



EUROPEAN COMMISSION

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COMMISSION DECISION

of 14.5.2012

**on the application of Article 9(9) of Directive 2009/72/EC to Transmission
System Operation in Scotland**

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/72/EC concerning common rules for the internal market in electricity¹, and in particular, Article 9(10) thereof,

Having regard to Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity², and in particular, Article 3(6) thereof,

Whereas:

Introduction

- (1) Directive 2009/72/EC sets out rules aimed to ensure the effective separation of networks from the activities of production and/or supply and removing any conflict of interests between producers and/or suppliers, on one hand, and network operators, on the other hand, or unbundling.
- (2) In Scotland the functions of transmission system operation are currently shared between Scottish Power Transmission Limited and Scottish Hydro Electric Limited - the owners of transmission assets – (hereafter, "the Scottish transmission companies") both of whom are vertically integrated undertakings, and National Grid as the ownership unbundled Great Britain system operator³.
- (3) The United Kingdom's legislation transposing Directive 2009/72/EC provides for the application of Article 9(9) of Directive 2009/72/EC. The latter provision allows arrangements already in place on 3 September 2009 to be kept if they ensure more effective independence of the transmission system operator than the one provided for under the unbundling model of independent transmission operator in Articles 17 to 23 of Directive 2009/72/EC.
- (4) The Scottish transmission companies applied to be certified as transmission system operators on this basis. On 13 March 2012, the Gas and Electricity Markets Authority ("Ofgem"), the national regulatory authority for Great Britain, notified its preliminary certification decisions on the two Scottish transmission companies to the Commission.

¹ OJ L 211, 14.08.2009 p. 55.

² OJ L 211, 14.08.2009 p. 15.

³ C(2012) 2735

- (5) Ofgem's assessment is that the system of licence obligations, enforcement powers and the involvement of National Grid in transmission system operation arrangements applying in Scotland brings significant benefits compared to the independent transmission operator model, and therefore allows for certification under Article 9(9) of Directive 2009/72/EC.
- (6) Pursuant to Article 10(6) of Directive 2009/72/EC, the Commission must verify that the arrangements being certified clearly guarantee more effective independence than the independent transmission operator model. Article 3(6) of Regulation (EC) No 714/2009 requires Ofgem to comply with the decision of the Commission in relation to certification.

2. Unbundling requirements of Directive 2009/72/EC

2.1 Three unbundling models

- (7) Directive 2009/72/EC sets out three models of unbundling for transmission system operators. These are:
 - full ownership unbundling, which requires the appointments of the owner of the transmission system as transmission system operator and its independence from production or supply interests.
 - the independent system operator model under which an undertaking with production or supply interests may continue to own the transmission system, but appoints an independent entity to carry out all the functions of the transmission system operator.
 - the independent transmission operator model (ITO) under which an undertaking with production or supply interests may continue to own the transmission system, but with stringent ring fencing provisions based on a pillar of organisational measures and a pillar of measures related to investment. These are complemented *inter alia* by cooling off periods governing the movement of staff between the transmission system operator and the production or supply functions of the vertically integrated undertaking.
- (8) Each model should deliver effective unbundling, albeit with a different mix of structural and regulatory solutions.

2.2 Article 9(9)

- (9) Article 9(9) of Directive 2009/72/EC provides that Member States may choose not to apply any of the three models described above, only where on 3 September 2009 the transmission system belonged to a vertically integrated undertaking and at that date arrangements were in place which guarantee more effective independence of the transmission system operator (TSO) than the specific provisions concerning the ITO model under Articles 17-23 of Directive 2009/72/EC.
- (10) Furthermore, according to Article 9(10) of Directive 2009/72/EC, the Commission must verify that the arrangements in place clearly guarantee more effective independence of the TSO than the provisions of Articles 17-23 of that Directive. Only

if that is the case can the TSO be certified. The regulatory authority must follow the decision of the Commission in this respect.⁴

- (11) The obligation of the Commission is to assess whether the requirements of Article 9(9) are met and verify, in particular, the effectiveness of the arrangements in place. This entails assessing whether the conclusions presented by the national regulatory authority in relation to the effectiveness of the arrangements in question are correct, and whether the arrangements, existing on 3 September 2009 and still in place at the time of certification, clearly deliver more effective independence of the TSO than the provisions of Article 17 to 23 of the Directive. This requirement goes beyond a test of equivalency. The Commission considers it appropriate in this respect to assess the effectiveness of the independence of the TSO by taking into particular consideration the aim of the unbundling rules of Directive 2009/72/EC,⁵ as well as the role and tasks of the TSO, set out therein,⁶ since the application of Article 9(9) should always ensure that the aim of Directive 2009/72/EC is fully achieved.

2.3 Effective independence under the independent transmission operator model

- (12) The independent transmission operator model requires the establishment of an independent separate legal entity within the vertically integrated undertaking. Recital (19) of Directive 2009/72/EC indicates that the rules on the independent transmission operator aim to provide an appropriate regulatory framework to guarantee fair competition, sufficient investment, access for new market entrants and the integration of electricity markets, four specific outcomes which should result in effective independence and unbundling. It goes on to explain that effective unbundling and independence of the independent transmission operator provisions is based on:
- a pillar of organisational measures and measures relating to the governance of transmission system operators;
 - a pillar of measures relating to investment, connecting new production capacities to the network and market integration through regional cooperation; and
 - *inter alia*, ‘cooling-off’ periods during which no management or other relevant activity giving access to the same information as could have been obtained in a managerial position is exercised in the vertically integrated undertaking.

⁴ See Article 3(6) of Regulation (EC) No 714/2009.

⁵ Recital 12 of Directive 2009/72/EC makes clear that "any system for unbundling should be effective in removing any conflict of interests between producers, suppliers and transmission system operators, in order to create incentives for the necessary investments and guarantee the access of new market entrants under a transparent and efficient regulatory regime". Without such effective unbundling there will continue to be an inherent risk of discrimination in the operation of the network and in the incentives for vertically integrated undertakings to invest adequately in their networks.

⁶ See, for example, Article 12 of Directive 2009/72/EC for the tasks of transmission system operators. These include, *inter alia*, ensuring the long term ability of the system to meet reasonable demands for electricity, contributing to security of supply, managing flows on the system, ensuring non-discrimination between users of the system, providing users with the information they need for efficient access to the system. These tasks involve both short and long term activities, as well as investment in new transmission infrastructure and facilitating others investments in generation. A transmission system operator should efficiently integrate these activities to minimise the costs for system users.

- (13) The detailed requirements of the independent transmission operator model, set out in Chapter V of Directive 2009/72/EC (Articles 17 to 23) address the barriers that vertical integration presents to fair competition, sufficient investment, access for new market entrants and the integration of electricity markets.
- (14) The main provisions of the independent transmission operator model are:
- Article 17 of Directive 2009/72/EC sets out the essentials of legal and functional unbundling which must apply under the independent transmission operator model. As well as being responsible for carrying out the general tasks of a transmission system operator, the independent transmission operator model creates an explicit requirement that additional tasks are attributed to the transmission system operator. Not only must personnel necessary for the activity of the transmission operation be employed by the transmission system operator, there is also a prohibition on the leasing (secondment) of personnel from the vertically integrated undertaking. The transmission system operator is also not allowed to share IT systems or equipment, share premises or security systems with the vertically integrated undertaking.
 - Article 18 provides for the independence of the independent transmission operator. It includes the ability to raise capital itself on the capital markets.
 - Article 19 provides for the independence of the staff and management of the transmission system operator. In particular persons responsible for management or members of the administrative bodies of the independent transmission operators may have no other professional position or interest with the vertically integrated undertaking. Their remuneration may not depend on the activities of the vertically integrated undertaking, and there is a minimum four year cooling off period before they can take up employment with the vertically integrated undertaking.
 - Article 20 establishes a Supervisory Body which is responsible for decisions of the independent transmission operator relating to decisions which may have a significant impact on the value of the assets of the shareholders in the transmission system operator. It may not be involved in the development of the network development plan. The same independence obligations applying to the majority of the management of the independent transmission operator apply to one half, minus one, of the Supervisory Body.
 - Article 21 establishes a compliance officer, appointed by the Supervisory Body and approved by the national regulatory authority, to whom the independence obligations applying to the management of the independent transmission operator apply. The compliance officer may not have any other professional links with the vertically integrated undertaking. The compliance officer is responsible for reporting on the compliance of the independent transmission operator with its obligations. The compliance officer attends meetings of both the supervisory board and of management or administrative bodies of the independent transmission operator.
 - Article 22 requires the independent transmission operator to develop a ten year network development plan, which is monitored and evaluated by the national

regulatory authority. The national regulatory authority has the power to require the independent transmission operator execute the investments or take other measures to ensure the investment is made and can compel the independent transmission operator to increase its capital. The national regulatory authority can require the independent transmission operator to agree to the financing or construction of the investment by any third party.

- Article 23 sets out in detail the obligations of the independent transmission operator relating to connecting new generation to its transmission system.
- (15) In summary, despite being owned by a vertically integrated undertaking, the independent transmission operator is an independent entity whose management and/or members of its administrative bodies, and employees have no interest in the performance of the vertically integrated undertaking and who may not work for the vertically integrated undertaking after leaving the independent transmission operator before the expiry of a cooling off period. The vertically integrated undertaking has no influence on, or visibility of, operation of the transmission system, granting of new connections or network planning issues.
- (16) The vertically integrated undertakings interests are looked after by a supervisory board, which is primarily concerned with decisions which may have a significant impact on the value of the assets of the shareholders in the independent transmission operator. However, the national regulatory authority has the power to compel the independent transmission system operator to increase its capital, including by taking on new investors.
- (17) A compliance officer, who is fully independent of the vertically integrated undertaking, oversees this system. In particular it can report to the national regulatory authority any problems which arise. This reporting aims to facilitate the intervention of the national regulatory authority to compel new investments.

3. The Scottish Arrangements

- (18) The system currently applying in Scotland was established in 2005 when the British Electricity Transmission and Trading Arrangements were established. These replaced the previous arrangements whereby the Scottish market was separate from that in England and Wales. Previously, in England and Wales National Grid operated as an unbundled transmission system operator, while in Scotland, Scottish Power and Scottish and Southern/Scottish Hydro Electricity Transmission (together the Scottish transmission companies) operated as vertically integrated undertakings.
- (19) When developing the British Electricity Transmission and Trading Arrangements the functions of transmission system operation in Scotland were shared between the Scottish transmission companies and National Grid, a fully ownership unbundled transmission system operator, as the Great Britain system operator.

3.1 Transmission system operation in Scotland

3.1.1 Real time operation

- (20) National Grid is responsible for real time operation of the transmission systems on behalf of the Scottish companies. This means it is responsible for all balancing

operations and the procurement of all ancillary services for the transmission system in Scotland on the same basis as in the rest of Great Britain.

3.1.2 Access and charging

- (21) National Grid is also responsible for determining the methodology of charges for access to the transmission system (transmission network use of system charges and balancing services use of system charges). The Scottish Companies are not involved in determining these charges directly or indirectly. National Grid collects charges from all system users. Revenues due to the Scottish transmission companies for the use of their systems are collected by National Grid before being transferred to the Scottish transmission companies.

3.1.3 New connections

- (22) National Grid has overall responsibility for managing requests for connection to the system in Scotland as in the rest of Great Britain and acts as the interface with system users. National Grid determines the planning assumptions upon which connection offers are made. Based on these planning assumptions the Scottish transmission companies submit to National Grid their view of the best connection offer(s) in a pro forma note. These are then confirmed by an Application Steering Group which includes National Grid. Disputes regarding connection offers can be referred to Ofgem which may oblige the Scottish transmission companies to issue a connection offer consistent with its determination.
- (23) The Scottish transmission companies are responsible for carrying out the works necessary for new connections.

3.1.4 Investments

- (24) National Grid is responsible for producing the seven year statements which set out the planned investments for the entire Great Britain system and ensure that system security and quality of service standards are met. However, the seven year statement is not directly binding on the Scottish transmission companies.
- (25) The Scottish transmission companies are each responsible for transmission planning and producing their own transmission plans. These plans are drawn up on the basis of planning assumptions developed by National Grid (essentially expected power flows on the transmission system). National Grid can request the Scottish transmission companies to amend their investment plans. If they do not comply with this request, a dispute can be referred to Ofgem whose judgement is binding subject only to judicial review.

3.1.5 Summary

- (26) In summary, the British Electricity Transmission and Trading Arrangements have the effect of putting National Grid, a fully ownership unbundled transmission system operator, in charge of most functions of transmission system operation in Scotland. National Grid is responsible for the day to day operation of the Scottish transmission system. The Scottish transmission companies have a role regarding connections but do not interact with system users. Finally, the Scottish transmission companies plan their own systems within the context of the wider development of the Great Britain system

by National Grid who take a coordinating role with respect to the Scottish transmission companies, with a possibility of appeal to Ofgem.

4. Assessment

- (27) The arrangements described above were in place on 3 September 2009, and continue to be in place. The Scottish transmission companies were part of vertically integrated undertakings on 3 September 2009 and continue to be.

4.1 Ensuring independence in the Scottish arrangements

- (28) It is appropriate to assess the rules governing the Scottish transmission companies by comparison to the rules applying to independent transmission operators under Directive 2009/72/EC.

4.1.1 Assets, equipment, staff and identity and independence of the Scottish transmission companies

- (29) The Scottish transmission companies are each legally separate companies from the vertically integrated undertakings with a distinct identity. The Scottish transmission companies are subject to non-discrimination obligations in carrying out their tasks.
- (30) The Scottish transmission companies are obliged to have all sufficient resources to ensure that they are able to properly and efficiently carry out the transmission business and to comply with their obligations under the transmission licence.
- (31) Scottish transmission companies are prohibited from disposing of assets relating to transmission without the consent of Ofgem, and are obliged to have available all resources to carry out their obligations in relation to transmission, including the development and maintenance of the transmission systems.
- (32) In this regard the Scottish transmission companies are required each year to provide an annual certificate that they will have sufficient financial resources and facilities available for the following twelve months, including a cash flow forecast, and a report by the companies' auditors. Ofgem has stated that having received this information it typically follows it up with questions and a site visit, and regards the suite of information which it receives to be stronger than that detailed in the independent transmission operator model.
- (33) The Scottish transmission companies are required to maintain an investment grade credit rating. Ofgem comments that this means the use of the capital market to raise funds may be considered.

4.1.2 Independence of the staff and management

- (34) The Scottish transmission companies are obliged to maintain full operational and managerial independence from the vertically integrated undertaking. There is also an obligation on the vertically integrated undertakings to ensure (by giving legally enforceable undertakings) that they refrain from any action which would be likely to cause the Scottish transmission companies to breach any of their obligations.

- (35) Persons employed by the Scottish transmission companies may not also provide services for the vertically integrated undertaking. There is an obligation on the Scottish transmission companies to prevent any person who has ceased to be engaged in the management or operation of the transmission business from being engaged in any other business of the vertically integrated undertaking until the expiry of an appropriate time which is based on a risk assessment including the role of the individuals. Share ownership and bonus schemes based on the performance of the vertically integrated undertaking are allowed and apply in Scottish transmission companies. According to the information provided by Ofgem in all cases this is less than 10% of total remuneration.
- (36) The Scottish transmission companies are obliged to have a managing director who is responsible for the business and who may work solely for the Scottish transmission company concerned.

4.1.3 Supervisory Body

- (37) The managing director is answerable to a board, appointed by the vertically integrated undertaking without regulatory oversight. Ofgem puts weight on the legal obligations that the board may only instruct the managing director if they consider it in good faith to be in the interest of the Scottish transmission company. The board provide the managing director instructions in writing and must provide Ofgem with a copy of any such instructions.
- (38) The ultimate controller of the two Scottish transmission companies (i.e. the vertically integrated undertaking or any person who controls the vertically integrated undertaking) is required to provide a legally enforceable undertaking that it will refrain from any actions which would put the transmission company in breach of its obligations.

4.1.4 Compliance officer and compliance programme

- (39) The Scottish transmission companies are obliged to establish a compliance plan and, following consultation with the Ofgem, appoint a compliance officer. The compliance officer must produce an annual compliance report.
- (40) The Ofgem application states that Henderson Loggie, a firm of accountants, has been compliance officer for Scottish Hydro Electric Transmission Limited since 2000. The head of internal audit for ScottishPower is the compliance officer for Scottish Power Transmission Limited.
- (41) The Compliance Officer is not required to report on the financial relations with the vertically integrated undertaking. However, the transfer of financial information is addressed by suite of financial information provided in the annual certificate referred to above.

4.1.5 Network development and powers to make investment decisions

- (42) The Scottish transmission companies must develop seven year investment plans using National Grid planning assumptions. The plans form part of a wider Great Britain transmission development plan. National Grid can request the Scottish transmission

companies to amend their plans, and if they refuse can refer the dispute to Ofgem for binding determination.

- (43) Ofgem considers the role of National Grid, a transmission system operator with overall responsibility for the Great Britain transmission system, in determining the investment planning, together with their right to determine the investment plan in the event of a dispute, to deliver more effective independence than review by a regulatory authority as provided for in the independent transmission operator model.

4.1.6 Connection of new plant to the system

- (44) National Grid is responsible for all interactions with system users and manages the overall connection process. The Scottish transmission companies are obliged to make an offer to national Grid, based on National Grid assumptions, to allow new users to be connected to their systems. National Grid reviews the offers made, may request they be amended, and can raise disputes with Ofgem.
- (45) Ofgem considers that the involvement of a regulated third party outside the vertically integrated undertakings adds a layer of independence not present in the independent transmission operator model.

4.1.7 Analysis

- (46) The key difference between the arrangements applying in Scotland and the three unbundling models is the role of National Grid in the functions of the transmission system operator alongside the Scottish transmission companies. Of particular importance is that National Grid has overall responsibility for the Great Britain transmission system and is itself the transmission system owner in England and Wales. Thus it brings a level of independence, knowledge, and responsibility to transmission system operation in Scotland which would not be present in the independent transmission operator model.
- (47) Arrangements which merge large parts of the operation of a vertically integrated undertakings transmission system with those of a fully ownership unbundled transmission system operator deliver significant advantages in terms of day to day operation and regional integration. For those transmission system operator functions which are shared between National Grid and the Scottish transmission companies, the involvement of National Grid therefore brings a degree of independence to the process which is missing in the independent transmission operator model.
- (48) The different approach taken in the Scottish arrangements and the more limited role of the Scottish transmission companies compared to the independent transmission operator mean that that there are different rules governing the Scottish transmission companies than apply in the independent transmission operator model. However, these are similar to the pillars applying to independent transmission operators, as referred to earlier above.
- (49) In relation to the cooling off periods for management in the Scottish transmission companies, the fact that the licence allows a cooling off period to be defined on a case by case basis and under the control of Ofgem provides important protection against influence being exerted by the vertically integrated undertaking. The Commission considers that the rules of Directive 2009/72/EC applicable to the independent

transmission operator model represent the starting point for assessing the appropriate cooling off period.

- (50) The Commission accepts Ofgem's conclusion that the share ownership and group wide bonus schemes which apply across the vertically integrated undertakings are relatively insignificant. In relation to compliance officers in the Scottish arrangements, each person appointed to this role must be reviewed on a case by case basis. The Commission notes that a compliance officer was appointed who was an employee of the vertically integrated undertaking, albeit in internal audit. However, the Commission accepts that Ofgem undertook an examination of the individual and the role of internal audit in the vertically integrated undertaking to satisfy itself that this was an appropriate appointment.
- (51) Overall, what might appear less strict rules in relation to the independence of the management of the Scottish transmission companies are addressed by the application of a case by case assessment. The legally enforceable guarantee from the ultimate controller adds a layer of independence. Bonus schemes based on group performance are counterbalanced by the more limited role of the Scottish transmission companies compared to that of an independent transmission operator. The Commission also notes that there are measures, including updating the applicable licences, which can be taken to further strengthen individual elements in the Scottish arrangements for example the cooling off periods, the criteria for assessing the independence of the compliance officer and ensuring that share ownership and group wide bonus schemes are insignificant. Such measures would be welcomed by the Commission.

5. Conclusion

5.1 Real time operation and access and charging

- (52) In relation to day to day operation of the system, more effective independence is guaranteed by National Grid carrying out this role than would apply with the independent transmission operator model. Of particular importance here is not just that National Grid is a fully ownership unbundled company, but that it is also responsible for the wider Great Britain system, which means it takes a Great Britain wide approach to decisions, for example in relation to balancing.

5.2 Investments and new connections

- (53) In relation to investment decisions and connection approval, the central role of National Grid, as a fully ownership unbundled transmission system operator, brings a Great Britain wide approach to decisions in the carrying out of the transmission system operator role in Scotland. In relation to the limited tasks of Scottish transmission companies in transmission system operation, the possibility of bringing a dispute to Ofgem and the regulatory safeguards applying to the Scottish transmission companies provide strong guarantees of independence. Taken together these ensure that the Scottish arrangements deliver more effective independence than the independent transmission operator model in relation to investments and new connections.

HAS ADOPTED THIS DECISION:

Article 1

The arrangements in place in relation to the vertical integration and operation of the transmission systems belonging to Scottish Power Transmission Limited and Scottish Hydro Electric Transmission Limited, existing already on 3 September 2009, meet the requirements of Article 9(9) of Directive 2009/72/EC and clearly guarantee more effective independence of the transmission system operators than the provisions of Chapter V of Directive 2009/72/EC. The Commission consequently considers that certification should be granted.

Article 2

This Decision is addressed to Ofgem, 9 Millbank London SW1P 3GE, United Kingdom.

Done at Brussels, 14.5.2012

For the Commission

Michel BARNIER

Member of the Commission

