Certification of TSOs, Opinions of The European Commission

– Brief critical analysis

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1. General

1.1 Definition of the VIU

The definition of the "Vertical Integrated Undertaking" is important for the applicability of certain unbundling provisions; especially a narrow definition which could deprive undertakings of the possibility to apply for the ISO or ITO model.
According to Article 2 (20) of Directive 2009/73/EC (Directive 2009/72/EC, identical) a VIU is "*a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas*".
In some Member States this definition was adapted to refer only to activities in the European Union.[1]
The European Commission considers that such definition is categorically excluding companies controlled by a VIU located outside the European Union while the Directives do not foresee any geographical restriction[2].

1.2 Core tasks of a TSO

According to Art 13 (1) (a) of Directive 2009/73/EC (Article 12 (1) (a) of Directive 2009/72/EC) any TSO shall operate, maintain and develop under economic conditions secure, reliable and efficient transmission facilities to secure an open market, with due regard to the environment, ensure adequate means to meet service obligations. These tasks are seen as the "core" tasks of a TSO.
In some of the Commission Opinions, the issue arose, whether a TSO has to carry out all works connected to these tasks itself or whether or not the TSO may outsource some or all of the works necessary to fulfil these tasks.
The European Commission gave different answers regarding the different unbundling–models taking into account also the specific features of each model.

As regards Ownership Unbundling, in its Commission Opinion regarding the certification of the Austrian TSO "VÜN"[3] the European Commission made clear that certain tasks of the TSO have to be carried out by the TSO itself, stating that *„this situation, whereby core tasks of transmission system operation are outsourced to a vertically integrated undertaking, is not compatible with the ownership unbundling model. For VÜN to be considered as an ownership unbundled transmission system operator, the Commission considers that it should at least carry out the administration of the transmission system and the control room services itself.*"
Regarding the ISO, the Directives contain a specific additional reference. Pursuant to Article 13 (4) of Directive 2009/72/EC (Article 14 (4) of Directive 2009/73/EC) the ISO shall "*be responsible"* for granting and managing third party access, the operation, maintenance and development of the pipeline system, etc. According to the Commission Opinion regarding the certification of the Austrian TSO Trans Austria Gasleitung GmbH as ISO [4], the operation, maintenance and development of the network belong to the core tasks of a TSO and that these tasks can be outsourced as long as the ISO is capable of supervising and the subcontractor is independent from the VIU.

It remains unclear to what extent an ITO may outsource tasks to

subcontractors who are not influenced by supply or production interests.

The European Commission considered that it is not compatible with the ISO model that tasks are outsourced in a way that the owner of the pipeline system is de facto exercising the core tasks of a system operator. The European Commission recalled that "*one of the main principles of the ISO model is that the ISO shall run the network independent from its owner, being responsible itself for operation, development and maintenance of the system*".
According to this opinion, it seems that an ISO (and the same should also apply to an Ownership unbundled TSO) may outsource certain but not all tasks as long as the TSO has the overall supervision and can control the core functions of a TSO and the tasks are outsourced to an independent entity, but not to the owner of the transmission system. The specific borderline has still to be defined in a case specific manner.
As regards the ITO, the wording of the Directives is more concrete. The ITO shall "*be equipped with all ... resources necessary for ... carrying out the activity of electricity/gas transmission*"[5].
From the wording ("*carrying out*") it seems that an ITO has to perform any and all the works itself with personnel employed with the ITO. In its Interpretative Note – The Unbundling Regime, the European Commission considered that amongst others management and network operation belong to the core tasks of an ITO[6]. Art 17 (1) (c) of Directives 2009/72(73)/EC provides that the provision of services from the VIU to the ITO is forbidden. From this explicit provision it can be deduced that the provision of services from other subcontractors to the ITO should be possible. In this regard the European Commission mentioned in its Interpretative Note – The Unbundling Regime that "*Only if the ITO has employed a sufficient number of staff members for day-to-day handling of these activities may it, in specific circumstances and by way of exception, conclude contracts with third-party service providers for legal, IT, or accountancy services. The same applies to specific services relating to, for example, the development and repair of the network*".
In its Opinion regarding the certification of the Austrian TSO "BOG"[7] the European Commission stated that "*... to be certified as an ITO, BOG must have all the necessary resources to ensure that it can adequately fulfil its tasks as an ITO independently. In the present case, the Commission observes that key functions are not exercised by BOG. De facto, the operation of WAG is split over BOG and GCA. ... On this basis, the Commission considers that BOG cannot be certified in the present setting as ITO operating WAG.*"
Also in the "Thyssengas Opinion"[8] the European Commission considered that "*... the direct mother company of Thyssengas, provides certain services to Thyssengas ... The Commission furthermore agrees that the aforementioned services are to be carried out by the TSO itself as the assessment and decisions regarding investments and infrastructure projects constitute a core task of a TSO and should be taken without being potentially influenced by undertakings with supply or production interests*".
In respect of the ITO-model the European Commission's opinion seems to be firm: core tasks of the ITO as TSO have to be carried out by the ITO itself. However, to what extent an ITO has to perform any and all works connected to the core tasks "*operation, maintenance and development"* itself (including e.g. the construction of compressor stations) and to what extent tasks may be outsourced to subcontractors (not influenced by supply or production interests) remains unclear.

2. Ownership Unbundling

The main issue which the European Commission had to deal with is the effective separation of shareholders of the ownership unbundled TSO from production and supply interests and the evaluation of specific cases related thereto.
From the European Commission Opinions several principles can be elaborated in which cases a "*person*" can still invest at the same time in ownership unbundled TSOs and in production and/or supply companies.

2.1 Geographic scope

For the European Commission it is decisive whether the interest in production and/or supply activities bears a potential for discrimination with regard to network access. For example National Grid plc[9] which controls the British TSOs National Grid Electricity Transmission plc, National Grid Gas plc and National Grid Interconnectors Limited is involved in generation of electricity in the United States via its subsidiary National Grid USA. The European Commission considered that, because of the missing interface between the US and the UK electricity systems, there was no obstacle to certification. Such constellation could bear no potential for discrimination regarding network access in Europe in favor of US generation plants.

2.2 Significance

Some shareholders of ownership unbundled TSOs hold directly or indirectly participations in companies active in production

(generation) and/or supply. The crucial point is whether the participation is significant enough to constitute a potential for discrimination against other network users. A good example is the case of the Italian TSO Società Gasdotti Italia S.p.A. (SGI)[10] which applied for certification under the ownership unbundling model. SGI is a 100% subsidiary of Eiser, which has participations in four other companies active in generation of electricity. Two of them are active in generation of solar energy in Spain sold at regulated prices, the others are waste management companies, both of small size, one located in the United Kingdom and one situated in another part of Italy, selling the electricity as a by-product at a regulated price. The European Commission considered that, if the generation plants are of such a small size, not located where the GSI gas network is situated and especially when electricity is produced as a mere by-product or even sold at a regulated price, there was no potential for discrimination of other network users.

2.3 Storage/exchanges

In "energienet.dk – gas"[11] the European Commission stated that the ownership and operation of a gas storage facility falls outside the scope of relevant activities listed in Article 9 (1) b (ii) juncto Article 9 (3) of Directive 2009/73/EC. Furthermore, the European Commission took the view that activities of gas exchanges cannot be qualified as "supply" [12].

2.4 Public bodies

Pursuant to Art 9 (6) of Directive 2009/72(73)/EC "*two separate public bodies ... shall be deemed not to be the same person ...* ". In its Interpretative Note – The Unbundling Regime the European Commission considered that "*two separate public bodies should be seen as two distinct persons ... provided that they are not under the common influence of another public entity in violation of the rules on ownership unbundling ...; the public bodies concerned must be truly separate*". In a Latvian case the European Commission considered that "*two separate Ministries ... can under certain circumstances constitute bodies with a sufficient degree of separation ...*"[13]. The European Commission checked in detail whether or not the two Ministries had separate decision making powers. In an Austrian case[14] the European Commission had doubts that the two members of the provincial government had independent decision making powers in all aspects and in addition deemed it necessary to have also a strict separation between the officials administering the respective participation rights of the province.

3. The ITO-model

The purpose of the ITO model is to allow TSOs to remain part of the VIU under corporate law. In order to ensure effective unbundling the European Commission is interpreting the independence provisions in a strict manner.

3.1 Service Provision of the VIU to the ITO

According to Article 17 (1) (c) of Directives 2009 72/73/EC the rendering of services from the VIU to the ITO is forbidden. In several decisions the European Commission stated that a provision of services from the VIU to the ITO is only possible in "*exceptional circumstances*".

Such derogation should be

- construed narrowly,
- not go beyond what is strictly necessary to protect overriding interests (e.g. security and reliability of the transmission system),
- just in case there is no other service provider except for the VIU who could provide these services,
- in principle of a transitional nature, limited in time and
- it should be ensured that transactions occur at arm's length in order to avoid cross subsidisation.

3.2 Independence of the Management/Supervisory Board

Legislation in some member states[15] explicitly provides that the independence requirements according to Art 19 (3) of Directive 2009/72(73)/EC are only applicable regarding appointments effective after 3 March 2012. The European Commission considers that this is not in line with Directive 2009/72(73)/EC and that the regulatory authorities should ensure that members of the Management/Supervisory Board fulfil the independence requirements of the Directive irrespective of their date of appointment[16]. In Germany the law also provides that members of the management, who acquired interests in other parts of the VIU, are allowed to keep them until 31 March 2016. The European Commission considers that financial interests should be sold immediately, or at least be put into the hands of an independent trustee[17]. The European Commission also noted that the threshold for decisions of the supervisory body should be set at such a level that the approval rights do not undermine the autonomy of the Management Board[18].

3.3 Corporate Identity

In order to underline the autonomy of the ITO, confusion of market players regarding its separate identity from the VIU shall be avoided. Therefore the ITO has to refrain from using marks, names, etc. resembling those of the VIU.

In the Commission Opinions regarding the Austrian TSO GCA[19] and also the Hungarian TSO FGSZ[20] the European Commission made clear that any reference to the label of the VIU was forbidden.

3.4 IT/auditors

The ITO is prohibited from using the same IT-service providers and auditors to reduce the risk that the VIU could gain confidential data from the ITO. The European Commission disagrees with the German national regulatory authority Bundesnetzagentur (BNetzA), who was of the opinion that the same external service provider or auditing company can be engaged, as long as it is ensured that specific employees are designated to advise exclusively the ITO[21].

3.5 "pipe-in-pipe-concept" / "co-ownership"

These concepts are common in Germany. For example the German TSO "jordgas"[22], which applied for certification under the ITO model, holds shares in NETRA GmbH & Co KG which is the civil owner of the Norddeutschen Erdgas Transversale ("NETRA"). The other shareholders are Open Grid Europe (OGE) and Gasunie Deutschland Transport Services GmbH (GUD). Besides exercising joint control over NETRA KG, jordgas has rights of use and disposal in NETRA equivalent to those of an owner. The European Commission considers that the requirement of ownership of the pipeline system is fulfilled as long as all shareholders are certified TSOs and exercise (joint) control within the meaning of the Directives 2009/72/73/EC[23]. The ownership of such subsidiary is attributed to a controlling shareholder. Joint control is sufficient.

Certification as ISO ensures independence from the interests in production or supply.

3.6 Does the ITO as of certification remain part of the VIU for unbundling purposes?

What applies if the ITO itself is holding a participating interest in another transmission system? Is the ITO as shareholder to be treated as part of the VIU having influence and interests in supply and production or deemed to be independent?

The fundamental objective of all unbundling options is to ensure effective and efficient separation of networks from activities of production and supply (Directive 2009/73/EC recitals 9, 12, 13). This aim is achieved with the implementation of the ITO model as well as any other unbundling option (recitals 13, 16). Following this interpretation the European Commission stated in its opinion to the certification of Net4Gas, 30 November 2012, C (2012) 8867, that "*The certification of Net4Gas as ITO [...] will ensure that RWE Transgas a.s. cannot instruct the management of Net4Gas to grant RWE Transgas a.s. preferential access to that non exempted capacity of the Gazelle pipeline [...]. The independence of the management of Net4Gas, as well as all other measures taken to obtain certification as ITO, will ensure a level playing field between gas suppliers to obtain access to non exempted capacity of Gazelle while not endangering the commercial viability of the project.*"

Therefore the certification as ITO ensures independence from the interests in production or supply.

This opinion was shared by the German Bundesnetzagentur which stated in its decision regarding the certification of GRTgaz Deutschland GmbH as ITO, 9 November, BK7-12-029, that "*due to the certification of GRTgaz S.A. as Independent Transmission System Operator the unbundling requirements of Section 10 to 10e EnWG are not applicable in relation between the applicant and GRTgaz S.A.. This complies with the objective of the unbundling provisions of the law to prevent discrimination by a network operator in favour of affiliated companies* [verbundene Wettbewerbsunternehmen], *as well as the intention of the legislature to enforce cooperation between network operators.*

Furthermore also with regard to the shareholding of GDF SUEZ in GRTgaz S.A. no potential for discrimination exists, as GRTgaz S.A. as Independent Transmission System Operator fulfils the independence and unbundling requirements set by the Directive 2009/73/EC and the fulfilment of these requirements ensures that discrimination by GRTgaz S.A. in favour of undertakings belonging to the GDF SUEZ group are not feasible."

In the recently published opinion regarding the certification of Baumgarten–Oberkappel Gasleitung GmbH (BOG) as ITO[24] the European Commission agreed with the Austrian national regulatory authority that the ITO in corporate law terms remains part of the VIU. Therefore the ITO-model can be chosen according to Article 9 (8) (b) of Directive/72(73)/EC. With regard to the prohibition of the rendering of services from the VIU to an ITO, the European Commission recognized that, the shareholder Gas Connect Austria GmbH (GCA) as effectively unbundled ITO should not be considered as ordinary "other part" of the VIU.

Owing to the fact that the OMV group[25] is exercising all of its rights in BOG through GCA as an independent ITO, the possibility of a conflict of interest is minimized. In our opinion this can be deduced from the wording and the objectives of Directive 2009/73/EC. The detailed ITO requirements themselves assume that for the purpose of unbundling an ITO can no longer be considered as part of the VIU. For example Art 17 (5) stipulates that "The transmission system operator shall not share IT systems or equipment [...] with any part of the vertically integrated undertaking."
On the contrary in certain areas of the text the term VIU is used inconsistently. For example in Art 17 (1) c) first the ITO is described as part of the VIU and is afterwards opposed to the VIU. Considering these discrepancies in the wording the Directive has to be interpreted in conformity with primary law:

The European Court ruled[26] that in case of lack of clarity an interpretation in the light of the overall scheme and the objectives of the directive is to be preferred. The primary objective of the unbundling rules is the effective separation from supply and production interests which is ensured by the ITO model.
Taking the reasoning above this applies not only to the provision of services from an ITO to its subsidiary but also to all other specific requirements of the ITO-model. For the purpose of the evaluation of the specific requirements of the ITO-model the certified ITO shall be deemed to be independent.

4. Conclusion

The opinions issued by the European Commission in respect of certification of TSOs in Europe show that the European Commission interprets the Directives in a very strict manner. In specific cases the European Commission takes into account the primary objectives of the unbundling rules and assesses in a case by case manner and evaluates whether these objectives are infringed or not. Thereby the European Commission sometimes comes to the opinion that a deviation from the strict wording of the Directives is justified. It is not always foreseeable when the European Commission will apply such an interpretation considering the primary objectives of the Directives.
On some issues, e.g. the concrete scope of the "*core activities*", the European Commission does not give detailed guidance as to the interpretation and leaves it to the national regulatory authorities to decide.

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1 See for example Section 3 no. 38 German Energy Act (Energiewirtschaftsgesetz – EnWG)
2 See for example regarding France: Commission Opinion, C (2011) 8570, Certification of RTE; regarding Germany: Commission Opinion, C (2012) 9106, Certification of GASCADE.
3 Commission Opinion, C (2012) 2244, Certification of VÜN.
4 Commission Opinion, C (2013) 649, Certification of TAG.
5 Article 17 (1), Directive 2009/72(73)/EC.
6 Commission Staff Working Paper, Interpretative Note – The Unbundling Regime, 22 January 2010.
7 Commission Opinion, C (2013) 963, Certification of BOG.
8 Commission Opinion, C (2013) 570, Certification of Thyssengas.
9 Commission Opinion, C (2012) 2735, Certification of National Grid Electricity Transmission plc, National Grid Gas plc and National Grid Interconnectors Limited.
10 Commission Opinion, C (2013) 380, Certification of SGI.
11 Commission Opinion, C (2012) 88, Certification of Energienet. dk (gas).
12 See for example: Commission Opinion, C (2011) 8570, Certification of RTE.
13 See for example: Commission Opinion, C (2012) 9108, Certification of Augstsprieguma tikls.
14 Commission Opinion, C (2012) 2244, Certification of Vorarlberger Übertragungsnetze GmbH
15 Section 114 par 1 no. 2 of the Austrian Gas Act 2011 (GWG 2011); § 10c par 2 German EnWG;
16 See for example regarding Austria: Commission Opinion, C (2012) 3734, Certification of Gas Connect; and regarding Germany: Commission Opinion, C (2012) 6261, Certification of Bayernets.
17 See for example: Commission Opinion, C (2012) 6261, Certification of Bayernets.
18 See for example: Commission Opinion, C (2011) 8570, Certification of RTE;
19 Commission Opinion, C (2012) 3734, Certification of Gas Connect.
20 Commission Opinion, C (2011) 8984, Certification of FGSZ.
21 See for example: Commission Opinion, C (2012) 6261, Certification of Bayernets.
22 Commission Opinion, C (2012) 6255, Certification of jordgas.
23 See e.g. Recital (10) and Article 2 (36), Directive 2009/73/EC;
24 Commission Opinion, C (2013) 963, Certification of BOG.
25 GCA is indirectly owned 100% by OMV AG.
26 See for example: *Van Gend en Loos* (5.2.1963); *Netherlands v. Commission* (7.2.1979); *France v. Commission* (31.3.1998).