



To
All Transmission System Operators
and relevant stakeholders

**Department for Business, Energy &
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Dear Colleague,

TSO unbundling

European legislation prohibits transmission system operators (TSOs) from owning or controlling assets for the production or supply of energy, or being controlled by persons that own or control such interests. This is known as 'unbundling'. The aim of this is to avoid conflicts of interest, the potential for discrimination among network users and uncompetitive behaviour. Ofgem, as National Regulatory Authority, has to certify that GB TSOs comply with the unbundling requirements. Proposed certification decisions must be considered by the Commission and their opinion taken into account by Ofgem in the final decision.

The purpose of this letter is to inform you of a forthcoming amendment to the GB legislation that implements the unbundling requirements that is required to be made by the Commission and what this means for currently certified GB TSOs. We are considering transitional arrangements to manage the impact, as well as guidance for stakeholders to understand implications for existing and future certifications.

GB legal framework

In GB the ownership unbundling requirements set out in EU Directive 2009/72¹ have been transposed through the Electricity and Gas (Internal Markets) Regulations 2011 which amend the Electricity Act 1989 and the Gas Act 1986 to implement the requirements. Ofgem assesses a certification application against five certification tests under the full ownership unbundling model which are set out in this legislation². Where one or more of the tests is not passed, Ofgem may decide to treat such tests as passed if satisfied that there is no risk of discrimination and it would be in line with its principal objective and general duties to do so; the 'discretionary power'³.

Due to the UK's particular geographical situation, and the lack of interface between GB transmission networks and those of non-European Economic Area (EEA) states, it was considered that there would be no possibility for a GB TSO to engage in discrimination in relation to production, generation and supply interests outside the EEA that would lead to a breach of the unbundling requirements. On that basis, it was seen as disproportionate to require Ofgem to make an assessment of non-EEA state interests when making certification

¹ <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0072>

² Section 10F of the Electricity Act 1989 and section 8H of the Gas Act 1986

³ Section 10F(9A) of the Electricity Act 1989 and section 8H(9A) of the Gas Act 1986

decisions. Therefore, when implementing the unbundling requirements, consideration of production, generation and supply activities was limited to those taking place within the EEA. This was through the definition of 'relevant producer or supplier' ('RPOS') that is applied by Ofgem when considering the five certification tests. A summary of these tests and the meaning of RPOS is provided at annex 1 to this letter.

Commission's concerns

The Commission have now communicated to us concerns over the GB transposition of the unbundling requirements. Their principal concern is that other Member States, which have borders with non-EEA states, may see the GB transposition as setting a precedent they can use, risking potential discrimination and anti-competitive behaviour as a result of unbundling decisions in their territories. The Commission have made it clear that they do not have any concerns over any individual unbundling certification decisions made to date in GB.

However, the Commission is concerned that our inclusion of the EEA limitation is incompatible with EU legislation and sets an unhelpful precedent. Therefore the Commission require our current legislation to change. Accordingly, we plan to amend the Electricity Act 1989 and the Gas Act 1986 to remove the EEA limitation from the definition of RPOS as illustrated in annex 2 to this letter.

We note stakeholders may have a concern on how this amendment interacts with Brexit. We note that until exit negotiations are concluded, the UK remains a full member of the EU and all the rights and obligations of EU membership remain in force.

Timings

We currently expect that the amendment will come into force in April 2017, and therefore intend to lay the implementing regulations in Parliament before the end of March.

Effect and implications

On and from the date of the amendment, relevant production, generation or supply interests both inside and outside the EEA must be considered as part of the five certification tests. This will apply to future certifications, e.g. for the next round of TSOs to be appointed following Ofgem's offshore transmission tender rounds 4 and 5.

We note that this amendment may have implications for a number of GB TSOs that are currently certified as fully ownership unbundled⁴. Where there is a change to a TSO's existing certification basis, Ofgem is required to carry out a review of the certification⁵.

Impact and Transitional Arrangements

To manage the potential implications of the amendment for currently certified TSOs, we are going to implement transitional arrangements applicable to TSOs that are certified at the date the amendment comes into force. It is not intended that the amendment of the legislation will, by itself, be an event triggering a requirement for a review of existing certifications. Rather, a review will only be required if and when a later trigger event occurs. We propose to include provision in the legislation clarifying this, and to provide guidance to stakeholders. Therefore, a TSO's certification basis will not be affected immediately on coming into force of the amendment. Where a review of certification is to be carried out after the amendment comes into force, it will be done in accordance with the amended legislation.

⁴ Under section 10E(3) of the Electricity Act 1989 and section 8G(3) of the Gas Act 1986.

⁵ Section 10L of the Electricity Act 1989 and section 8K of the Gas Act 1986.

Guidance

Ofgem has published guidance in March 2015 on the GB certification arrangements⁶. The guidance highlights Ofgem's intended approach in applying the discretionary power in relation to RPoS interests in the EEA. Once the legislative amendment is in force, note that the discretionary power will also be available in relation to interests outside the EEA. Therefore Ofgem can certify a TSO under the discretionary power where a test is failed due to a connection with RPoS interests outside the EEA. Ofgem will review and publish updated guidance as a result of the legislative amendment in due course.

Next steps

Ofgem will communicate further regarding updated guidance. In the meantime, we appreciate that you may like to discuss this amendment with us so you can understand any implications for your business. Therefore, we are offering meetings for interested stakeholders. If you would like to arrange such a meeting please contact Callum.Galloway@beis.gov.uk by 10/03/2017.

Yours faithfully,

Callum Galloway Green

⁶ A copy of the guidance can be located here: <https://www.ofgem.gov.uk/publications-and-updates/certification-arrangements-great-britain-following-amendments-ownership-unbundling-requirements-gas-act-1986-and-electricity-act-1989>

ANNEX 1

A summary of the five certification tests and the meaning of RPoS set out in sections 10F and 10O of the Electricity Act 1989 and sections 8H and 8Q of the Gas Act 1986

First test: the applicant

- a) does not control a RPoS;
- b) does not have a majority shareholding in a RPoS; and
- c) will not, on or after the relevant date⁷, 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 undertaking⁸ 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.

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 EEA and:

- requires or 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.

⁷ Section 10A(4) of the Electricity Act 1989 and section 8C(4) of the Gas Act 1986

⁸ The definition of “electricity undertaking” is set out in section 10O(2) of the Electricity Act 1989. The definition of “gas undertaking” is set out in section 8Q(2) of the Gas Act 1986.

ANNEX 2

Electricity Act 1989, section 100:

“(3) In this Part “relevant producer or supplier”, in relation to an applicant for certification or a certified person, means a person who falls within each of subsections (4) and (5).

(4) A person falls within this section if the person—

- (a) is an electricity undertaking;
- (b) gets natural gas from its natural condition in strata otherwise than as an unintended consequence of the storage of gas, and requires a licence under section 3 of the Petroleum Act 1998 (licences to search and bore for and get petroleum) to do so or would require such a licence if getting the gas in Great Britain;
- (c) produces any other gas, including in particular biomethane, which is suitable for conveyance through pipes to premises in accordance with a licence under section 7 of the Gas Act 1986;
- (d) supplies to any premises gas which has been conveyed to those premises through pipes;
- (e) 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; or
- (f) otherwise sells gas,

and terms used in paragraphs (b) to (f) of this subsection have the same meanings in those paragraphs as in Part 1 of the Gas Act 1986.

(5) A person falls within this subsection if the person carries out ~~in an EEA state~~ some or all of the activity by virtue of which the person falls within subsection (4) and—

- (a) requires a licence under section 7A of the Gas Act 1986 (licensing of gas suppliers and gas shippers) or section 6 of this Act to do so;
- (b) would, in the Authority’s opinion, require such a licence if carrying out the activity in Great Britain; or
- (c) has a relationship with the applicant or certified person which the Authority thinks might lead the applicant or certified person to discriminate in favour of the person.]”

Gas Act 1986, section 8Q:

“(3) In this Part “relevant producer or supplier”, in relation to an applicant for certification or a certified person, means a person who falls within each of subsections (4) and (5).

(4) A person falls within this subsection if the person—

- (a) is a gas undertaking;
- (b) generates electricity for the purpose of giving a supply to any premises or enabling a supply to be so given;
- (c) supplies electricity to any premises; or

(d) otherwise generates or sells electricity,

and terms used in paragraphs (b) and (c) of this subsection have the same meanings in those paragraphs as in Part 1 of the Electricity Act 1989.

(5) A person falls within this subsection if the person carries out ~~in an EEA state~~ some or all of the activity by virtue of which the person falls within subsection (4) and—

(a) requires a licence under section 7A of this Act or section 6 of the Electricity Act 1989 (licences authorising supply, etc) to do so;

(b) would, in the Authority's opinion, require such a licence if carrying out the activity in Great Britain; or

(c) has a relationship with the applicant or certified person which the Authority thinks might lead the applicant or certified person to discriminate in favour of the person.]”