



Brussels, 25.9.2018
C(2018) 6306 final

COMMISSION OPINION

of 25.9.2018

pursuant to Article 3(1) of Regulation (EC) No 714/2009 and Articles 10(6) of Directive 2009/72/EC – United Kingdom - Certification of National Grid Electricity System Operator Limited

(only the English version is authentic)

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I. PROCEDURE

By letter of 27 July 2018, the Commission received a notification from the national regulatory authority in the United Kingdom (UK) responsible for Great Britain (GB), the Office of Gas and Electricity Markets (hereafter “Ofgem”), of a preliminary decision concerning the certification of National Grid Electricity System Operator Limited (hereafter “NGESO”) as transmission system operator (TSO) for electricity.

Pursuant to Article 3 of Regulation (EC) No 714/2009¹ (hereafter "Electricity Regulation") and Article 10 of Directive 2009/72/EC² (hereafter, "Electricity Directive"), 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 Articles 9 and 10(2) of Directive 2009/72/EC.

II. DESCRIPTION OF THE NOTIFIED DRAFT DECISION

According to Ofgem's preliminary certification decision, NGESO is applying for certification under the ownership unbundling regime further to the envisaged separation of the current transmission system operator, National Grid Electricity Transmission (NGET) into i) a separate Transmission Owner (TO) company and ii) an Electricity System Operator (ESO) company.

NGET is the transmission system operator for electricity in the United Kingdom which owns and operates the parts of the UK national electricity transmission system situated in England and Wales.

Further to this envisaged separation, the current NGET electricity transmission licence is in the process of being partially transferred and split into two separate electricity transmission licences – an NGET (TO) licence, and a new ESO licence for NGESO. Upon grant of this new ESO licence, NGESO will have the sole business focus of system operation of the electricity transmission network for GB. Ofgem notes that this separation will enhance the effective functioning of the transmission system and ensure greater independence of system operation functions.

¹ 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.

² 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.

The ultimate owner and controller of the NGESO is National Grid plc. National Grid plc is an investor-owned utility company whose subsidiaries distribute gas, own the electricity transmission network in England and Wales, the gas transmission network in Great Britain, electricity transmission networks in the North-eastern United States, and operate the electricity transmission system in GB (England, Wales and Scotland).

Ofgem points out that NGESO is currently a shell company, and therefore the directors are interim shell directors until the full directors of NGESO are appointed ahead of the company holding a transmission licence.

Ofgem has analysed whether NGESO complies with the requirements of the ownership unbundling model, as laid down in the UK legislation transposing the Electricity Directive. In its preliminary decision, Ofgem concludes that NGESO complies with these requirements.

On this basis, Ofgem submitted its draft decision to the Commission requesting an opinion.

III. COMMENTS

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

1. Ownership of the network

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.

According to Ofgem's preliminary certification decision, NGESO would act as system operator for parts of the UK national electricity transmission system situated in England and Wales, but would not own the transmission assets.³

Insofar, the envisaged arrangement would not be compatible with the requirement of the current Article 9(1)(a) of the Electricity Directive.

In this regard, it should be noted that the Commission proposal of 30 November 2016 for a recast of the Electricity Directive 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.⁴ At the date of adoption of the present opinion, the legislative procedure for said Commission proposal was still pending. The Commission's assessment of Ofgem's draft certification decision is thus based primarily on the current legal framework.

However, the Commission considers that the following facts should be taken into account: that the pending Commission proposal would specifically allow for the arrangement pursued by NGESO (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.

³ The Commission notes that Ofgem's preliminary decision does not contain an analysis of the intended contractual arrangements between the future TO and NGESO as the future ESO.

⁴ Cf. Article 40 paragraph 2 of Commission proposal COM(2016)864 of 30 November 2016.

Further to these considerations, the Commission 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.

However, the Commission considers that Ofgem should re-assess the situation following the conclusion of the legislative procedure for the cited Commission proposal. In the event that the Commission proposal is not adopted or that the specific provision that would allow for the intended arrangement is materially changed in the final recast, it would become necessary to re-open the procedure for the certification of NGENSO.

2. Generation and supply interests linked to NGENSO's ultimate controller

Article 9(1)(b)(i) of the Electricity Directive prohibits the same person(s) from directly or indirectly exercising control over an undertaking performing any of the functions of generation or supply, and directly or indirectly exercising control or exercising any right over a TSO or over a transmission system. Article 9(1)(b)(ii) of the Electricity Directive prohibits the same person(s) from directly or indirectly exercising control over a TSO or over a transmission system, and directly or indirectly exercising control or exercising any right over an undertaking performing any of the functions of generation or supply.

According to Ofgem's preliminary certification decision, National Grid plc as the ultimate controller of NGENSO owns electricity generation and supply interests in the United States, some of which qualify as "relevant producers or suppliers" under UK national law:

'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).

'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).

'Massachusetts Electric Company', a wholly-owned subsidiary of National Grid plc. It is a renewable solar energy company of approximately 20MW capacity, delivering electric energy to retail customers in Massachusetts. This company is subject to the jurisdiction of the Massachusetts Department of Public Utilities and the FERC.

'East Hampton Energy Storage Center LLC', 50% National Grid plc ownership (other 50% owned by NextEra Energy). It is a 5MW battery storage facility which is under construction with a projected operational commencement date of June 2018. The project holds a 20-year power purchase agreement with the Long Island Power Authority.

In its draft certification, Ofgem has assessed whether there is any risk of discrimination resulting from the ownership of the above-listed generation and supply interests. Ofgem notes that there is no direct interface between the electricity transmission systems or networks in the

UK and the United States, and no possibility that the actions of NGENSO as system operator in the UK could benefit any generation or supply undertakings in the United States controlled by National Grid plc, and vice versa. Ofgem adds that the generation interests located in the United States do not have any market share of the electricity generation in the UK energy market and that National Grid plc's share in the US generation market from a US national market perspective is minimal.

Ofgem also notes that under the applicable operator licence, NGENSO must not give any cross-subsidy to or receive any cross-subsidy from, any other business of the licensee or of an affiliate of the licensee including the generation and supply interests of National Grid plc in the United States, and that if NGENSO were to breach any of its licence requirements, Ofgem would be able to take enforcement action, which could include enforcement orders, fines of up to 10% of annual turnover, or ultimately licence revocation.

Ofgem concludes that due to National Grid plc having no market share of the electricity generation in the GB energy market, there is no opportunity for NGENSO to discriminate, and that, given the very small market share National Grid plc has in the US generation market, National Grid plc lacks the ability to discriminate in favour of either its generation or supply interests in the US, or in favour of NGENSO or its other transmission interests.

Commission assessment

The Commission considers that the objective which the unbundling rules of the Electricity Directive pursue is the removal of any conflict of interest between, on the one hand, generators/producers and suppliers and, on the other hand, TSOs. As explained in the Staff Working Paper 'Ownership Unbundling: The Commission's practice in assessing a conflict of interest including in the case of financial investors' (SWP (2013) 177), 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.

In relation to the generation and supply assets held by National Grid plc in the United States, the Commission 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 NGENSO of network users in the UK. Therefore, the Commission considers 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 NGENSO.

3. Ongoing monitoring

The Commission recalls the obligation set out in Article 10(4) of the Electricity Directive for national regulatory authorities to monitor the continuing compliance of TSOs with the unbundling requirements of Article 9 Electricity Directive.

Should Ofgem decide to certify NGENSO, the Commission invites Ofgem to continue monitoring the case also 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. In particular, the outcome of the legislative procedure for the proposed recast of the Electricity Directive may require a renewed assessment.

IV. CONCLUSION

Pursuant to Article 3 of the Electricity Regulation, Ofgem shall take utmost account of the above comments of the Commission when taking its final decisions regarding the certification of NGESO, and when it does so, shall communicate its decisions 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, on the compatibility of any national implementing measure with EU law.

Since the UK notified on 29 March 2017 its intention to leave the EU, pursuant to Article 50 of the Treaty on European Union, the Treaties will cease to apply to the UK from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification, unless the European Council in agreement with the UK decides to extend this period. As a consequence, and without prejudice to any provisions of the withdrawal agreement, the EU legislation on which this opinion is based and refers to will only apply to the UK until the UK ceases to be a Member State.

The Commission will publish this document on its website. The Commission does not consider the information contained therein to be confidential. Ofgem is invited to inform the Commission within five working days following receipt whether and why they consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which they wish to have deleted prior to such publication.

Done at Brussels, 25.9.2018

For the Commission
Miguel ARIAS CAÑETE
Member of the Commission

