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COMMISSION OPINION

of **XXX**

**pursuant to Article 3(1) of Regulation (EC) No 714/2009 and Article 10 of Directive
2009/72/EC - Latvia - Certification of Augstsprieguma tīkls**

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I. PROCEDURE

On 8 October 2012, the Commission received a notification from the Latvian national regulatory authority, the 'Public Utilities Commission' (hereafter, "PUC"), in accordance with Article 10(6) of Directive 2009/72/EC¹ (hereafter, "Electricity Directive"), of a draft decision on the certification of "Augstsprieguma tīkls" (hereafter, "AST") as a Transmission System Operator (TSO) for electricity.

Pursuant to Article 3(1) Regulation (EC) No 714/2009² (hereafter, "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

AST is a transmission system operator which operates the entire electricity transmission grid of Latvia. AST is owned for 100% by the Latvian State, while the State participation in AST is managed by the Ministry of Finance. The transmission assets however, are owned by JSC "Latvijas elektriskie tīkli" (hereafter, "LET"), which is a 100% daughter company of the vertically integrated electricity utility JSC "Latvenergo" (hereafter, "LE"). The owner of LE is again the Latvian State, but the participation in LE is managed by the Ministry of Economics. At present, AST employs 58 persons.

In order to comply with the applicable rules on unbundling of transmission system operators, AST has chosen the Independent System Operator (ISO) model, referred to in Article 9(8)(a) Electricity Directive. This choice is available to AST under the Latvian legislation transposing the Electricity Directive.

Article 9 Electricity Directive sets out rules on the unbundling of transmission systems and transmission system operators. Article 9(8)(a) therein provides that where on 3 September 2009 the transmission system belongs to a VIU a Member State may decide not to apply paragraph 1, provided that the Member State concerned designates an independent system operator in accordance with Article 13 of the Directive.

PUC has analysed whether and to what extent AST complies with the unbundling rules of the ISO model as laid down in the Latvian legislation transposing the Electricity Directive. PUC has come to the preliminary conclusion that AST complies with these requirements, subject to the condition that AST shall carry out the maintenance of the transmission assets itself, or

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.

conclude an agreement for the performance of these services with a company which is neither directly nor indirectly associated with activities of electricity generation, within 24 months after the date of the certification decision.

III. COMMENTS

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

1. Choice of the ISO model

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

2. Separation within the State

Article 9(6) Electricity Directive opens up the possibility, in the context of the ownership unbundling model and for the purpose of complying with the requirements of Article 9(1)(b), (c) and (d), for the State controlling transmission activities, as well as generation, production and/or supply activities. However, the respective activities shall be exercised by separate public entities. This provision applies to the ISO-model as well, in view of Article 13(2)(a) Electricity Directive, which requires the candidate Independent System Operator to demonstrate that it complies with the requirements of Article 9(1)(b), (c) and (d) Electricity Directive. In this context, two separate public bodies should therefore be seen as two distinct persons and should be able to control generation and/or supply activities, on the one hand, and transmission activities, on the other, provided that it can be demonstrated that they are not under the common influence of another public entity in violation of the unbundling rules. The public bodies concerned must be truly separate. In these cases, it must be demonstrated that the requirements of Article 9(1)(b), (c) and (d) Electricity and Gas Directives are duly complied with. This will have to be assessed on a case-by-case basis.

Under the rules of the ISO-model, the ownership of the transmission system is held by another person than the Independent System Operator. In the present case, the transmission system assets are owned by LET, a 100% daughter company of LE, active in the generation and supply of electricity in Latvia. LE is in turn 100% owned by the Latvian State, and the participation in LET is managed by the Ministry of Economics. AST, the candidate Independent System Operator, is also a 100% daughter of the Latvian State, and the participation in AST is managed by the Ministry of Finance. The Commission considers that two separate Ministries controlling, on the one hand transmission of electricity, and on the other hand activities of generation, production and/or supply of electricity and/or gas, can under certain circumstances constitute bodies with a sufficient degree of separation, as required by Article 9(6) Electricity Directive.

In its preliminary decision PUC has undertaken an in-depth evaluation of the degree of separation between the two Ministries concerned, focusing on the legal structure of the State administration and the regulations determining the competences of Ministries in Latvia. PUC notes that ministers are politically responsible for the operations of their Ministry in the specific sector of competence as set out in binding regulations. Both the operations of the Ministry of Finance and the Ministry of Economics are governed by such regulations. A Ministry has no means to interfere in the competence of another Ministry, nor in companies in which another Ministry manages a shareholding. PUC also points out that, in carrying out

their tasks, ministers shall take into consideration the 'Declaration of the Cabinet of Ministers' and main political guidelines set by the Prime Minister. These are however restricted to high level political guidelines and cannot encompass orders to a Ministry on the daily activities of a state owned company in which a Ministry manages a shareholding. PUC has furthermore established that the Ministry of Finance does not hold shares in other companies involved in the generation, trading or distribution of electricity. It remains however unclear whether the Ministry of Finance holds any shares in companies involved in the production or supply of natural gas.

The independent operation of AST is further assured through the fact that state owned companies are managed and governed primarily according to commercial law. Decisions with regard to AST are taken on three levels: by the State, represented by the Ministry of Finance, as the sole shareholder, by the meeting of stockholders in which the State Secretary of the Ministry of Finance represents the State, and finally, by the separate Board of AST. The Board is responsible for all decisions related to the day-to-day activities of the operation of the transmission system. It needs prior consent from the meeting of stockholders for more important decisions with a strategic character, such as decisions on the acquisition of companies, the opening and closing of branches and on investments exceeding ~EUR 350.000. However, for investment decisions on the development of the transmission system (including on connections) no such consent is necessary. As regards compliance with Article 9(1)(d) Electricity Directive, Board members are not allowed to have positions in the boards of other companies active in the generation or supply of electricity. It remains however unclear whether and to what extent the Board members of AST also comply with the other independence requirements of Article 9(1), namely, under (b) which stipulates that the same person or persons are not entitled directly or indirectly to exercise control over a transmission system operator or over a transmission system, and directly or indirectly to exercise control or exercise *any right* over an undertaking performing any of the functions of production or supply.

In view of the assessment referred to above, the Commission agrees with PUC that the provisions in Article 9(1)(b), (c) and (d) could be considered adhered to, provided, however, that it is confirmed that the Ministry of Finance does not manage any shareholdings in State owned companies active in production and/or supply of natural gas and provided that it is established with certainty that the Board members of AST comply with the independence requirements of Article 9(1)(b).

3. Legal and functional unbundling of LET from LE

Where an Independent System Operator has been designated, the Electricity Directive requires that the transmission system owner is legally and functionally unbundled from the VIU. In the present case this implies that LET must be legally and functionally unbundled from LE. Article 14(1) Electricity Directive refers explicitly to the obligation of legal unbundling, while Article 14(2) Electricity Directive contains minimum rules on functional unbundling. These rules aim to ensure the independence of the transmission system owner from other activities of the vertically integrated company not related to transmission, in terms of organisation and decision-making power (subparagraphs (a) and (b)), and require the establishment of a compliance programme (subparagraph (c)).

In its preliminary decision, PUC establishes on the basis of the information received from LET, that board members of transmission system owner LET are not involved in other bodies of LE and that they are able to make decisions independently from the VIU. The preliminary decision also describes the way in which the confidentiality of information that LET as system owner receives, is ensured vis-à-vis LE. However, it does not become clear from the

preliminary decision whether and to what extent the other requirements related to the legal and functional unbundling are complied with. In particular it appears that it has not been ensured that the persons responsible for the management of LET do not participate in company structures of LE, nor that a compliance programme is established by LET setting out the obligations of employees and other measures taken to ensure that discriminatory conduct is excluded. The Commission requests PUC, before issuing its final certification decision, to analyse whether also these requirements, as laid down in Article 14(2), are adhered to.

4. Provision of services by LET to AST

The legal owner of the transmission system operated by AST is LET. Article 13 Electricity Directive requires a detailed division of tasks between the system owner, on the one hand, and the Independent System Operator, on the other. As regards its tasks, the ISO should be considered as a TSO and has to comply with all the obligations applicable to TSOs under the Electricity Directive and the Electricity Regulation. This follows from Article 13(4) Electricity Directive which states that ‘... *the independent system operator shall act as a transmission system operator* ...’ Article 12 Electricity Directive specifies the tasks that the transmission system operator is responsible for. In particular, this means that each Independent System Operator shall be responsible for granting and managing third-party access, including the collection of access charges, congestion charges, and payments under the inter-TSO compensation mechanism in compliance with the Electricity Regulation. The Independent System Operator shall also be responsible for operating, maintaining and developing the transmission system. This list of tasks is not exhaustive. The role of the system owner, on the other hand, is to enable the Independent System Operator to carry out its tasks by fulfilling the obligations laid down in Article 13(5) Electricity Directive.

From the preliminary decision of PUC it appears that in the case of AST a number of TSO-tasks are contracted out to the system owner LET. Firstly, LET provides certain IT-services to AST. These services include the main software to ensure remote monitoring and control of the system, and measurement services of the electrical waves in the grid based on a phasor network that is part of a Wide-Area Measurement System. The Commission considers that, whilst the systems and devices used to carry out these services can be considered an integral and physical part of the transmission grid and may thus be owned by LET, the actual provision of the services concerned, which are essential to the operation of the transmission grid³, should be carried out by the Independent System Operator.

Secondly, it appears from the preliminary decision that LET carries out the maintenance of the transmission system. As mentioned in Chapter II of this Opinion, PUC intends to certify AST on the condition that AST carries out itself, within 24 months after certification, the maintenance of the fixed assets, or concludes an agreement for performance of these services with a company which is neither directly, nor indirectly associated with activities of electricity generation. The Commission supports PUC's condition given the importance of carrying out maintenance for the independent operation of a transmission system.

However, the Commission notes that it appears from the preliminary decision that the development and construction of new transmission system assets may continue to be contracted from and carried out by LET. The Commission recalls that, in accordance with Article 12(a) of the Electricity Directive, "*ensuring the long term ability of the system to meet reasonable demands for the transmission of electricity [...] and developing under economic conditions secure, reliable and efficient transmission systems with due regard to the environment*" belongs explicitly to the tasks of the TSO. The planning function, including the

³ The IT-services concerned regard the SCADA/EMS and AEUS programmes and checkpoint registration device WAMS

development of ten year network development plans, but also operational decisions on the construction of new lines, should therefore be taken by AST at the latest from the date of certification onwards. If for transitional reasons staff carrying out the physical construction of lines cannot be immediately transferred to or recruited by AST, the Commission calls upon PUC to investigate the possibilities of transferring these activities, as well as the personell required for their performance from LET to AST, within a similar period of 24 months as stipulated with regard to the maintenance activities.

5. Provision of services by LE to AST

The provisions related to the ISO-model, laid down in the Electricity Directive, are aimed at ensuring the independence of the Independent System Operator from the system owner and of the system owner from the VIU. To that end, under Article 13(2)(b), the Independent System Operator is obliged to have at its disposal the necessary financial, technical, physical and human resources to carry out the tasks mentioned in Article 12 Electricity Directive. In its preliminary decision, however, PUC describes a number of services that AST receives from LE, which seem not to be in line with the independence requirements. These services consist of IT-related services and services related to the provision of electricity needed for the stable and balanced operation of the grid.

With regard to the IT-services, it follows from the preliminary decision that these appear to be related solely to access to historical data for record keeping reasons. The Commission invites PUC to verify whether this is indeed the case. If however, the services also were to include the handling of new data by LE, then the Commission would take the view that it must be investigated how and when these services could in the future be carried out by AST, at least as far as new data are concerned.

With regard to the services related to the provision of electricity needed to ensure the stable operation of the grid and the secure supply of electricity, the preliminary decision by PUC describes a number of services that, in the current situation of the Latvian market, can only be satisfactorily performed by LE. The Commission considers that only in exceptional cases, where the services concerned are strictly necessary to protect overriding interests, such as the secure and stable operation of the system, and where no other service provider, except for the VIU could provide these services to the Independent System Operator, can the carrying out of these functions by the VIU be justified. Such a situation should however in principle be of a transitional nature, limited in time. In addition, it should be ensured that transactions between other parts of the VIU and the Independent System Operator occur at arm's length in order to avoid cross subsidisation and that the remuneration is reasonable, reflecting the actual costs incurred. In the draft decision the PUC has concluded but not clearly demonstrated that all the services which are provided to AST by LE are indeed strictly necessary to protect the overriding interests referred to above. Neither has the PUC demonstrated whether the services concerned could in the foreseeable future be provided by other service providers not related to the VIU. Finally, it does not become clear from the preliminary decision whether the conditions against which LE performs these services are reasonable and cost-reflective. The Commission invites PUC to investigate and ensure that these conditions are complied with in its final decision.

IV. CONCLUSION

Pursuant to Article 3(2) Electricity Regulation, PUC shall take utmost account of the above comments of the Commission when taking its final decision regarding the certification of AST, 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. PUC 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,

For the Commission

Member of the Commission