



Current and future electricity transmission; gas transportation; electricity interconnector; and gas interconnector licensees

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*Promoting choice and value for all gas and electricity customers*

Date: 6 March 2015

Dear Colleague,

**Certification arrangements in Great Britain following amendments to the ownership unbundling requirements of the Gas Act 1986 and the Electricity Act 1989**

This letter sets out information on our intended approach to processing applications for certification following amendments to the ownership unbundling requirements of the Electricity Act 1989 and the Gas Act 1986, as detailed in the annex. The requirements were amended by the Electricity and Gas (Ownership Unbundling) Regulations 2014, which came into force on 15 January 2015 ("the 2014 Regulations").

The amendments affect the following types of current or prospective licensees in Great Britain: (i) electricity transmission; (ii) gas transportation (high-pressure only); (iii) electricity interconnector; and (iv) gas interconnector.

We are not expressly seeking comments at this stage but should you wish to contact us about the contents of this document, please contact Chris Chow ([chris.chow@ofgem.gov.uk](mailto:chris.chow@ofgem.gov.uk)) or Anthony Mungall ([anthony.mungall@ofgem.gov.uk](mailto:anthony.mungall@ofgem.gov.uk)).

Yours faithfully

**Stephen Beel**  
**Associate Partner, Electricity Transmission**

## **Annex 1 - Certification arrangements in Great Britain following amendments to the ownership unbundling requirements of the Gas Act 1986 and the Electricity Act 1989**

### **1. Summary**

EU legislation requires ownership 'unbundling'. Unbundling means separating the ownership and operation of a transmission network from the activities of electricity generation, gas production and energy supply.

The government recently made some changes to the ownership unbundling provisions of the Electricity Act 1989 ('the Electricity Act') and Gas Act 1986 ('the Gas Act'). The amending regulations, the Electricity and Gas (Ownership Unbundling) Regulations 2014, came into force on 15 January 2015<sup>1</sup> ('the 2014 Regulations').

The Authority<sup>2</sup> is responsible for administering the certification process in Great Britain ('GB') in accordance with the unbundling requirements of the Third Package<sup>3</sup>. Although there are a number of certification grounds, ownership unbundling is the only ground affected by the 2014 Regulations and is the only certification ground considered here. Those applying for certification under the ownership unbundling ground<sup>4</sup> must pass five tests<sup>5</sup> for certification to be granted and continue to meet these tests to retain certification.

The 2014 Regulations amend the transposition of the EU unbundling requirements into GB legislation and allow us to use some discretion when considering certain certification cases under all five tests. Where one or more of the tests is not passed, we may decide to treat such tests as passed if the Authority is satisfied that there is no risk of discrimination and it would be in line with our principal objective and general duties to do so.

This document outlines the changes introduced by the 2014 Regulations and highlights our intended approach to the application of the discretion. This document is not a substitute for the requirements of the legislation. We encourage applicants to seek legal advice on applying the legislation to their specific circumstances.

The 2014 Regulations do not apply to applications received or reviews of certification commenced prior to 15 January 2015 on which we have yet to make a decision.

### **2. Background**

EU legislation requires the ownership 'unbundling' of transmission system operators ('TSOs')<sup>6</sup>. Unbundling means separating the ownership and operation of a transmission system from the activities of electricity generation, gas production and energy supply. One

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<sup>1</sup> [http://www.legislation.gov.uk/ukxi/2014/3333/pdfs/ukxi\\_20143333\\_en.pdf](http://www.legislation.gov.uk/ukxi/2014/3333/pdfs/ukxi_20143333_en.pdf)

<sup>2</sup> The Gas and Electricity Markets Authority ('the Authority'). In this document, the terms 'Authority', 'Ofgem', 'we' and 'us' are used interchangeably.

<sup>3</sup> 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 ('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 ('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 ('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 ('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. It entered into force on 3 September 2009. The requirements and intent of the EU ownership unbundling legislation remain unchanged as a result of the 2014 Regulations.

<sup>4</sup> Section 10E(3) of the Electricity Act and section 8G(3) of the Gas Act.

<sup>5</sup> Sections 10F(2)-(6) and (8) of the Electricity Act and sections 8H(2)-(8) of the Gas Act.

<sup>6</sup> 'Transmission system operator' 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 interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity. This definition is set out in Article 2(4) of the Electricity and Gas Directives.

of the aims of the provisions is to make sure that TSOs take their decisions independently, ensuring transparency and non-discrimination towards all network users.

The Electricity and Gas (Internal Markets) Regulations ('the 2011 Regulations'), which came into force on 10 November 2011, transposed the EU unbundling requirements into domestic law and provided the current legal framework for the structural separation of TSOs in GB.<sup>7</sup> Our open letter of 10 November 2011<sup>8</sup> detailed our procedure for processing applications for certification under the ownership unbundling requirements of the Third Package.<sup>9</sup> Under the Electricity Act and the Gas Act, gas and electricity interconnector, electricity transmission and certain gas transporter licensees are required to be certified.<sup>10</sup>

Following a call for comments<sup>11</sup> in September 2014 (the 'call for comments'), the Department for Energy and Climate Change ('DECC') decided to proceed with its proposal to amend the ownership unbundling provisions of the Electricity Act and Gas Act. In the call for comments, DECC stated that the intended effect of the proposed legislative amendment was to "*encourage investment in the UK energy markets whilst retaining the overall aims of the EU Directives' ownership unbundling requirements.*"

The call for comments also noted the interaction with the European Commission staff working paper (May 2013), which set out the Commission's approach to assessing certification applications.<sup>12</sup>

### 3. The GB legal framework

The 2014 Regulations do not change any of the five certification tests. The five tests, as set out in the legislation, are:

- **First test:** the applicant
  - a) does not control a relevant producer or supplier ('RPoS');
  - b) does not have a majority shareholding in a RPoS; and
  - c) will not, on or after the relevant date<sup>13</sup>, exercise shareholder rights in relation to a RPoS.
- **Second test:** if 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 undertaking<sup>14</sup> which is a RPoS; or
  - b) has a majority shareholding in an undertaking which is a RPoS.
- **Third test:** if the applicant is a company, partnership or other business, none of its senior officers is also a senior officer of an undertaking which is a RPoS.
- **Fourth test:** the applicant is not controlled by a person who controls a RPoS.
- **Fifth test:** the applicant is not controlled by a person who has a majority shareholding in a RPoS.

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<sup>7</sup> There was a separate transposition for Northern Ireland.

<sup>8</sup> <https://www.ofgem.gov.uk/ofgem-publications/59314/111110-open-letter-certification-post-legislation.pdf>

<sup>9</sup> As amended by the Electricity and Gas (Internal Markets) Regulations 2011.

<sup>10</sup> Section 10A of the Electricity Act and 8C of the Gas Act.

<sup>11</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/354981/unbundling\\_call\\_4\\_comments.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/354981/unbundling_call_4_comments.pdf)

<sup>12</sup> [http://ec.europa.eu/energy/sites/ener/files/documents/swd\\_2013\\_0177\\_en.pdf](http://ec.europa.eu/energy/sites/ener/files/documents/swd_2013_0177_en.pdf)

<sup>13</sup> Section 10A(4) of the Electricity Act and 8C(4) of the Gas Act.

<sup>14</sup> The definition of "electricity undertaking" is set out in Section 100(2) of the Electricity Act. The definition of "gas undertaking" is set out in Section 8Q(2) of the Gas Act.

### **Who is an applicant?**

In this document we refer to persons applying for certification (under section 10B(1) of the Electricity Act or section 8D(1) of the Gas Act) and those whose certification is being reviewed (under section 10I(3) or (5) of the Electricity Act or section 8K(3) or (5) of the Gas Act) collectively as 'the applicant'. To date, all applicants for certification have been either current or prospective electricity transmission licensees (onshore and offshore), electricity interconnector licensees, gas transporter licensees (who carry out the activity of transmission) and gas interconnector licensees.

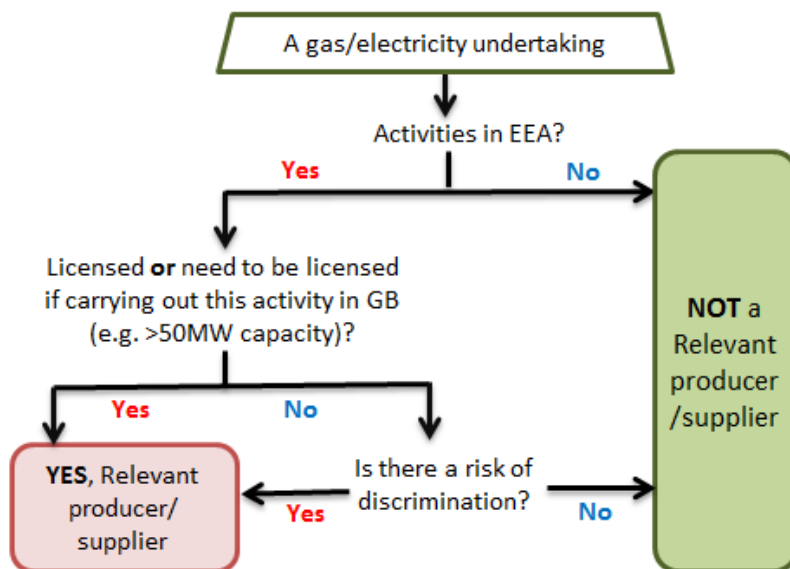
### **Who is a relevant producer or supplier ('RPOS')?**

The relationship between the applicant and the RPOS is at the heart of each of the five certification tests. A RPOS is anyone who participates in one or more of the activities of electricity generation, gas production and/or energy supply in the European Economic Area (EEA) and

- requires or, in the Authority's opinion, would need a licence to carry out that activity or activities in GB; or
- does not require a licence, or is operating under an exemption granted by the Secretary of State, but has a relationship with the applicant which we think might lead the applicant to discriminate in favour of that person.

This definition is set out in Section 100(3)-(5) of the Electricity Act and sections 8Q(3)-(5) of the Gas Act. There is an illustration of the term RPOS in Figure 1 below.

**Figure 1: Illustration of the term "Relevant producer or supplier" within the meaning of section 100 of the Electricity Act and section 8Q of the Gas Act**



Until the 2014 Regulations came into force, the Authority could only grant certification to an applicant if satisfied that all of the above tests were passed (subject to the limited exception for the Authority to treat the fourth and fifth tests as passed in specific circumstances<sup>15</sup>).

<sup>15</sup> See section 10F(7) and (9) of the Electricity Act and Section 8H(7) and (9) of the Gas Act.

## What is risk of discrimination?

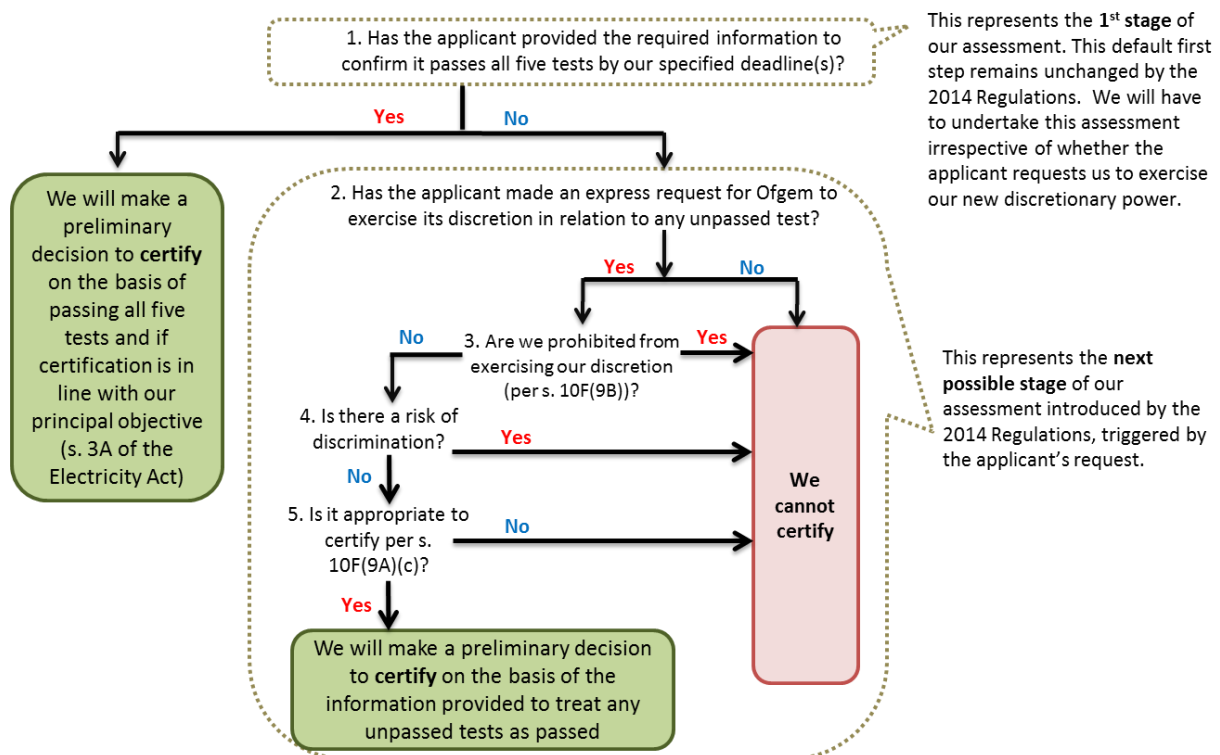
In this document our assessment of risk of discrimination refers to whether an applicant has a relationship with a RPoS which might lead the applicant to discriminate in favour of the RPoS.

## 4. What has changed?

The 2014 Regulations give us a new discretionary power ('the discretion') to certify an applicant on the ownership unbundling ground even if one or more of the five certification tests is not passed, provided that the Authority is satisfied that there is no risk of discrimination and that to do so would be in line with our principal objective and general duties. We can use this discretion for all applicants for certification under the ownership unbundling ground and in relation to all five certification tests, but there is a specific exception which applies to applicants under the Electricity Act only. Below there is a diagram showing the amended transposition of the EU unbundling requirements into the Electricity Act.

In addition, the 2014 Regulations amend the timescales for reviewing certification to align with those which previously only applied to new applications.

**Figure 2 – Overview of certification assessment under the Electricity Act** (apart from step 3, this chart also applies to applications for certification under the Gas Act)



Note:

- Steps 2, 3 and 4 represent the process changes introduced by the 2014 Regulations.
- Steps 1 and 5 remain unchanged under the 2014 Regulations.
- Our assessment process may include Ofgem request(s) for clarification or further information from the applicant regarding the application by a specific deadline.

## 5. What has not changed?

Most aspects of the legislation remain unchanged. In particular, we note that:

- The five certification tests do not change.

- Applicants for certification who pass all five tests will be certified as ownership unbundled, provided that certification is in line with our principal objective.
- We are still able to treat the fourth and fifth tests as passed in specific circumstances<sup>16</sup> and for a specified period<sup>17</sup> of time.
- The Authority retains the power to set a deadline for the provision of information requested from an applicant.<sup>18</sup>
- The definition of a RPoS, the risk of discrimination test<sup>19</sup>, and the provisions relating to exercising certain shareholder rights<sup>20</sup> remain unchanged.
- Apart from the timing amendment (described in more detail in section 6 below), the process for review of applications has not changed.
- We are still required to take utmost account of the European Commission's opinion when making our final certification decision.
- We still have a duty to cooperate with other National Regulatory Authorities and with the Agency for the Cooperation of Energy Regulators (ACER) where relevant.
- We still have a duty to monitor and review whether the basis on which a person has been certified continues to apply.<sup>21</sup>
- The rules relating to security of energy supply which apply when a person from a third country<sup>22</sup> controls an applicant for certification<sup>23</sup> are unaffected.

## **6. The discretion to treat one or more of the five tests as passed**

New section 10F(9A) of the Electricity Act sets out how the discretion applies to applicants under that Act, unless the exception in subsection (9B) applies. Subsection (9B) relates to circumstances where the Authority is prohibited from exercising its discretion. This is discussed in more detail later in this section.

Section 10F9(A) states:

"(9A) Except where subsection (9B) applies, the Authority may treat one or more of the five tests in this section as passed if—

- (a) the test or tests are not passed in relation to a relevant producer or supplier,
- (b) the applicant has demonstrated to the Authority's satisfaction that the applicant does not have a relationship with the relevant producer or supplier which might lead the applicant to discriminate in favour of the relevant producer or supplier, and
- (c) the Authority thinks it appropriate to treat the test or tests as passed."

New section 8H(9A) of the Gas Act sets out how the discretion applies to applicants under that Act, shown below.

"(9A) The Authority may treat one or more of the five tests in this section as passed if—

- (a) the test or tests are not passed in relation to a relevant producer or supplier,
- (b) the applicant has demonstrated to the Authority's satisfaction that the applicant does not have a relationship with the relevant producer or supplier which might lead the applicant to discriminate in favour of the relevant producer or supplier, and
- (c) the Authority thinks it appropriate to treat the test or tests as passed."

<sup>16</sup> Section 10F(7) and (9) of the Electricity Act and section 8H(7) and (9) of the Gas Act.

<sup>17</sup> Section 10G(2) of the Electricity Act and section 8I(2) of the Gas Act.

<sup>18</sup> Sections 10B(6) and 10J(4) of the Electricity Act and sections 8D(6) and 8L(4) of the Gas Act.

<sup>19</sup> Set out in section 10O(5)(c) of the Electricity Act and section 8Q(5)(c) of the Gas Act.

<sup>20</sup> The exercise of certain shareholder rights (see sections 10M and 10N of the Electricity Act and sections 8O and 8P of the Gas Act) is subject to possible review by the court on application of any person. Where the court determines that such a right has been exercised in breach of the prohibition set out in the legislation, the court may declare its exercise as void.

<sup>21</sup> Sections 10I, 10J and 10L of the Electricity Act and sections 8K, 8L and 8N of the Gas Act.

<sup>22</sup> As defined in section 10O of the Electricity Act and section 8Q of the Gas Act.

<sup>23</sup> See sections 10E(8)) and 10L(10) of the Electricity Act and sections 8G(8) and 8N(10) of the Gas Act.

## General approach

Below we describe our general approach to exercising the discretion according to the above provisions. Unless otherwise stated, this approach applies equally to all applicants for certification under the ownership unbundling ground.

- a) For applicants under the Electricity Act only, we are prohibited from exercising the discretion to treat one or more of the five tests as passed where the circumstances discussed in new section 10F(9B) apply. This is discussed further below.
- b) Where the circumstances in (a) do not apply, the starting point remains that an applicant who does not meet all five tests will not be certified. The onus is on the applicant to ask us to consider exercising the discretion. We expect the applicant to:
  - i. expressly request that we consider exercising our discretion, and with reference to the particular test or tests which are not passed.
  - ii. detail the reasons why it believes that there is no risk of discrimination in the particular circumstances.
  - iii. provide information to support its explanation. The nature of such information will depend on the particular test or tests which the applicant is asking us to treat as passed and the circumstances of each individual case, but the following may be relevant:
    - Corporate governance arrangements between the applicant and the RPoS, such as details of shareholder agreements and corporate charts.
    - Information to confirm the size and physical location of the relevant assets such as maps or grid references and copies of connection agreements.
    - Other evidence such as copies of licence documents, export capacity agreements and exporting market details.

Unless we are satisfied, on the basis of the information received, that the applicant does not have a relationship with the RPoS which might lead the applicant to discriminate in favour of that RPoS, the applicant will not be certified.

- c) To decide whether it is appropriate to treat the tests as passed, we will need to consider the wider circumstances of the application by having regard to our principal objective and general duties.

## Risk of discrimination

This section lists the factors that we consider may be particularly relevant to assessing the risk of discrimination and our ability to exercise discretion.<sup>24</sup>

Each case will be assessed on its merits, taking into account the context and conditions likely to affect the competitiveness of the energy markets in which the applicant and the RPoS operate. No factor alone will be decisive and further factors may be relevant.

- **Geographical proximity of the assets under the ownership or operational control of the applicant and the RPoS' assets.** The closer the two are, the stronger the indication that a risk of discrimination may exist and the stronger the evidence we will require to rebut it. The risk of discrimination is likely to be greater when the applicant's and RPoS' assets are both located in GB. Conversely, the risk is likely to be lower when the assets are not in the same or a neighbouring market.

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<sup>24</sup> For the avoidance of doubt, this approach would also apply to assessments under section 100(5)(c) of the Electricity Act and section 8Q(5)(c) of the Gas Act.

- **Role carried out by the applicant<sup>25</sup>.** Each type of licensee has a different role in the GB energy market. Some have an extensive range of responsibilities in operating a large integrated network and establishing the commercial terms for access to a network, and have some influence over investment planning decisions. Others have a more limited range of activities relating to a point-to-point system, which connects to the larger integrated network. The more activities performed by the licensee, the greater the risk of discrimination and the stronger the evidence we will need to rebut it. We consider the risk of discrimination greater if the applicant carries out significant system operation functions or is responsible for investment planning in the geographical area in which the RPoS connects.
- **Market share of electricity generation, gas production and energy supply activities concerned.** We will be particularly concerned about the risk of discrimination if an applicant, or a controller of the applicant, has a relationship which amounts to control over a RPoS, or some RPoS' collectively, who has a large share of the market that both the applicant and the RPoS are active in. The greater the market share, the easier it is to create an opportunity for discrimination, and the stronger the evidence we will require to rebut it. The information gathered as part of this assessment may also be used as part of a broader assessment of potential market power, if necessary. For example, our concerns about the risk of discrimination may be moderated by evidence of the extent to which the RPoS is a price-taker in the relevant market or is insensitive to wholesale market fluctuations.
- **Type of energy assets operated.** We consider that the likelihood of discrimination would be greater when the applicant and the RPoS operate assets in the same sector (i.e. electricity or gas) than otherwise. We may also consider whether the gas production, electricity generation or energy supply activity is the result of a by-product of another primary operation, and whether this affects the risk of discrimination.
- **Arrangements governing the relationship between the applicant, or its controller, and the RPoS.** For example, we are likely to have particular concerns about the risk of discrimination where an applicant, or its controller, has access to confidential information on the activities of a RPoS.

### Appropriateness

As noted above, the Authority will also consider whether it is appropriate to treat the relevant tests as passed by having regard to our principal objective and general duties.

### Circumstances where the Authority is prohibited from exercising its discretion

The 2014 Regulations introduce the following exception for applicants under the Electricity Act:

“(9B) This subsection applies where the applicant, or a person who controls or has a majority shareholding in the applicant, controls or has a majority shareholding in a person (“A”) who operates a generating station and—

- (a) A is a relevant producer or supplier; and
- (b) the generating station is directly physically connected to anything that forms part of the applicant’s transmission system or electricity interconnector.”

In the September 2014 call for comments, DECC explained that this exception is appropriate as certification cannot be granted in these specific circumstances because: *“there would always and necessarily be an unacceptable risk of discrimination in such a*

<sup>25</sup> Electricity transmission (onshore and offshore), electricity interconnector licensees, gas transporter licensees (who carry out the activity of transmission) and gas interconnector licensees.



*situation, i.e. if an electricity TSO were not ownership unbundled from a generator to which it is directly physically connected.”*

An example of a scenario where we would be prohibited from exercising the discretion is where the same person controls, or has a majority shareholding in, an offshore transmission asset and a generating station connected to it.

## **7. Timetable for certification review**

The 2014 Regulations amend the review timescales so that the four-month time period for reviews will begin on the day the last of the information requested (in accordance with the deadline for the supply of information set by the Authority set out in section 10J(4) of the Electricity Act and section 8L(4) of the Gas Act) is received. This aligns the time period for reviews with those which previously applied to new applications only.

It is in the applicants’ interest to provide us with information promptly to prevent unnecessary delays. This means that we will expect all applicants to evaluate their application against the five certification tests. The detail they provide should be sufficient to mitigate the need for a protracted appraisal of the information and the grounds for exercising our discretion (where expressly requested). This in turn would enable the Authority to initiate the four-month review period confident that we have all the information we need to make a decision.

The onus is on the applicant to expressly request that we consider exercising our discretion to treat one or more of the five tests as passed. If the information to support this request is not provided on time according to the deadline for the supply of information set by the Authority, we will not be able to assess whether there is a risk of discrimination. In the case of a review of certification status, this may result in us withdrawing certification. We remind applicants that the requirement to provide information in response to a request from us is a relevant requirement.<sup>26</sup> Failure to comply may lead to enforcement action.

## **8. Transitional arrangements**

The 2014 Regulations state that the new provisions will only apply to applications received and reviews started on or after the day that the Regulations come into force, which was on 15 January 2015.

A review of an existing certification decision can be triggered:

- When a certified person notifies us of an event or circumstance which may affect the basis for certification;
- When we think that the basis for certification no longer applies<sup>27</sup>; or
- At the request of the European Commission.

## **9. Other relevant legislation and regulation**

We remind applicants and certified persons that, notwithstanding their certification status, they must continue to comply with all legal requirements applicable to them, including licence conditions.

If you have any queries please contact Chris Chow ([chris.chow@ofgem.gov.uk](mailto:chris.chow@ofgem.gov.uk)) or Anthony Mungall ([anthony.mungall@ofgem.gov.uk](mailto:anthony.mungall@ofgem.gov.uk)).

We may choose to update the guidance from time to time.

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<sup>26</sup> Section 25 of the Electricity Act and section 28 of the Gas Act.

<sup>27</sup> Section 10I of the Electricity Act and section 8K of the Gas Act.