

Brussels, 7.8.2019 C(2019) 5994 final

COMMISSION OPINION

of 7.8.2019

pursuant to Article 3(1) of Regulation (EC) No 714/2009 and Articles 10(6) and 11(6) of Directive 2009/72/EC – United Kingdom - Certification of Diamond Transmission Partners Galloper Limited

(ONLY THE ENGLISH VERSION IS AUTHENTIC)

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I. PROCEDURE

On 4 June 2019, 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 Diamond Transmission Partners Galloper Limited (hereafter "Galloper OFTO") as transmission system operator for electricity (hereafter "TSO"). On 24 June 2019, the Commission received an updated notification due to a change in legal form and country of registration of one of the ultimate controllers of Galloper OFTO.

Pursuant to Article 3 of Regulation (EC) No 714/2009¹ (hereafter "Electricity Regulation") and Articles 10 and 11 of Directive 2009/72/EC² (hereafter "Electricity Directive"), the Commission is required to examine the notified draft decision and to deliver an opinion to the relevant national regulatory authority as to its compatibility with Articles 9, 10(2) and 11(7) of Directive 2009/72/EC.

II. DESCRIPTION OF THE NOTIFIED DRAFT DECISION

Galloper OFTO is a special purpose vehicle established to own and operate the Galloper offshore transmission system which will connect the Galloper Offshore Wind Farm (with an installed capacity of 336MW located 27 km from the coast of Suffolk in GB) with the onshore network at the connection point at Leiston (Suffolk, East Anglia). Neither the Galloper Offshore Wind Farm nor the adjacent Greater Gabbard offshore wind farm³ nor the onshore transmission system are owned or operated by Galloper OFTO. Galloper OFTO would be a licensed offshore transmission system owner (hereafter "OFTO") under the specific national regime for such projects ('OFTO Regime').

Ofgem identifies Mitsubishi Corporation (hereafter "MC"), HICL Infrastructure Company PLC (hereafter "HICL") and InfraRed Capital Partners (Management) LLP (hereafter "InfraRed") as ultimate controllers of Galloper OFTO. In the initial notification of 4 June 2019, HICL was named as HICL Infrastructure Company Limited, but in the updated notification received on 24 June 2019 the Commission was informed that the legal form of the

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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.

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.

See Commission opinions C(2013) 3705 of 10 June 2013 and C(2017) 9029 of 20 December 2017.

entity changed to a PLC and that the company is no longer registered in Guernsey, but in England and Wales.

Galloper OFTO is a 100% subsidiary of Diamond Transmission Partners Galloper (Holdings) Limited (hereafter "HoldCo"). The ownership structure of HoldCo is identical to the one of Diamond Transmission Partners RB (Holdings) Limited, the owner of Diamond Transmission Partners RB Limited (hereafter "RB OFTO") whose certification was subject to Commission opinion C(2019) 699 final of 24 January 2019.

51% of the shares of HoldCo are held by Diamond Transmission Corporation Limited (hereafter "DTC") which is a 100% subsidiary of MC, a global integrated business enterprise. The purpose of DTC is to act as holding company for offshore transmission investments of MC in Europe, including, next to Galloper OFTO, the four Blue Transmission OFTOs which were the subject of Commission opinion C(2016)27 final, Diamond Transmission Partners BBE Limited (see Commission opinion C(2018) 2266 final of 12 April 2018) and RB OFTO (see Commission opinion C(2019) 699 final of 24 January 2019).

The other 49% of HoldCo's shares will be indirectly held by HICL, a long-term equity investor in infrastructure registered in England and Wales, through a series of 100% subsidiaries including Infrastructure Investments Ltd Partnership. Infrastructure Investments Ltd Partnership is indirectly controlled by InfraRed. The control stems from an Operator Agreement, ultimately giving Infrastructure Investments General Partner Ltd, a subsidiary of InfraRed, responsibility for the control and management of Infrastructure Investments Ltd Partnership.

Ofgem has analysed whether Galloper OFTO 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 Galloper OFTO complies with these requirements.

Furthermore, given that MC is registered in Japan, hence in a third country, Ofgem was also required to ascertain that granting the certification would not put at risk the security of energy supply of the UK and the Union, in accordance with the requirements set out in Article 11 Electricity Directive. Ofgem asked the UK Department for Business, Energy & Industrial Strategy (hereafter "BEIS") for its opinion. In its letter of 24 April 2019 BEIS concluded that it does not consider that the security of electricity supplies in the UK or in any other EEA state would be put at risk by the certification of Galloper OFTO.

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. Generation and supply interests linked to Galloper OFTO's controllers

Article 9(1)(b)(i) 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) 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.

In relation to electricity generation or supply participations of the ultimate controllers of Galloper OFTO, Ofgem notes that both MC and InfraRed have controlling interests over "relevant producers or suppliers" as defined in UK law, whereas HICL does not have any interests in or control over "relevant producers or suppliers".

According to the draft certification decision by Ofgem, MC and InfraRed hold the following participations in the EEA which qualify as "relevant producers or suppliers" under UK legislation:

Participations of MC

- The Luchterduinen Offshore Wind Farm Project ('Luchterduinen Project'): MC has a 50% share in this 129MW wind farm, located off the coast of The Netherlands.
- A 48MW battery energy storage system project in Germany ('BESS Project'): MC has a 50% equity interest in the BESS Project. The BESS Project connects to the TenneT transmission system in Germany.
- ElectroRoute Holdings Limited ('ElectroRoute'): MC holds a 57.7% share in this Irish energy trading company that trades in electricity markets located in the EEA, including GB markets, and which owns a total of 600 MW electricity generation capacity using gas and diesel.

Compared to the certification of RB OFTO, Ofgem's draft certification of Galloper OFTO mentions two further participations of MC:

- OVO Energy: MC has a 20% minority interest.
- The Norther Offshore Wind Farm Project (hereafter "Norther Project"): MC has a 25% share in this 379 MW offshore wind farm, located off the cost of Belgium, and may exercise indirect control via voting and veto rights.

Additionally, Ofgem's draft certification lists effective shareholdings of MC in several onshore renewable electricity production installations in the EEA, which, in the meaning of UK unbundling legislation, are not "relevant producers or suppliers": Next to installations with an installed generation capacity of 1 MW in Spain and 35 MW in Portugal, MC has an interest in 7 projects in France with an installed generation capacity of in total 161 MW.

Participations of InfraRed

- Crystal Rigg II Limited ('Crystal Rigg II'): InfraRed has 49% share in this 67MW onshore wind farm located in the east of Scotland.
- Statera Energy Ltd ('Statera Project'): InfraRed has 70% share in this project, which
 is proposing to fund the roll-out of a pipeline of three 50 MW flexible gas and one
 50MW battery storage projects in UK.
- Sheringham Shoal Offshore wind farm: Infrared has indirect control of this 317 MW offshore wind farm located off the coast of Norfolk, East Anglia.
- Green Frog Power Limited and GFPII Limited ('Green Frog'): InfraRed holds a 51% equity interest in Green Frog. Green Frog provides balancing services in the GB electricity market. It owns 12 diesel and 14 gas-fired generation sites located throughout UK with a total capacity of 575 MW. It also has a power trading business, providing a route to market for its generation assets.

- Merkur Offshore Wind Farm: Infrared has a 25% interest in this 396MW offshore wind farm located in Germany which is expected to be fully operational in June 2019. InfraRed may exercise indirect control over this wind farm as a result of voting and veto rights.
- Pallas windfarm Ltd ('Clahane'): Infrared purchased 100% interest in this 55MW onshore wind farm, located in the Republic of Ireland, in January 2018.
- Pallas Energy Supply Limited ('Pallas'): An electricity supplier in the Republic of Ireland which buys the output from 'Clahane' (see above) and sells it on the Irish wholesale market.

Ofgem's final decision and analysis on the application for certification of RB OFTO communicated to the Commission on 20 March 2019 had mentioned also the following participations which, however, are no longer included in the draft certification of Galloper OFTO:

- Afton Wind farm ('Afton'): InfraRed has a 100% share in this 50MW wind farm near Cumnock, in Scotland.
- Ibereolica Solar Oliveniza S.L. ('Oliveniza Project'): InfraRed has a 14% share in this 50MW solar plant located in Spain.
- Ibereolica Solar Moron S.L. ('Moron Project'): InfraRed has a 15% share in this 50MW solar plant located in Spain.

Compared to the certification of RB OFTO, Ofgem's draft certification of Galloper OFTO mentions two further participations of InfraRed:

- Jadraas Vindkraft AB ('Jadraas'): InfraRed has a 100% interest in this 212.9 MW onshore wind farm in Sweden.
- Erstrask Vind AB ('Erstrask'): InfraRed as a 75% interest in this 229.1 MW onshore wind farm in Sweden which is partially operational and expected to be fully operational in the first quarter of 2020.

Additionally, Ofgem's draft certification lists effective shareholdings of InfraRed in a 10 MW diesel generator in Italy and in multiple onshore renewable electricity generation installations in the EEA, which, in the meaning of UK unbundling legislation, are not "relevant producers or suppliers":

- 26 projects in the UK with an installed generation capacity of in total 455 MW.
- 3 projects in Ireland with an installed generation capacity of in total 35.2 MW.
- 24 projects in France with an installed generation capacity of in total 178.2 MW

Ofgem notes that, as pointed out by the Commission on the occasion of past certifications, the Electricity Directive does not limit relevant generation or supply interests to those over a certain capacity. Ofgem states that it has therefore considered these small-scale interests for the purpose of assessing whether there is any risk of discrimination.

Ofgem notes that MC and InfraRed also hold interests in a number of "relevant producers or suppliers" that are located outside the EEA: in North America, Asia and Australia. MC and InfraRed also have interests in future generation projects which will become operational between 2020 and 2021. Ofgem notes that these projects are not covered by the assessment on which the draft decision is based, since their details are not yet sufficiently certain to undertake properly informed consideration. These future interests would be quite

considerable: In the case of MC, minority interests in Dutch and UK offshore wind farms; in the case of InfraRed, full ownership of solar photovoltaic projects in Spain with a capacity of 1.5 GW⁴.

In its draft decision, Ofgem notes that, as the owner and operator of an offshore transmission system, Galloper OFTO has a very limited role compared to onshore TSOs, having no control or direct influence over the network beyond the onshore connection point. Ofgem also notes that whereas in theory Galloper OFTO has the ability to impact on the profitability of the wind farm or to create an opportunity for another generator to provide balancing services, there would be limited incentive to do so since any reduction in the availability of the Galloper OFTO's offshore transmission system below 98% is penalised through a reduction in its revenue. Both Galloper OFTO and the wind park, but also National Electricity Transmission System Operator as operator of the onshore electricity grid, have reporting requirements to ensure enforcement of this minimum capacity requirement.

Ofgem adds that potential concerns regarding information sharing are addressed via conditions in Galloper OFTO's licence that ensure that information about the transmission business cannot be shared with any associated business, including anyone within the corporate groups of Galloper OFTO's ultimate controllers. In view of the penalties for breach of these conditions, Ofgem considers that there is no realistic prospect or incentive for Galloper OFTO, its controllers or one of their subsidiaries to discriminate in favour of associated companies by sharing information available to Galloper OFTO.

With regard to the total generation capacity linked to the above-mentioned participations, Ofgem considers that in the context of the EEA generation market as a whole, MC and InfraRed have a relatively small share of less than 0.1% (including generation interests where they do not have control) and in GB of just over 2.4%. Ofgem considers that this share is not sufficient to give either of these controllers significant market power or the ability to discriminate in favour of either their generation or supply interests, or in favour of Galloper OFTO or their other transmission interests.

With regard to the participations of MC and InfraRed in energy trading, Ofgem notes that respective geographical locations of these companies and Galloper OFTO are not in close proximity to each other.

In relation to MC, Ofgem adds that MC does not have the ability to influence Galloper OFTO's decisions in favour of its relevant production or supply interests, as its joint venture partner (HICL/InfraRed), which owns 49% of Galloper OFTO's owner HoldCo, is not an investor in any of MC's interests, and would have no incentive to allow this to happen.

Ofgem points out that the preliminary assessment excludes the potential development of a North Sea Offshore Grid and the possibility of the Dutch electricity transmission system becoming directly linked to the transmission lines of Galloper OFTO, but intends to keep developments in this regard under review.

Ofgem concludes that, for the reasons given above, there is no scope for Galloper OFTO to discriminate against other users of the GB transmission system or any other national transmission system and no scope for discrimination in relation to generation and supply interests of its ultimate controllers and that Galloper OFTO would have no incentive (and

https://www.ircp.com/news-media/news/article/infrared-capital-partners-and-progressum-reach-agreement-regarding-15gw-solar-photovoltaic-in-spain.html

significant disincentive) to discriminate in favour of any relevant producers or suppliers in a way that would jeopardise its own transmission availability and revenue stream.

Background to the Commission assessment

The Commission considers that the objective which the unbundling rules of the Electricity and Gas Directives pursue is the removal of any conflict of interest between, on the one hand, generators/producers and suppliers and, on the other hand, TSOs. The purpose of the Directives was to provide a *structural* solution for the problems that owners of electricity or gas infrastructure may use the ownership over this infrastructure (constituting a natural monopoly or an "essential facility") to favour their own generation or supply business. The unbundling regime is meant to prevent such practices and replaced the previous regime of behavioural measures (reporting, ex post control) by a structural separation between supply and transport infrastructure which excludes the possibility to use the infrastructure to influence competition.

However, there may be exceptions to the strict application of EU unbundling rules. 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), a certification of a TSO should not 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 interest to the detriment of other network users. It is therefore necessary to assess whether a risk for discrimination can be excluded in the present case.

Missing incentive to use ownership of transmission assets to influence markets

The Commission agrees with Ofgem that the transmission system to be operated by Galloper OFTO, essentially a connection between an offshore wind farm and an onshore grid (both under third party ownership), is of limited size compared with the size of the GB grid, its total capacity and peak loads and that therefore incentive and ability of MC and InfraRed to abuse the transmission monopoly in Galloper OFTO to favour their own generation interests appears to be limited in the present case. The TSO responsibilities of Galloper OFTO are limited to operating this specific point-to-point offshore connection between a power-generating facility and the onshore grid.

The Commission also takes into account in its assessment that many participations of MC and InfraRed in generation assets are of a relatively small scale and that many generation assets are geographically distant from the transmission system operated by Galloper OFTO, operating in different price zones or even outside the EEA.

The Commission agrees with Ofgem that the limited size of the transmission system at stake, the limited possibilities to influence the market and the lack of a direct connection with most of the generation assets held by MC and InfraRed are relevant factors which limit the ability and incentives for MC and InfraRed to discriminate in favour of their own generation interests.

However, the Commission also notes in this context that several factors in the certification submitted to the Commission cast doubts as to whether there is sufficient certainty that MC and InfraRed will not have any incentives to influence the markets using their transmission lines:

- First, the Commission notes that the controlling shareholders MC and InfraRed both own significant electricity generation assets, exceeding a total capacity of 1 GW already today. The notification also indicates that MC and InfraRed are building even further generation capacity in the UK and in other EU countries, which will become operational in 2020 and 2021.
- Second, some of the wind farms owned by MC or InfraRed are in areas which appear geographically and electrically closely linked (e.g. the Sheringham Shoal Offshore wind farm is located in the same region as the Galloper Offshore Wind Farm).
- Third, Ofgem acknowledges that MC and InfraRed would have the *ability* to impact the profitability of the wind farm by using the grid connection (e.g. by creating an opportunity for another generator to provide balancing services).

As concerns Ofgem's arguments that MC and InfraRed will not have an incentive to use the ability to influence the market, because any reduction in the availability of the Galloper OFTO's offshore transmission system below 98% would be penalised through a reduction in its revenue, the Commission agrees that such penalisation mechanism may be useful to reduce the incentive to use the transmission line to influence markets. However, based on the limited information available, it is not sufficiently clear for the Commission whether the penalty system is deterrent enough to avoid any abuse. For example, such incentive would also need to be absent in times of very high price peaks where foregoing transmission income may still be profitable in view of extra earnings by the generators.

Relevance of projects under construction for the assessment

Moreover, the Commission observes that Galloper OFTO's ultimate controllers continue to invest, or intend to invest, significantly in generation assets located in the EEA. For example, according to the information provided by Ofgem, Green Frog^5 now owns 14 gas-fired generation sites in GB, six more than when RB OFTO applied for certification; InfraRed plans to be in full ownership of solar photovoltaic projects in Spain with a capacity of 1.5 GW^6 .

Investments like these add, or will likely add, a significant amount of generation capacity to the portfolios of Galloper OFTO's ultimate controllers. Some of these investments are not only under consideration, but have already reached the construction phase.

While the Commission notes that Ofgem announced that it plans to impose specific requirements in the licence further limiting the possibility of Galloper OFTO to discriminate in favour of other interests of MC or InfraRed, the information available to the Commission does not allow to conclude that the significant increase of MC's and InfraRed's presence in the generation and transmission markets is without effect for the incentives to use their assets.

The Commission stresses that the certification decision requires an assessment of possible competition risks resulting from the ownership of a transmission line. While the Commission agrees that future projects which are not sufficiently concrete do not need to be taken fully into account for this assessment, regulators should consider at least those projects which are already under construction and which will become operational within the next one or two years in their analysis.

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⁵ Cf. information on participations of InfraRed, on page 3 above.

https://www.ircp.com/news-media/news/article/infrared-capital-partners-and-progressum-reach-agreement-regarding-15gw-solar-photovoltaic-in-spain.html

Conclusion

Against this background, the Commission has doubts whether the factual evidence submitted by Ofgem is sufficient to justify the absence of any incentive to use their different transmission lines to influence the electricity market. In this respect the Commission stresses that the structural separation between ownership of generation and transmission assets is a core pillar of the internal market, and that under the Electricity and Gas Directives the onwership unbundling principle for new transmission lines does not provide for any explicit examples. In view of this legal situation, allowing ownership of generation and supply assets requires *clear evidence* that there is no ability or there are no incentives to influence the market (see SWP (2013) 177).

Therefore, the Commission would invite Ofgem to provide further information on how the relative market share of MC and InfraRed in the wholesale electricity market compares with the market share of their competitors, in particular those who are or will be connected by OFTOs controlled by MC or InfraRed.

The Commission would also invite Ofgem to assess the impact of at least those investments which are close to completion and which will be geographically connected to the GB/Irish system. Such an assessment should include a review of whether and why the incentives and penalties set under the OFTO Regime are still sufficient to effectively discourage discrimination in favour of other assets of Galloper OFTO's ultimate controllers or their subsidiaries. In this context, increased interconnector capacities between GB/the UK and other EEA markets and price zones should be taken into account when assessing assets located outside the UK/Irish area.

2. Application of Article 11 – Certification in relation to third countries

Pursuant to Article 11, Ofgem is to refuse certification unless it is demonstrated, on the basis of an assessment, that granting certification does not put at risk the security of supply of the UK or the EU. In present case, the application of Article 11 is triggered due to the fact that MC is registered in Japan.

In this context, Ofgem enquired with the Department for Business, Energy & Industrial Strategy (hereafter "BEIS") if the certification of Galloper OFTO would put the security of electricity supply of the UK or any other EEA States at risk.

BEIS concluded in their letter of 24 April 2019 that this is not the case, since i) Galloper OFTO would only control a specific OFTO without much impact on the UK electricity system as a whole, and ii) from the perspective of BEIS' wider work on potential risks of foreign investment in the UK energy system, companies from Japan do not, in and of itself, trigger particular concerns.

In relation to the first point, BEIS notes that the windfarm connected by Galloper OFTO has a capacity of 336MW, whilst the UK has a peak demand of around 60GW, and is connected with the national transmission system operated by National Grid Electricity Transmission on a point-to-point basis and is thus not part of a meshed network.

Commission assessment

Japan is an OECD member and – as also most EU Member States – a member of the International Energy Agency (IEA), an organisation which has among its main tasks to increase the security of the energy supply of its members. Both the EU and Japan are

cooperating on energy issues in the G7 context and are partners through the multilateral ITER Project. An Economic Partnership Agreement between the EU and Japan was finalised in 2017 and entered into force on 1 February 2019⁷. Furthermore, at the EU and Japan Summit on 6 July 2017 a political agreement was achieved on the main elements of a Strategic Partnership Agreement to increase cooperation including on energy⁸ and negotiations on this agreement were concluded on 25 April 2018⁹. On 11 July 2017 a 'Memorandum of Cooperation between the EU and Japan on promoting and establishing a liquid, flexible and transparent global Liquefied Natural Gas (LNG) market' was signed, further showing how closely the EU and Japan are cooperating in addressing issues of security of supply. Most recently, the EU and Japan committed to establishing a partnership on sustainable connectivity and quality infrastructure, including on energy, at the summit of 25 April 2019.

In view of the above, and given both the limited amount of generation capacity connected via the Galloper OFTO system and the limited impact of Galloper OFTO on the operation of the UK's national transmission system mentioned by BEIS, the Commission shares the view that the granting of certification to Galloper OFTO would not put at risk the security of supply of the UK or the EU.

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 Galloper OFTO, 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 start of operations of the future generation projects in which the ultimate controllers of Galloper OFTO hold participations may require a renewed assessment.

IV. CONCLUSION

Pursuant to Article 3 Electricity Regulation, Ofgem shall take utmost account of the above comments of the Commission when taking its final decisions regarding the certification of Galloper OFTO, 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.

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http://ec.europa.eu/trade/policy/in-focus/eu-japan-economic-partnership-agreement/

http://europa.eu/rapid/press-release_IP-17-1927_en.htm

https://eeas.europa.eu/sites/eeas/files/factsheet_eu-japan_strategic_partnership_agreement_japan.pdf

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, 7.8.2019

For the Commission Cecilia MALMSTRÖM Member of the Commission

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION