

The Authority's final decision and summary analysis on the application for certification as unbundled by National Grid Electricity System Operator Limited

This document explains the Authority's final decision on compliance by National Grid Electricity System Operator Limited ('the Applicant') 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') opinion on our preliminary decision on the application for certification submitted by the Applicant, the Authority² concludes that the Applicant complies with the requirements of the full ownership unbundling model as set out in GB legislation and should therefore be certified as ownership unbundled.

2. GB Legislation – Transposition of Directive 2009/72 (the 'Electricity Directive')

2.1. In GB the ownership unbundling requirements set out in the Electricity Directive have been transposed through the Electricity and Gas (Internal Markets) Regulations 2011 which inserted sections 10A to 10O into the Electricity Act 1989 (the 'Electricity Act'). Section 10F of the Electricity Act – 'the ownership unbundling requirement' – states that "*the ownership unbundling requirement is met by an applicant for certification if in relation to each of the five tests below – (a) the Authority thinks that it is passed, or (b) it is treated as passed by virtue of subsection (7), (9) or (9A)*". In accordance with subsection 10F(9A), 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 appropriate and in line with our principal objective and general duties to do so.³

3. The Applicant

3.1. The Applicant is currently in the process of undertaking voluntary legal separation from National Grid Electricity Transmission plc (NGET) as part of the System Operator/Transmission Operator separation. This will enhance the effective functioning of the transmission system and ensure greater independence of system operation functions, in line with the certification and unbundling aims. It is expected that the

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", "our" and "us" are used interchangeably.

³ https://www.ofgem.gov.uk/system/files/docs/2017/08/certification_open_letter_2017.pdf

electricity transmission licence currently granted to NGET under section 6(1)(b) of the Electricity Act will be partially transferred to the NGESO under section 7A of the Electricity Act. The new NGESO licence will take effect from 01 April 2019.

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. The Applicant has confirmed it does not have any shareholding in or control any other company.
- 4.3. Further, the Applicant has provided a signed undertaking that, during the term of its licence, it will not exercise, or cause to be exercised on its behalf, any shareholder rights in relation to a relevant producer or supplier that it might acquire during the currency of the undertaking. Therefore, the Applicant meets the requirements of the first test.
- 4.4. *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.*
- 4.5. The Applicant has provided details of the process for appointing directors. The right to appoint the Applicant's directors sits with the Applicant's Board, and the Applicant's members (National Grid Holdings One plc (NGHO), the Applicant's sole direct 100% shareholder). Neither the Applicant nor NGHO controls nor has a majority shareholding in any relevant producers or suppliers.
- 4.6. The appointment of senior officers of the Applicant can be influenced by NG plc, according to information provided by the Applicant. The Applicant is ultimately controlled by National Grid plc ('NG plc'). NG plc controls the National Grid group companies in the United States of America, which includes the following interests that are now considered relevant producers or suppliers (following recent legislative amendments in 2017):
 - 'National Grid Generation LLC', a wholly-owned subsidiary of National Grid plc, fossil fuel electric generation capacity of approximately 3,600MW located on Long Island, New York;
 - 'National Grid Glenwood Energy Centre LLC', a wholly-owned subsidiary of National Grid plc. A Delaware limited liability company and is an exempt wholesale generator ('EWG') or approximately 80MW electric peaking capacity on Long Island, New York. It also sells wholesale capacity, energy, and ancillary services at market-based rates pursuant to authority granted by the Federal Energy Regulation Commission (FERC); and
 - 'National Grid Port Jefferson Energy Centre LLC', a wholly-owned subsidiary of National Grid plc. A Delaware limited liability company and is an exempt wholesale generator ('EWG') or approximately 80MW electric peaking capacity on Long Island, New York. It also sells wholesale capacity, energy, and ancillary services at market-based rates pursuant to authority granted by the Federal Energy Regulation Commission (FERC).

- 4.7. In practice, NG plc has involvement in and oversight of the appointment of NGENSO's directors, by virtue of internal governance arrangements within the National Grid group. Section 10F(9A) of the Electricity Act provides that the Authority may use its discretion to treat one or more of the five tests as passed in certain circumstances.
- 4.8. While NG plc plays a role in the appointment of the Applicant's directors and at the same time controls relevant producer and suppliers, the Applicant has demonstrated to our satisfaction that the National Grid group has appropriate governance arrangements in place, and that there is no risk that NG's involvement could lead to discrimination on the part of the Applicant or NG to benefit generation interests in the US controlled by National Grid. We are therefore satisfied that the Applicant does not have a relationship with these relevant producers or suppliers that might lead the Applicant to discriminate in favour of these relevant producers or suppliers. Further information on the factors we consider to be particularly relevant in assessing the risk of discrimination and our ability to exercise our discretion are detailed in our August 2017 open letter⁴ and are reflected in the Commission's opinion.⁵
- 4.9. On this basis the Authority considers it is appropriate to treat the second test as passed in accordance with section 10F(9A) of the Electricity Act. The Applicant therefore meets the requirements of the second test.
- 4.10. *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.*
- 4.11. The Applicant has confirmed that none of its senior officers are also senior officers of an electricity undertaking which is a relevant producer or supplier. Therefore, based on the information that is currently available, the Applicant meets the requirements of the third test.
- 4.12. *Fourth and Fifth Tests: The applicant is not controlled by a person who (a) controls a relevant producer or supplier; or (b) has a majority shareholding in a relevant producer or supplier.*
- 4.13. The Applicant is ultimately controlled by NG plc. The Applicant has provided a comprehensive account of the corporate structure and interests of its controllers. As noted above, NG plc owns and controls interests in the United States that qualify as relevant producers or suppliers.
- 4.14. Section 10F(9A) of the Electricity Act provides that the Authority may use its discretion to treat one or more of the five tests as passed in certain circumstances.
- 4.15. While the Applicant's controller does also control and in some cases holds a majority shareholding in relevant producers or suppliers in the United States, the Applicant has demonstrated to our satisfaction that it does not have a relationship with these relevant producers or suppliers that might lead the Applicant to discriminate in favour of NG plc's generation interests in the United States. Further information on the factors we consider to be particularly relevant in assessing the risk of discrimination and our ability

⁴ https://www.ofgem.gov.uk/system/files/docs/2017/08/certification_open_letter_2017.pdf

⁵ https://ec.europa.eu/energy/sites/ener/files/documents/2018_143_uk_en.pdf

to exercise our discretion are detailed in our August 2017 open letter⁶ and are reflected in the Commission's opinion.⁷

4.16. On this basis, the Authority considers that it is appropriate and in line with our principle objective and general duties to treat tests four and five as passed in accordance with section 10F(9A) of the Electricity Act. The Applicant therefore meets the requirements of the fourth and fifth tests.

5. European Commission Opinion

5.1. The Commission's opinion is dated 25 September 2018.⁸

5.2. 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 decision. We summarise below how we have taken utmost account of the Commission's opinion on our preliminary certification decision in relation to the Applicant.

Ownership of the network

5.3. The Commission noted that "Article 9(1)(a) of the Electricity Directive provides that in the ownership unbundling model each undertaking which owns a transmission system acts as a transmission system operator.". However, the Commission noted that it has proposed a recast of the Electricity Directive, which "contains a new provision that expressly allows for the transfer of TSO responsibilities to another operator which must be certified but does not have to own the system."⁹

5.4. The Commission further commented that they believe the following facts should be taken into account: "that the pending Commission proposal would specifically allow for the arrangement pursued by NGENSO (i.e. a split of responsibilities between a transmission system owner and a transmission system operator); that the pending legislative procedure is expected to be concluded in the coming months; that, at the time of writing of the present opinion, neither the Council nor the European Parliament in their adopted positions had expressed opposition to the pertinent provision in the Commission proposal."

5.5. Further to these considerations, the Commission stated that it is of the view that "it would be disproportionate to deny NGENSO's application for certification solely due to the non-compliance with the requirement of the current Article 9(1)(a) of the Electricity Directive."

5.6. We note the Commission's position that Ofgem should re-assess the situation following the conclusion of the legislative procedure for the cited Commission proposal, and will continue to monitor this process.

Generation and supply interests

5.7. The Commission commented that the objective which the unbundling rules of the Electricity Directive pursue is the removal of any conflict of interest between, on the

⁶ https://www.ofgem.gov.uk/system/files/docs/2017/08/certification_open_letter_2017.pdf

⁷ https://ec.europa.eu/energy/sites/ener/files/documents/2018_143_uk_en.pdf

⁸ The Commission's opinions can be found at:

https://ec.europa.eu/energy/sites/ener/files/documents/certifications_decisions_final2018.pdf

⁹ Cf. Article 40 paragraph 2 of Commission proposal COM(2016)864 of 30 November 2016.

one hand, generators/producers and suppliers and, on the other hand, TSOs. The Commission noted that it would not be in line with this objective if certification of a TSO were to be refused in cases where it can be clearly demonstrated that there is no incentive and ability for a shareholder in a TSO to influence the TSO's decision making in order to favour its generation, production and/or supply interests to the detriment of other network users.'

- 5.8. In relation to the generation and supply assets held by National Grid plc in the United States, the Commission noted that it "shares Ofgem's view that given absence of any physical connection between the electricity systems of the United States and the UK, there appears to be no scope for a conflict of interest, nor a resulting risk of discrimination by NGEESO of network users in the UK." The Commission concluded that "the generation and supply interests currently held by National Grid plc in the United States should not constitute an obstacle to the certification of NGEESO."

6. Monitoring

- 6.1. We note that the Commission recalled the obligation set out in Article 10(4) of the Electricity Directive and invited Ofgem to continue monitoring the case after the adoption of the final certification decision, in order to satisfy itself that no new facts emerge which would justify a change of its assessment.
- 6.2. The GB legal framework provides a number of measures to ensure the robustness of our certification decisions on an ongoing basis. The Authority has an obligation under section 10I, 10J and 10L of the Electricity Act to monitor and review whether a certified person should remain certified according to the process set out in the Electricity Act. We require certified parties to inform the Authority of any significant changes that are relevant to our certification decisions promptly and to provide the Authority with an annual update.
- 6.3. In compliance with the GB legal framework and the Electricity Directive, we will continue to monitor whether the basis on which the Authority decided to certify the Applicant continues to apply.