities, property or personnel by both the transmission business and any other business of any affiliate or related undertaking of the licensee do not restrict, distort or prevent competition in the generation or supply of electricity (Special Licence Condition D of SHETL's and SPTL's licence).

128 Special Licence Condition C of the SHETL's and SPTL's licence.

129 SLC B9 of the transmission licence.

130 The full detail of the requirements is set out in Article 18 of the Electricity Directive.

operational independence of the transmission business and any external transmission activities from each other business<sup>131</sup>. There is also an obligation on the group company to ensure (by giving a legally enforceable undertaking) that it refrains from any action which would be likely to cause the licensee to breach any of its obligations under the Electricity Act 1989 or under the licence<sup>132</sup>. Regarding the activities of subsidiaries, the Scottish electricity transmission companies are prevented from having shareholdings in any affiliates<sup>133</sup>. They are explicitly prohibited from cross-subsidising between the transmission business and any affiliates<sup>134</sup> and the financial transactions that can take place with affiliated businesses are narrowly defined<sup>135</sup>. Both SHETL and SPTL can raise funds directly on the capital market<sup>136</sup>.

### *Supervisory Body*

3.36. Under the ITO model the TSO is obliged to have in place a Supervisory Body to be in charge of taking decisions which may have a significant impact on the value of assets of the shareholders within the TSO, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the TSO and the amount of dividends distributed to shareholders<sup>137</sup>. Decisions falling under the remit of the Supervisory Body do not relate to day to day activities. It shall be composed of members representing the vertically integrated undertaking, members representing third-party shareholders and, where the Member State legislation provides, members representing other interested parties such as employees of the TSO.

3.37. SHETL and SPTL must have a managing director that is responsible for the conduct of the business<sup>138</sup>. While there are no specific licence conditions relating to the requirement for SHETL and SPTL to have boards of directors to have a board, under company law SHETL and SPTL, as private companies, must have at least one director<sup>139</sup>. A director owes certain duties to the company, such as to act in accordance with the company's constitution and to only exercise powers only for the purposes for which they are conferred; the duty to act in the way he considers, in good faith, would be most likely to promote the success of the company for the

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131 Special Licence Condition D of SHETL's and SPTL's licence. Note, however, that that SHETL and SPTL are permitted to manage and operate their electricity transmission companies along with their related distribution businesses.

132 SLC B8 of the transmission licence.

133 SLC B6 of the transmission licence.

134 SLC B5 of the transmission licence.

135 SLC B9 of the transmission licence.

136 SLC B10 of the transmission licence requires the licensee to maintain an investment grade credit rating at all times.

137 The full detail of the requirements is set out in Article 20 of the Electricity Directive.

138 Special Licence Condition D of SHETL's and SPTL's licence.

139 Section 154 of the Companies Act 2006.

benefit of its members; the duty to exercise independent judgement and the duty to exercise reasonable care, skill and diligence<sup>140</sup>.

#### *Independence of staff and management*

3.38. The ITO model requires independence of the management of the TSO<sup>141</sup>. In particular, it requires the Supervisory Body to make decisions on appointments and renewals, working conditions and termination of the term of office of persons responsible for management (including the executive management i.e. chairperson, managing director and/or the CEO of the TSO and/or any member of the board having decision-making powers) and to notify those decisions to the regulatory authority accordingly. The regulatory authority may object to these decisions<sup>142</sup>. It also has a role in appeals against premature determinations.

3.39. Furthermore, the ITO model prevents persons responsible for management to have any direct/indirect linkage with the vertically integrated undertaking (or its controlling shareholders) and requires "cooling-off" periods for persons responsible for management<sup>143</sup> who move between the TSO and generation and supply parts of the vertically integrated undertaking. The management<sup>144</sup> and employees of the TSO are required not to hold interest in or receive any financial benefit, directly or indirectly, from the vertically integrated undertaking other than the TSO. The remuneration of management shall not depend on the performance of the vertically integrated undertaking, other than the TSO. In certain cases these requirements also apply to persons reporting directly to the executive management.

3.40. Under the Scottish transmission arrangements, SHETL and SPTL are required to appoint a managing director with responsibility for the conduct of the transmission business and any external transmission activities<sup>145</sup>. The managing director is required to be provided "from time to time" with the services of persons, resources and finance as may be reasonably required. SHETL and SPTL are also required to treat information relating to or deriving from the management or operation of the transmission business as confidential and no one can have access to it save for employees who are engaged in this activity<sup>146</sup>. Furthermore, SHETL and SPTL are required to observe "the expiry of an appropriate time" on termination of

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140 Sections 171 to 174 of the Companies Act 2006.

141 Article 19 of the Electricity Directive.

142 On the grounds that doubts arise as to the professional independence of a nominated person or, in the case of premature termination of office, doubts exist regarding the justification of such premature termination. The requirement for the regulatory authority to be notified, and to have the right to object, is also provided for regarding half of the members of the Supervisory Body minus one. The regulatory authority has the right to object where it has doubts over the premature termination of office of any member of the Supervisory Body (Article 20(3)).

143 This includes at least half of the members of the Supervisory Body minus one.

144 This includes at least half of the members of the Supervisory Body minus one.

145 Special Licence Condition D of SHETL's and SPTL's licence.

146 Special Licence Condition C of SHETL's and SPTL's licence.

employment<sup>147</sup> before a person engaged in the management or operation of the transmission company can work in any affiliate or related undertaking of the licence<sup>148</sup>.

### *Compliance programme*

3.41. The ITO model requires that there is a compliance programme in place, approved by the regulator, which sets out both the measures taken to ensure discriminatory conduct is excluded and the specific obligations of employees to meet these objectives<sup>149</sup>. Without prejudice to the powers of the regulatory authority, an independent compliance officer, appointed by the Supervisory Body (and subject to the approval of the regulatory authority), shall monitor compliance with the programme. It shall be responsible for, amongst other things, monitoring the implementation of the compliance programme, elaborating an annual report, notifying the regulatory authority on any substantial breaches with regard to implementation of the compliance programme and monitoring compliance with confidentiality requirements. The compliance officer is also responsible for submitting proposed decisions on the investment plan/on individual investments in the network to the regulatory authority and notifying the regulatory authority of any decisions which have the effect of preventing or delaying investments, which under the ten-year network development plan were to be executed in the following three years.

3.42. With respect to the Scottish transmission arrangements, the Scottish electricity transmission companies are obliged to establish a compliance programme and to appoint a compliance officer for the purpose of ensuring compliance with the restrictions regarding the use of information<sup>150</sup>. The compliance officer is appointed by the transmission company "following consultation with the Authority" and his role includes monitoring the implementation of the compliance programme, investigating any complaint or representation made to him and recommending and advising upon the remedial action which the investigation has demonstrated to be necessary. The compliance officer is also required to produce an annual report to the Authority<sup>151</sup>.

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147 These provisions are set out in Special Licence Condition D of SHETL's and SPTL's licence.

148 Note, however, because SHETL and SPTL are permitted to manage and operate their electricity transmission companies along with their related distribution businesses, this does not apply to staff transferring to or from the distribution company.

149 The full detail of the requirements is set out in Article 21 of the Electricity Directive.

150 Special Licence Condition E of SHETL's and SPTL's licence.

151 Special Licence condition E of SHETL's and SPTL's licence.

## 4. Next steps

4.1. We strongly encourage industry participants and others to respond to the questions this document raises and the options proposed. In particular, we welcome views on the TSOs we have identified as requiring assessment under the unbundling provisions. We also welcome views on our approach to National Grid plc, BBL Company, Interconnector (UK), future OFTOs and the Scottish electricity transmission companies.

4.2. We will continue to develop our thinking regarding the appropriate certification of TSOs, in coordination with the undertakings concerned and, where appropriate, with other regulatory authorities and the European Commission. At present, we do not intend to consult again before reaching certification decisions. However, depending on how our understanding may develop further, we reserve the right to consult again on these matters.

4.3. Subject to transposition of the Third Package as anticipated, we envisage reaching decisions in early 2011, which we would notify to the European Commission as required. As required by the Third Package, our final certification decisions, along our reasons for the decisions, and the European Commission's opinion will be published.

## Appendices

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## Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. (In particular, we would like to hear from Consumers and their representatives, gas and electricity transmission and distribution companies, generators and offshore producers, energy suppliers, gas shippers, government, the city and other interested parties.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 23 September 2010 and should be sent to:

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1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.7. Any questions on this document should, in the first instance, be directed to:

Siobhán Carty,  
Manager,  
European Strategy team  
9 Millbank,

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**CHAPTER: One**

There are no questions in this section.

**CHAPTER: Two**

Question 1: Have we correctly identified the GB TSOs that require certification? Are there other TSOs that would require certification?

Question 2: Are there reasons why the subsidiaries of National Grid plc that act as TSOs should not be certified according to the OU model? What are these?

Question 3: What do you think of our proposed approach to certifying the various interconnectors?

Question 4: Do you agree that OFTOs should require certification with respect to the unbundling provisions and be obliged to comply with the ownership unbundling model (with possible exceptions noted below)?

**CHAPTER: Three**

Question 5: Do you consider that the arrangements relating to the Scottish electricity transmission companies guarantee more effective independence of such licensees from the vertically integrated undertakings of which they are part of than the provisions of the ITO model? Why?

Question 6: Are there further areas of investigation or clarification we could consider?

Question 7: Do you consider our overall approach to the assessment of the Scottish electricity transmission companies against the Article 9(9) derogation appropriate?

## Appendix 2 – The ITO model, the Electricity Directive

### CHAPTER V

#### INDEPENDENT TRANSMISSION OPERATOR

##### Article 17

##### Assets, equipment, staff and identity

1. Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission, in particular:

- (a) assets that are necessary for the activity of electricity transmission, including the transmission system, shall be owned by the transmission system operator;
- (b) personnel, necessary for the activity of electricity transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator;
- (c) leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited. A transmission system operator may, however, render services to the vertically integrated undertaking as long as:
  - (i) the provision of those services does not discriminate between system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in generation or supply; and
  - (ii) the terms and conditions of the provision of those services are approved by the regulatory authority;
- (d) without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.

2. The activity of electricity transmission shall include at least the following tasks in addition to those listed in Article 12:

- (a) the representation of the transmission system operator and contacts to third parties and the regulatory authorities;
- (b) the representation of the transmission system operator within the European Network of Transmission System Operators for Electricity (ENTSO for Electricity);
- (c) granting and managing third-party access on a non-discriminatory basis between system users or classes of system users;
- (d) the collection of all the transmission system related charges including access charges, balancing charges for ancillary services such as purchasing of services (balancing costs, energy for losses);
- (e) the operation, maintenance and development of a secure, efficient and economic transmission system;
- (f) investment planning ensuring the long-term ability of the system to meet reasonable demand and guaranteeing security of supply;
- (g) the setting up of appropriate joint ventures, including with one or more transmission system operators, power exchanges, and the other relevant actors

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pursuing the objectives to develop the creation of regional markets or to facilitate the liberalisation process; and

(h) all corporate services, including legal services, accountancy and IT services.

3. Transmission system operators shall be organised in a legal form as referred to in Article 1 of Council Directive 68/151/EEC<sup>152</sup>

4. The transmission system operator shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the vertically integrated undertaking or any part thereof.

5. The transmission system operator shall not share IT systems or equipment, physical premises and security access systems with any part of the vertically integrated undertaking nor use the same consultants or external contractors for IT systems or equipment, and security access systems.

6. The accounts of transmission system operators shall be audited by an auditor other than the one auditing the vertically integrated undertaking or any part thereof.

#### Article 18

##### Independence of the transmission system operator

1. Without prejudice to the decisions of the Supervisory Body under Article 20, the transmission system operator shall have:

(a) effective decision-making rights, independent from the vertically integrated undertaking, with respect to assets necessary to operate, maintain or develop the transmission system; and

(b) the power to raise money on the capital market in particular through borrowing and capital increase.

2. The transmission system operator shall at all times act so as to ensure it has the resources it needs in order to carry out the activity of transmission properly and efficiently and develop and maintain an efficient, secure and economic transmission system.

3. Subsidiaries of the vertically integrated undertaking performing functions of generation or supply shall not have any direct or indirect shareholding in the transmission system operator. The transmission system operator shall neither have any direct or indirect shareholding in any subsidiary of the vertically integrated undertaking performing functions of generation or supply, nor receive dividends or any other financial benefit from that subsidiary.

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<sup>152</sup> First Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ L 65, 14.3.1968, p. 8).

4. The overall management structure and the corporate statutes of the transmission system operator shall ensure effective independence of the transmission system operator in compliance with this Chapter. The vertically integrated undertaking shall not determine, directly or indirectly, the competitive behaviour of the transmission system operator in relation to the day to day activities of the transmission system operator and management of the network, or in relation to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.
5. In fulfilling their tasks in Article 12 and Article 17(2) of this Directive, and in complying with Articles 14, 15 and 16 of Regulation (EC) No 714/2009, transmission system operators shall not discriminate against different persons or entities and shall not restrict, distort or prevent competition in generation or supply.
6. Any commercial and financial relations between the vertically integrated undertaking and the transmission system operator, including loans from the transmission system operator to the vertically integrated undertaking, shall comply with market conditions. The transmission system operator shall keep detailed records of such commercial and financial relations and make them available to the regulatory authority upon request.
7. The transmission system operator shall submit for approval by the regulatory authority all commercial and financial agreements with the vertically integrated undertaking.
8. The transmission system operator shall inform the regulatory authority of the financial resources, referred to in Article 17(1)(d), available for future investment projects and/or for the replacement of existing assets.
9. The vertically integrated undertaking shall refrain from any action impeding or prejudicing the transmission system operator from complying with its obligations in this Chapter and shall not require the transmission system operator to seek permission from the vertically integrated undertaking in fulfilling those obligations.
10. An undertaking which has been certified by the regulatory authority as being in compliance with the requirements of this Chapter shall be approved and designated as a transmission system operator by the Member State concerned. The certification procedure in either Article 10 of this Directive and Article 3 of Regulation (EC) No 714/2009 or in Article 11 of this Directive shall apply.

#### Article 19

##### Independence of the staff and the management of the transmission system operator

1. Decisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of office of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator shall be taken by the Supervisory Body of the transmission system operator appointed in accordance with Article 20.

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2. The identity and the conditions governing the term, the duration and the termination of office of the persons nominated by the Supervisory Body for appointment or renewal as persons responsible for the executive management and/or as members of the administrative bodies of the transmission system operator, and the reasons for any proposed decision terminating such term of office, shall be notified to the regulatory authority. Those conditions and the decisions referred to in paragraph 1 shall become binding only if the regulatory authority has raised no objections within three weeks of notification.

The regulatory authority may object to the decisions referred to in paragraph 1 where:

(a) doubts arise as to the professional independence of a nominated person responsible for the management and/or member of the administrative bodies; or  
(b) in the case of premature termination of a term of office, doubts exist regarding the justification of such premature termination.

3. No professional position or responsibility, interest or business relationship, directly or indirectly, with the vertically integrated undertaking or any part of it or its controlling shareholders other than the transmission system operator shall be exercised for a period of three years before the appointment of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are subject to this paragraph.

4. The persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the vertically integrated undertaking or with its controlling shareholders.

5. The persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall hold no interest in or receive any financial benefit, directly or indirectly, from any part of the vertically integrated undertaking other than the transmission system operator. Their remuneration shall not depend on activities or results of the vertically integrated undertaking other than those of the transmission system operator.

6. Effective rights of appeal to the regulatory authority shall be guaranteed for any complaints by the persons responsible for the management and/or members of the administrative bodies of the transmission system operator against premature terminations of their term of office.

7. After termination of their term of office in the transmission system operator, the persons responsible for its management and/or members of its administrative bodies shall have no professional position or responsibility, interest or business relationship with any part of the vertically integrated undertaking other than the transmission system operator, or with its controlling shareholders for a period of not less than four years.

8. Paragraph 3 shall apply to the majority of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator.

The persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are not subject to paragraph 3 shall have exercised no management or other relevant activity in the vertically integrated undertaking for a period of at least six months before their appointment.

The first subparagraph of this paragraph and paragraphs 4 to 7 shall be applicable to all the persons belonging to the executive management and to those directly reporting to them on matters related to the operation, maintenance or development of the network.

## Article 20

### Supervisory Body

1. The transmission system operator shall have a Supervisory Body which shall be in charge of taking decisions which may have a significant impact on the value of the assets of the shareholders within the transmission system operator, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the transmission system operator and the amount of dividends distributed to shareholders. The decisions falling under the remit of the Supervisory Body shall exclude those that are related to the day to day activities of the transmission system operator and management of the network, and to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.

2. The Supervisory Body shall be composed of members representing the vertically integrated undertaking, members representing third-party shareholders and, where the relevant legislation of a Member State so provides, members representing other interested parties such as employees of the transmission system operator.

3. The first subparagraph of Article 19(2) and Article 19(3) to (7) shall apply to at least half of the members of the Supervisory Body minus one.

Point (b) of the second subparagraph of Article 19(2) shall apply to all the members of the Supervisory Body.

## Article 21

### Compliance programme and compliance officer

1. Member States shall ensure that transmission system operators establish and implement a compliance programme which sets out the measures taken in order to ensure that discriminatory conduct is excluded, and ensure that the compliance with that programme is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. It shall be subject to approval by the regulatory authority. Without prejudice to the powers of the national regulator, compliance with the program shall be independently monitored by a compliance officer.

2. The compliance officer shall be appointed by the Supervisory Body, subject to the approval by the regulatory authority. The regulatory authority may refuse the approval of the compliance officer only for reasons of lack of independence or professional capacity. The compliance officer may be a natural or legal person. Article 19(2) to (8) shall apply to the compliance officer.

3. The compliance officer shall be in charge of:

- (a) monitoring the implementation of the compliance programme;
- (b) elaborating an annual report, setting out the measures taken in order to implement the compliance programme and submitting it to the regulatory authority;
- (c) reporting to the Supervisory Body and issuing recommendations on the compliance programme and its implementation;
- (d) notifying the regulatory authority on any substantial breaches with regard to the implementation of the compliance programme; and
- (e) reporting to the regulatory authority on any commercial and financial relations between the vertically integrated undertaking and the transmission system operator.

4. The compliance officer shall submit the proposed decisions on the investment plan or on individual investments in the network to the regulatory authority. This shall occur at the latest when the management and/or the competent administrative body of the transmission system operator submits them to the Supervisory Body.

5. Where the vertically integrated undertaking, in the general assembly or through the vote of the members of the Supervisory Body it has appointed, has prevented the adoption of a decision with the effect of preventing or delaying investments, which under the ten-year network development plan was to be executed in the following three years, the compliance officer shall report this to the regulatory authority, which then shall act in accordance with Article 22.

6. The conditions governing the mandate or the employment conditions of the compliance officer, including the duration of its mandate, shall be subject to approval by the regulatory authority. Those conditions shall ensure the independence of the compliance officer, including by providing him with all the resources necessary for fulfilling his duties. During his mandate, the compliance officer shall have no other professional position, responsibility or interest, directly or indirectly, in or with any part of the vertically integrated undertaking or with its controlling shareholders.

7. The compliance officer shall report regularly, either orally or in writing, to the regulatory authority and shall have the right to report regularly, either orally or in writing, to the Supervisory Body of the transmission system operator.

8. The compliance officer may attend all meetings of the management or administrative bodies of the transmission system operator, and those of the Supervisory Body and the general assembly. The compliance officer shall attend all meetings that address the following matters:

- (a) conditions for access to the network, as defined in Regulation (EC) No 714/2009, in particular regarding tariffs, third party access services, capacity allocation and congestion management, transparency, balancing and secondary markets;
- (b) projects undertaken in order to operate, maintain and develop the transmission system, including interconnection and connection investments;
- (c) energy purchases or sales necessary for the operation of the transmission system.

9. The compliance officer shall monitor the compliance of the transmission system operator with Article 16.

10. The compliance officer shall have access to all relevant data and to the offices of the transmission system operator and to all the information necessary for the fulfilment of his task.

11. After prior approval by the regulatory authority, the Supervisory Body may dismiss the compliance officer. It shall dismiss the compliance officer for reasons of lack of independence or professional capacity upon request of the regulatory authority.

12. The compliance officer shall have access to the offices of the transmission system operator without prior announcement.

## Article 22

### Network development and powers to make investment decisions

1. Every year, transmission system operators shall submit to the regulatory authority a ten-year network development plan based on existing and forecast supply and demand after having consulted all the relevant stakeholders. That network development plan shall contain efficient measures in order to guarantee the adequacy of the system and the security of supply.

2. The ten-year network development plan shall in particular:

- (a) indicate to market participants the main transmission infrastructure that needs to be built or upgraded over the next ten years;
- (b) contain all the investments already decided and identify new investments which have to be executed in the next three years; and
- (c) provide for a time frame for all investment projects.

3. When elaborating the ten-year network development plan, the transmission system operator shall make reasonable assumptions about the evolution of the generation, supply, consumption and exchanges with other countries, taking into account investment plans for regional and Community-wide networks.

4. The regulatory authority shall consult all actual or potential system users on the ten-year network development plan in an open and transparent manner. Persons or undertakings claiming to be potential system users may be required to substantiate such claims. The regulatory authority shall publish the result of the consultation process, in particular possible needs for investments.

5. The regulatory authority shall examine whether the ten-year network development plan covers all investment needs identified during the consultation process, and whether it is consistent with the non-binding Community-wide ten-year network development plan (Community-wide network development plan) referred to in Article 8(3)(b) of Regulation (EC) No 714/2009. If any doubt arises as to the consistency with the Community-wide network development plan, the regulatory authority shall consult the Agency. The regulatory authority may require the transmission system operator to amend its ten-year network development plan.

6. The regulatory authority shall monitor and evaluate the implementation of the ten-year network development plan.

7. In circumstances where the transmission system operator, other than for overriding reasons beyond its control, does not execute an investment, which, under the ten-year network development plan, was to be executed in the following three years, Member States shall ensure that the regulatory authority is required to take at least one of the following measures to ensure that the investment in question is made if such investment is still relevant on the basis of the most recent ten-year network development plan:

- (a) to require the transmission system operator to execute the investments in question;
- (b) to organise a tender procedure open to any investors for the investment in question; or
- (c) to oblige the transmission system operator to accept a capital increase to finance the necessary investments and allow independent investors to participate in the capital.

Where the regulatory authority has made use of its powers under point (b) of the first subparagraph, it may oblige the transmission system operator to agree to one or more of the following:

- (a) financing by any third party;
- (b) construction by any third party;
- (c) building the new assets concerned itself;
- (d) operating the new asset concerned itself.

The transmission system operator shall provide the investors with all information needed to realise the investment, shall connect new assets to the transmission network and shall generally make its best efforts to facilitate the implementation of the investment project.

The relevant financial arrangements shall be subject to approval by the regulatory authority.

8. Where the regulatory authority has made use of its powers under the first subparagraph of paragraph 7, the relevant tariff regulations shall cover the costs of the investments in question.

## Article 23

Decision-making powers regarding the connection of new power plant to the transmission system

1. The transmission system operator shall establish and publish transparent and efficient procedures for non-discriminatory connection of new power plants to the transmission system. Those procedures shall be subject to the approval of national regulatory authorities.
2. The transmission system operator shall not be entitled to refuse the connection of a new power plant on the grounds of possible future limitations to available network capacities, such as congestion in distant parts of the transmission system. The transmission system operator shall supply necessary information.
3. The transmission system operator shall not be entitled to refuse a new connection point, on the ground that it will lead to additional costs linked with necessary capacity increase of system elements in the close-up range to the connection point.

## Appendix 3 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>153</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>154</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>155</sup>;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>156</sup>

<sup>153</sup> entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>154</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>155</sup> Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

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1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed<sup>157</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>158</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>156</sup> The Authority may have regard to other descriptions of consumers.

<sup>157</sup> or persons authorised by exemptions to carry on any activity.

<sup>158</sup> Council Regulation (EC) 1/2003

## Appendix 4 - Glossary

### A

#### ACER

European Agency for the Cooperation of Energy Regulators (or the European Agency).

### B

#### BETTA

British Electricity Trading and Transmission Arrangements.

#### BSE

Balancing and Settlement Code.

### C

#### COREPER

The Permanent Representatives Committee, which is responsible for preparing the work of the Council of the European Union. It consists of the Member States' ambassadors to the European Union ("Permanent Representatives") and is chaired by the Member State which holds the Council Presidency.

#### CUSC

Customer Use of System Code.

### D

#### DECC

Department for Energy and Climate Change.

#### DETI

Department of Enterprise, Trade and Investment in Northern Ireland.

### E

#### ENTSO-E

European network of Transmission System Operators for Electricity.

### G

**GB**

Great Britain.

**I****IFA**

Interconnexion France Angleterre, the interconnector between the French and GB transmission systems.

**ISO**

Independent system operator.

**ITC**

Inter-TSO compensation mechanism.

**ITO**

Independent transmission operator.

**N****NGET**

National Grid Electricity Transmission.

**NGG**

National Grid Gas.

**NGIL**

National Grid Interconnector Limited.

**NIAUR**

Northern Ireland Authority for Utility Regulation.

**O****OFTO**

Offshore Transmission Owner.

**OU**

Ownership unbundling.

**R**

## RTE

Réseau de transport d'électricité, the French electricity TSO.

**S**

## SHETL

Scottish Hydro-Electric Transmission Limited.

## SLC

Standard Licence Condition.

## SO

System Operator.

## SPTL

SP Transmission Limited.

## SQSS

Security and Quality of Supply Standard.

## STC

System Operator-Transmission Operator Code.

**T**

## TSO

Transmission system operator.

**U**

## US

United States.

## Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

**Andrew MacFaul**  
Consultation Co-ordinator  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
[andrew.macfaul@ofgem.gov.uk](mailto:andrew.macfaul@ofgem.gov.uk)