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COMMISSION OPINION

of 16.12.2015

pursuant to Article 3(1) of Regulation (EC) No 714/2009 and Article 10 of Directive 2009/72/EC - Croatia - Certification of Hrvatski Operator Prijenosnog Sustava d.o.o. (HOPS)

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I. PROCEDURE

On 19th October 2015, the Commission received a notification from Hrvatska energetska regulatorna agencija (Croatian Energy Regulatory Agency; hereafter, "HERA", as per its initials in Croatian) in accordance with Article 10(6) of Directive 2009/72/EC¹ (hereinafter, "Electricity Directive"), of a draft decision on the certification of Hrvatski Operator Prijenosnog Sustava d.o.o. (hereinafter, "HOPS") as a transmission system operator (hereinafter, "TSO") for electricity.

Pursuant to Article 3(1) Regulation (EC) No 714/2009² (hereinafter, "Electricity Regulation") the Commission is required to examine the notified draft decision and deliver an opinion to the relevant national regulatory authority as to its compatibility with Article 10(2) and Article 9 of the Electricity Directive.

II. DESCRIPTION OF THE NOTIFIED DECISION

HOPS is the sole electricity TSO in the Republic of Croatia. It operates the entire Croatian transmission network, which, according to the draft decision, consists of switchyards, substations, overhead transmission lines and underground cables with voltage levels of 110kV, 220kV and 400kV, associated control buildings and land.

HOPS is a subsidiary of the vertically integrated energy company Hrvatska Elektroprivreda d.d. (hereinafter, "HEP"), fully owned by the Croatian State. HEP controls 100% of HOPS and of other subsidiaries active in power generation, distribution and supply, among other activities.

In order to comply with the applicable rules on unbundling of transmission system operators, HEP has chosen the Independent Transmission Operator (ITO) model, referred to in Article 9(8)(b) Electricity Directive. This choice is available to HEP under the provisions of Articles 18 and 23 of the Zakon o tržištu električne energije³ (Electricity Market Act; hereinafter, "EMA"). HOPS first applied for certification on 31st March 2014. Upon HERA's request, this application was supplemented with additional information provided at different dates. Based on national rules on administrative procedure, HERA considered 19th June 2015 as the date of presentation of a duly documented application.

¹ 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, OJ L 211/55 of 14.8.2009.

² 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, OJ L 211/15 of 14.8.2009.

³ Narodne novine, br. 22/13

In its draft decision of 12th October 2015, HERA concludes that the unbundling requirements are met and that HOPS can be certified as an ITO, subject to the following conditions (here presented in chronological order):

(1) By 30 June 2016, HOPS shall terminate the Agreement on the Lease of Business Premises concluded with HEP, as the lessor, and HOPS, as the lessee, relating to the business premises at Kupska 4, Zagreb, Republic of Croatia, and submit the evidence of termination to HERA.

(2) By 30 June 2016, HOPS shall complete the process of unbundling of its information technology (systems and application infrastructure) from the information technology systems of other companies which are part of the vertically integrated undertaking (hereinafter, "VIU") in order to achieve HOPS full IT independence, including the employment of a sufficient number of employees in the Process and Business Information Technology and Telecommunications Department. Within the same deadline, HOPS shall submit to HERA an independent audit report on its IT autonomy.

(3) By 31st December 2016, HOPS shall submit to HERA contracts on the procurement of ancillary services and contracts on the procurement of balancing energy which must comply with the relevant legal provisions.

(4) By 1st February 2018, HOPS shall submit to HERA the network use contracts concluded with all users of the transmission network for all constructions or parts of constructions that are connected to the transmission network for which there are currently no network use contracts with HOPS. These network use contracts shall ensure equal and non-discriminatory treatment by HOPS of all network users, regardless of their affiliation to the VIU.

(5) By 1st February 2018, HOPS shall submit evidence of the implementation of activities to establish its own telecommunications system as described in the documents *Description of the Final Model of Organization of Telecommunication Services for the Purposes of HOPS* and *Action Plan for the Unbundling of the Telecommunications System of HOPS*, submitted together with the application for certification. Within the same deadline, HOPS shall submit to HERA an independent audit report on the establishment of its own telecommunications system.

(6) By 1st May 2018, HOPS shall terminate all other contractual relations regarding the use of business premises owned by any of the companies which are part of the VIU, and with respect to which HOPS is the lessee, and submit the evidence of termination to the Croatian Energy Regulatory Agency.

The draft decision moreover clarifies that, should HOPS not fulfil any of these conditions, HERA shall, in accordance with Article 23(11) EMA, adopt a decision revoking the certification of HOPS as an independent transmission operator.

III. COMMENTS

On the basis of the present notification the Commission has the following comments on the draft decision.

As a general remark, the Commission observes that the conditions under which HERA intends to grant the certification concern compliance with core rules intended to ensure the autonomy of the TSO under the ITO model. Pursuant to the Electricity Regulation, the unbundling requirements should be fulfilled at the time of the certification of the TSO. On the basis of the information submitted, HOPS currently does not meet all the certification requirements. A deferred implementation of the unbundling requirements can only be justified in exceptional circumstances. If HERA decides to certify HOPS subject to a deferred

implementation of certain unbundling requirements, it should provide due justification in the final certification decision as to why this delay is necessary and justified in each instance.

In this case, the Commission strongly recommends the following:

- Where the envisaged deadlines for implementation extend beyond 30th June 2016, the Commission urges HERA to demonstrate in its final certification decision why compliance within earlier deadlines is not possible and, in the absence of such proof, to withhold the certification. The Commission invites HERA to share the reasoning put forward by HOPS and HERA's assessment thereof prior to the adoption of the final certification decision.
- In each instance where a need for a longer deadline is demonstrated, the Commission considers that HERA should introduce intermediate milestones that would allow monitoring of progress with the implementation of the respective requirements of the ITO model and, if needed, for HERA to formulate early warnings.
- In this respect, the Commission trusts that HERA will fully exercise its monitoring tasks under Article 10(4) and Article 37 Electricity Directive, e.g. by carrying out the necessary inspections under Article 37(5)(g) and, where justified, by imposing or proposing penalties under Article 37(5)(a), in relation with Article 37(4)(d).
- Finally, the Commission considers that HERA's annual report in accordance with Article 37(1)(e) Electricity Directive should include a detailed account of the steps taken by HOPS and HEP to comply with the different conditions and intermediate milestones set out in the final certification decision, as well as HERA's own assessment of the progress. The Commission also invites HERA to inform the Commission without delay should any of the conditions or intermediate milestone not be complied with.

1. Choice of the ITO model

According to Article 9(8) Electricity Directive, the ITO model may be applied in cases where, on 3 September 2009, the transmission system belonged to a VIU. The Commission agrees with HERA that the choice for the ITO model in the present case is legitimate, considering that the transmission system concerned did belong to a VIU on the relevant date.

2. Contracts for services between the VIU and the ITO

A. Services provided to the ITO by other parts of the VIU

Article 17(1)(c) Electricity Directive provides for specific rules on the contracting of services between the ITO and other parts of the VIU. As the ITO should be autonomous and not dependent on other parts of the VIU, the contracting of services to the ITO by any other part of the VIU is prohibited by the Electricity Directive.

The Commission considers that only in exceptional cases, e.g. in order to protect overriding interests such as the security and the reliability of the transmission system, and where no other market participants could provide these services to the ITO, the rendering of services to the ITO by the VIU could be envisaged.

In its draft decision, HERA does not explain why the balancing and ancillary services concerned could not be provided by other service providers not related to the VIU, now or in

the foreseeable future. The Commission therefore urges HERA to provide concrete evidence substantiating the lack of a market for balancing and ancillary services in Croatia (e.g. based on past failed tenders); such evidence would be a precondition for considering that HOPS can be certified despite balancing and ancillary services being provided by HEP subsidiaries.

The Commission urges HERA to ensure that the provision of services by the VIU or its subsidiaries to HOPS occurs only until a market for such services has developed; HERA's final certification decision should therefore guarantee that said provision of services is limited in time and subject to recurring regulatory review. In addition it is recalled that pursuant to Article 18(6) and (7), HERA shall verify that transactions between other parts of the VIU and the ITO occur at arm's length in order to avoid cross subsidisation.

In its draft decision, HERA asks HOPS to notify (new) contracts to be signed with HEP-Proizvodnja, a subsidiary of HEP active in power generation (hereinafter, "HEP-Generation"), by 31st December 2016. These new contracts shall be in line with new legislation (by-laws) implementing provisions of the EMA, which HERA expects to have been adopted by then. The Commission recalls in this respect that, under Article 37(6)(b) of the Electricity Directive, the regulatory authorities are responsible for fixing and approving sufficiently in advance of their entry into force at least the methodologies used to calculate or establish the terms and conditions for the provisions of balancing services.

The Commission considers that system services to ensure balancing, security and reliability of the system, should be assessed in accordance with the abovementioned principles. It also recommends HERA to include a reference to Article 18(7) of the Electricity Directive, recalling that such new contracts need to be approved by HERA.

B. Services provided by the ITO to other parts of the VIU

Article 17(1)(c) Electricity Directive allows in specific circumstances for the provision of services by the ITO to other parts of the VIU, in particular if there is no discrimination of other system users, if there is no restriction of competition in generation or supply and if the regulatory authority has approved the provision of the services concerned.

HERA refers in its draft decision to a significant number of contracts for services provided by the ITO to other parts of the VIU. HERA concludes that the provisions of balancing, connection and network use contracts "do not discriminate against the energy entities that are not part of the VIU". As for the "non-standard services" provided by HOPS, the relevant price list and applicable rules were approved by HERA in 2015.

HOPS also rents to the distribution company HEP-Operator distribucijskog sustava business premises in the business complex at Split.

The Commission takes the view that in the analysis of the contracts concerned, HERA should assess, in situations where a functioning market for the services concerned cannot be identified, whether the terms of the service contract can be considered cost reflective so as to ensure that there is no undue cross subsidization, especially in a highly concentrated market such as the Croatian one.

The draft decision moreover asks HOPS to submit by 1st February 2018 the network use contracts to be concluded with all users of the transmission network for all constructions or parts of constructions that are connected to the transmission network for which there are currently no network use contracts with HOPS. This concerns in particular a number of power plants of HEP-Generation.

The Commission considers that in the absence of these contracts, HERA is not in a position to assess whether the conditions under which HOPS provides network-related services to HEP-Generation are proportionate and cost reflective and that there is no discrimination between system users, particularly in favour of its related undertakings, as required by Article 12(f) Electricity Directive. The draft decision does not explain why a 2-year-deadline is needed for HOPS and HEP-Generation to produce the relevant contracts. The Commission invites HERA to further elaborate on the circumstances that justify granting such a long deadline. Therefore, as the shortcoming concerns one of the fundamental requirements of the Electricity Directive the Commission urges HERA to demonstrate and duly justify in its final certification decision why compliance within an earlier deadline than 1st February 2018 is not possible and, where this cannot be shown, to withhold the certification.

In the event that the need for such a long deadline is demonstrated, the Commission invites HERA to introduce several intermediate milestones (e.g. as of 31st December 2016) in order to monitor progress.

Furthermore, considering that HEP-Generation produces over 60% of the electricity transported by HOPS⁴, the Commission also invites HERA to examine whether it is possible to impose additional measures during the 2-year transitional period to protect HOPS economic interests and prevent possible cross subsidization in this case.

3. Separation of IT and telecommunication systems and equipment

Article 17(5) Electricity Directive prescribes that the ITO shall not share IT systems or equipment with any part of the VIU nor use the same consultants or external contractors for IT systems and equipment. The Commission is concerned about the potential conflicts of interests and abuses related to the use of commercially sensitive data that could take place as long as the IT systems have not been separated.

Concerning the deadline by which HOPS is required to bring the telecommunication system in conformity with the requirement of the Directive (by 1st February 2018), the Commission urges HERA to demonstrate in its final certification decision why compliance within an earlier deadline than 1st February 2018 is not possible and, where this cannot be shown, to withhold the certification.

In the event that the need for such a long deadline is demonstrated, the Commission invites HERA to introduce intermediate milestones in order to monitor progress (the first one being e.g. the presentation of the *Study on the Optimal Manner to Complete the Unbundling of the Telecommunications Infrastructure* referred to on page 21 of the draft decision).

In this context, the Commission recalls the need to duly monitor the respect by HOPS of the confidentiality requirements in Article 16 Electricity Directive.

4. Ownership and separation of premises

According to Article 17(5) Electricity Directive, the ITO shall not share the physical premises and security access systems with any part of the VIU.

The draft decision explains that HOPS operates in four major locations (Zagreb, Split, Opatija and Osijek). HOPS only owns the premises in Split. At the other three locations, HOPS uses the premises on the basis of lease agreements with HEP as the owner of the said premises.

⁴ Commission's own estimate based on the information in HERA's 2014 Annual Report (pp. 58 and 60) http://www.hera.hr/en/docs/HERA_Annual_Report_2013.pdf

HOPS also operates on the sites of power facilities where transformer substations and switchyards are located, which HOPS uses individually or jointly with companies that are part of the VIU and on which rights of easement exist for HOPS or for HEP, as appropriate. Having examined the existing agreements, HERA is satisfied that the safeguard measures in place adequately comply with the provisions on separation of activities and business premises.

The Commission agrees with HERA in considering that the most urgent action relates to the ownership and separation of the premises located in Zagreb, Kupska 5, where the National Dispatching Centre is located. According to Article 17(1)(a) Electricity Directive, assets that are necessary for the activity of electricity transmission, including the transmission system, shall be owned by the ITO. This obligation is not limited to the transmission assets, and necessarily includes the central dispatch centre.

The draft decision envisages as possible solutions either the ownership transfer from the VIU to HOPS or "other possible solutions" to be analysed separately, based among other on cost justification. HERA however only subordinates certification to the condition that HOPS terminates the lease agreement with the VIU concerning these premises by 1st June 2016 at the latest. The Commission considers that the condition related to Zagreb's premises should also include the obligation to ensure that after 1st June 2016, HOPS owns the premises where the National Dispatching Centre is located and that the security and the reliability of the transmission system are guaranteed throughout the whole process and take precedence over financial aspects (especially if it is decided to transfer these facilities to a different location).

Concerning the business premises of HOPS in Osijek and Opatija, the draft decision states that the relocation of said premises is already planned, and will be carried out by 31st December 2016 and 31st December 2017, respectively. The draft decision does not explain what will happen in case of delays in construction works on the site of the new location. The Commission urges HERA to demonstrate in its final certification decision why compliance within an earlier deadline than 1st May 2018 is not possible and, where this cannot be shown, to withhold the certification.

In the event that the need for such a long deadline is demonstrated, the Commission invites HERA to actively monitor the developments, by introducing milestones in the certification decision, in order to ensure an effective separation of the premises concerned by the deadline of 1st May 2018.

IV. CONCLUSION

Pursuant to Article 3(2) Electricity Regulation, Hrvatska energetska regulatorna agencija shall take utmost account of the above comments of the Commission when taking its final decision regarding the certification of Hrvatski Operator Prijenosnog Sustava d.o.o., and when it does so, shall communicate this decision to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take vis-à-vis national regulatory authorities on any other notified draft measures concerning certification, or vis-à-vis national authorities responsible for the transposition of EU legislation as regards the compatibility of any national implementing measure with EU law.

The Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. Hrvatska energetska regulatorna agencija is invited to inform the Commission within five working days following receipt whether it considers that, in accordance with EU and national rules on business

confidentiality, this document contains confidential information which it wishes to have deleted prior to such publication. Reasons should be given for any such request.

Done at Brussels, 16.12.2015

For the Commission
Miguel ARIAS CAÑETE
Member of the Commission

