

Internal Market

UK PAPER

EFFECTIVE UNBUNDLING OF ELECTRICITY AND GAS NETWORKS – KEY PRINCIPLES

Objective

1. We support the Commission's efforts through the third package to create competitive, transparent and better integrated EU energy markets, and believe that ownership unbundling is crucial to achieving this objective. Ownership unbundling is the only certain way of ensuring that the incentive for discrimination is removed and remains our ultimate objective. We are not convinced that there are other ways of achieving our objective which do not include structural separation of the TSO. However, elements of alternative options have been suggested which fall short of ownership unbundling. This paper sets out the principles against which any alternative arrangements will need to be assessed.

Spring Council mandate

2. The Spring European Council in March 2007 confirmed the need for:

“effective separation of supply and production activities from network operations (unbundling), based on independently run and adequately regulated network operation systems which guarantee equal and open access to transport infrastructures and independence of decisions on investment in infrastructure” .

3. Any modifications of the Commission's proposals on ownership unbundling must therefore meet these requirements.

Elements required to meet this mandate – Commission's view

4. The Commission's non-papers of 5 and 20 February set out the following five prerequisites which, in its view, must be met in order to comply with the Spring Council mandate:

- a) the unbundling arrangements must apply to both electricity and gas
- b) the TSO must be independent from the vertically integrated company
- c) the regulator must have the power to require investments to be made, either by the TSO or by third parties
- d) there must be no reversal of the requirements already required in the second package, with the national regulatory authority having sole responsibility for compliance at the national level
- e) regional cooperation must operate effectively.

Our view

5. We agree that a), b) d) are key prerequisites because:

- a) Discrimination is found in both gas and electricity markets so effective unbundling is needed for both.
- b) The TSO must be fully independent from the vertically integrated company so that it has no incentive to discriminate in favour of its affiliated production and supply businesses.
- d) The requirements in the third package must go beyond the provisions of the second package and lead to significant improvements in the operation of EU energy markets. In particular, independent regulators are best placed at the national level for compliance duties. This requires strong and independent regulators.

6. However, while recognising that mechanisms must be in place to ensure that the necessary transmission investments are made, we need to consider further how the options in the Commission's paper to achieve c), for example third party financing, power for the regulator to decide on investments, would work in practice. Such mechanisms would not be needed if the TSO were a separate company as it would have an incentive to invest to meet market demand without favouring affiliated businesses. For this reason, arrangements of the kind mentioned in the Commission's paper should not apply to the ownership unbundling and ISO models in the Commission's proposal.

7. We fully support more regional cooperation leading to greater market integration but see this as a separate issue from unbundling. Indeed, there are a number of provisions elsewhere in the third package on regional cooperation. It is not clear whether the measures on regional cooperation in the Commission's non-paper would supersede these provisions. It would be totally unworkable if they were meant to apply only to Member States choosing any alternative option. We are furthermore concerned that there is a real risk that TSOs which are not ownership unbundled could exercise market power at regional level and we are not convinced that the appointment of a compliance officer would be sufficient to prevent this. A strong regulatory structure needs to be put in place to supervise the activities of TSOs acting together at regional level. We believe the Agency should be given the powers to fulfil this task.

Effective delivery mechanisms required

8. The key to the success of any alternative to ownership unbundling is the effectiveness of the arrangements put in place to implement the principles agreed. Chief amongst these is the principle that the TSO must be truly independent from the vertically integrated company (VIU). The mechanisms to deliver this independence need to be clearly set out in any alternative unbundling model. Appointing a company compliance officer and/or an external trustee is not enough. It needs to be seen whether a level of independence that provides fair access to networks and the necessary investment can be achieved without ownership unbundling. We therefore suggest that the ideas in the Commission's non-paper should be complemented with at least the following minimum requirements:

9. **Mechanisms to ensure that the board and the staff of the TSO act independently of the other businesses in the VIU**, for example they must be directly employed by the TSO; they must have no financial interest in any company which could profit from influencing the TSO; they must not employ the same contractors and/or consultants as the VIU; they must not share information with the VIU that is not needed for the performance of its functions and which is not available to all market players; they must be housed in separate premises from the VIU with separate security systems; they must not share IT systems or equipment with the VIU; the TSO business must have

sufficient personnel, financial and physical resources to fulfil its functions; there must be no cross-subsidy from the TSO to the VIU and vice versa; the TSO business should be solely responsible for making investment decisions.

10. Specific obligations not to discriminate should be imposed, for example the TSO must not discriminate between users in respect of access to the system or interconnectors, in the provision of information, its use of balancing services, and investment in or maintenance of the system.

11. Measures must be in place to remove any conflict of interest, for example the TSO should be prohibited from holding any shares or investments in any business outside transmission, particularly generation or supply businesses, and from purchasing electricity or gas (except for balancing purposes).

12. There must be a strict enforcement regime. The obligations must be clearly and publicly set out in licences and/or legislation and be rigorously monitored and enforced by a regulatory authority independent of government. The regulatory authority must have the power to impose dissuasive penalties, including substantial fines, for breaches of these obligations. In addition, the Commission should have a role in certifying any alternative unbundling arrangements.

13. The TSO should be clearly accountable for complying with these obligations. There must also be obligations on the VIU not to engage in any activities that would cause the TSO to breach its obligations not to discriminate. Responsibility cannot be transferred to a compliance officer or trustee. However, they can exercise an important role in ensuring compliance which needs to be further defined.

14. Any alternative approach should only be available for Member States as a derogation from ownership unbundling or the ISO model which is time limited.