

Ofgem's final decision and analysis on National Grid Electricity Transmission plc's ("NGET's") application for certification as unbundled

This document sets out Ofgem's final decision on NGET's compliance with the requirements of the Third Package¹ for transmission system operators ("TSOs") to unbundle from generation, production and supply undertakings as implemented into the domestic legislation in Great Britain ("GB").

1. Certification Decision

1.1. Having taken utmost account of the European Commission's (the "Commission's") opinion on our preliminary certification decision on NGET, Ofgem concludes that NGET complies with the requirements of the ownership unbundling model as set out in GB legislation and should therefore be certified as ownership unbundled.

2. GB Legislation – Transposition of Directives 2009/72 and 2009/73

2.1. In GB the ownership unbundling requirements set out in Directive 2009/72 (the "Electricity Directive") have been transposed through the Electricity and Gas (Internal Markets) Regulations 2011 (the "Regulations") which insert new sections 10A to 10O into the Electricity Act 1989 (the "Electricity Act"). Section 8H of the Gas Act and 10F of the Electricity Act (inserted by the Regulations) – 'The ownership unbundling requirement' – state that *"the ownership unbundling requirement is met by the applicant if each of the following five tests is passed"*.

3. The Applicant

3.1. NGET (the "Applicant") owns the electricity transmission system in England and Wales and operates the transmission system in England, Wales and Scotland ("GB"). NGET holds an electricity transmission licence treated as granted under Section 6(1)(b) of the Electricity Act.

3.2. This document provides a summary of the analysis of the information submitted by NGET to the Authority² and the Commission for the purpose of assessing the Applicant's

¹ The term "Third Package" refers to 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 ('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 ('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 ('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 ('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.

² The Gas and Electricity Markets Authority (the "Authority"). In this document, the terms "Authority", "Ofgem", "we" and "us" are used interchangeably.

compliance with the unbundling requirements (the five tests) and its certification as independent from production, generation and supply undertakings under the GB legislation implementing the unbundling provisions of the Electricity Directive of the Third Package.

4. Summary of Ofgem analysis

4.1. *First test: the applicant (a) does not control a relevant producer or supplier; (b) does not have a majority shareholding in a relevant producer or supplier; and (c) will not, on or after the relevant date, exercise shareholder rights in relation to a relevant producer or supplier.*

4.2. NGET has confirmed that it holds shares in companies involved in the electricity sector and our own analysis of the information provided by NGET about the activities of these companies confirms that none of them is a relevant producer or supplier. Furthermore, NGET has provided a signed undertaking that it will not, on or after the relevant date³, exercise shareholder right in relation to a relevant producer or supplier. Therefore NGET meets the requirement of the first test.

4.3. *Second Test: where the applicant is a company, partnership or other business, none of its senior officers has been, or may be, appointed by a person who (a) controls an electricity undertaking which is a relevant producer or supplier; or (b) has a majority shareholding in an electricity undertaking which is a relevant producer or supplier.*

4.4. NGET has provided details of the process for appointing its directors. NGET meets the requirements of the second test as none of its senior officers has been, or may be, appointed by a person who (a) controls an electricity undertaking which is a relevant producer or supplier; or (b) has a majority shareholding in an electricity undertaking which is a relevant producer or supplier.

4.5. *Third Test: where the applicant is a company, partnership or other business, none of its senior officers is also a senior officer of an electricity undertaking which is a relevant producer or supplier.*

4.6. The information provided by NGET confirms that none of the directors or senior officers of NGET is also a senior officer of an electricity undertaking which is a relevant producer or supplier.

4.7. *Fourth and Fifth Tests: the applicant is not controlled by a person who (a) controls a relevant producer or supplier; and, (b) has a majority shareholding in a relevant producer or supplier.*

4.8. NGET is a wholly owned subsidiary of NGHL, which in turn is a wholly owned subsidiary of National Grid Holding One plc, which in turn is a wholly owned subsidiary of, and therefore controlled by, National Grid plc which is a FTSE-listed company. Our analysis confirms that none of the companies controlled by National Grid plc (as the ultimate parent company of the applicant) is a relevant producer or supplier and therefore the applicant is not controlled by a person who either controls a relevant producer or supplier or has a majority shareholding in a relevant producer or supplier. The requirements of the fourth and fifth tests are therefore met.

³ 3 March 2012

5. European Commission Opinion

5.1. Pursuant to Article 3(2) of the Electricity Regulation Ofgem is required to take "utmost account" of the Commission's opinion in reaching its final certification decisions. We summarise below how we have taken "utmost account" of the Commission's opinion of Ofgem's preliminary certification decision in relation to NGET.

5.2. Article 9(1)(b)(ii) of the Electricity Directive prohibits the same person or persons from directly or indirectly exercising control over a transmission system operator or over a transmission system, and directly or indirectly exercising control or exercising any right over an undertaking performing any of the functions of production or supply. National Grid plc, the ultimate controller of NGET, controls National Grid USA which is involved in generation of electricity in the United States. Ofgem's preliminary certification decision concluded that these generation interests in the United States were not considered relevant interests in terms of certification because they are held outside the European Economic Area (EEA). However, the Commission has pointed out that Article 9(1)(b)(ii) of the Electricity Directive is not restricted to generators, producers and suppliers operating in the EEA. Nevertheless, because there is no interaction between US and UK electricity systems, the Commission considers that the activities of National Grid in the United States should not prevent certification of NGET.

5.3. The Commission opinion also discussed the Independence of Board members. Article 9(1)(c) and (d) of the Electricity Directive require that members of the management of the TSO and persons that have the right to appoint them, must fulfil certain requirements of independence. In particular, the same person or persons are not entitled to control or exercise any right over an undertaking performing any of the functions of production or supply and at the same time be a member of or be entitled to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking.

5.4. The Commission agreed with Ofgem's approach that in the case of NGET, which is ultimately controlled by National Grid plc, it is necessary not only to assess the compliance with the independence requirements of members of the direct management of applicants, but also of members of the management of National Grid plc (the ultimate parent company of NGET). Ofgem carried out an analysis of the interests of all National Grid plc board members and investigated fully any interests that were potentially linked in any way to any functions of production or supply. After careful consideration and investigation Ofgem concluded that these interests were not considered relevant to the certification process.

5.5. However, the Commission asked Ofgem to satisfy itself that the interests of a non-executive director of National Grid plc who is also the chairman of a recycling, renewable energy and waste management company will not adversely affect the independence of the director concerned by creating an incentive to influence the decision making in the transmission system operator in order to favour these interests to the detriment of other network users.

5.6. The recycling, renewable energy and waste management company in question is not required to hold an electricity generation licence for its activities as they are below the licensable threshold in GB. In addition, this non-executive Director of National Grid plc is not a member of the NGET board and we therefore note that it is not possible for this single member of the national Grid plc board, acting alone, to exercise control over NGET.

5.7. Therefore, after further investigation we can confirm that we are satisfied that the interests of this non-executive Director of National Grid plc when taken in aggregate will not affect the independence of this non-executive Director. Nor will these interests give

rise to any incentive or ability for this non-executive Director to exert influence over the decision making of the transmission system operator.

5.8. The Commission also commented on further analysis in Ofgem's preliminary decision in relation to two other non-executive Directors of National Grid plc who have interests in generation and production companies in Kazakhstan and Iraq, and an interest in a company with interest in generation and production in Canada, India, Indonesia, Madagascar, Nigeria, Australia and Vietnam. Here, the Commission stated again that it considers that Article 9(1)(c) and (d) of the Electricity Directive is not restricted to the activities of generators, producers or suppliers operating in the EEA. Therefore, the Commission invited Ofgem to satisfy itself that these activities will not adversely affect the independence of the directors concerned.

5.9. As stated above we note that it is not possible for single members of the national Grid plc board, acting alone, to exercise control over NGET. We also confirm that we are satisfied that the interests of these Directors in activities carried out in Kazakhstan, Iraq, Canada, India, Indonesia, Madagascar, Nigeria, Australia and Vietnam will not adversely affect the independence of these directors or create an incentive to influence the decision making process of NGET.