

## Single Electricity Market

### **TSO Certification under Article 10 of Directive 2009/72/EC**

### **NIE Application Preliminary Decision Qualified Approval of NIE Application**

February, 2013

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# 1 Executive Summary

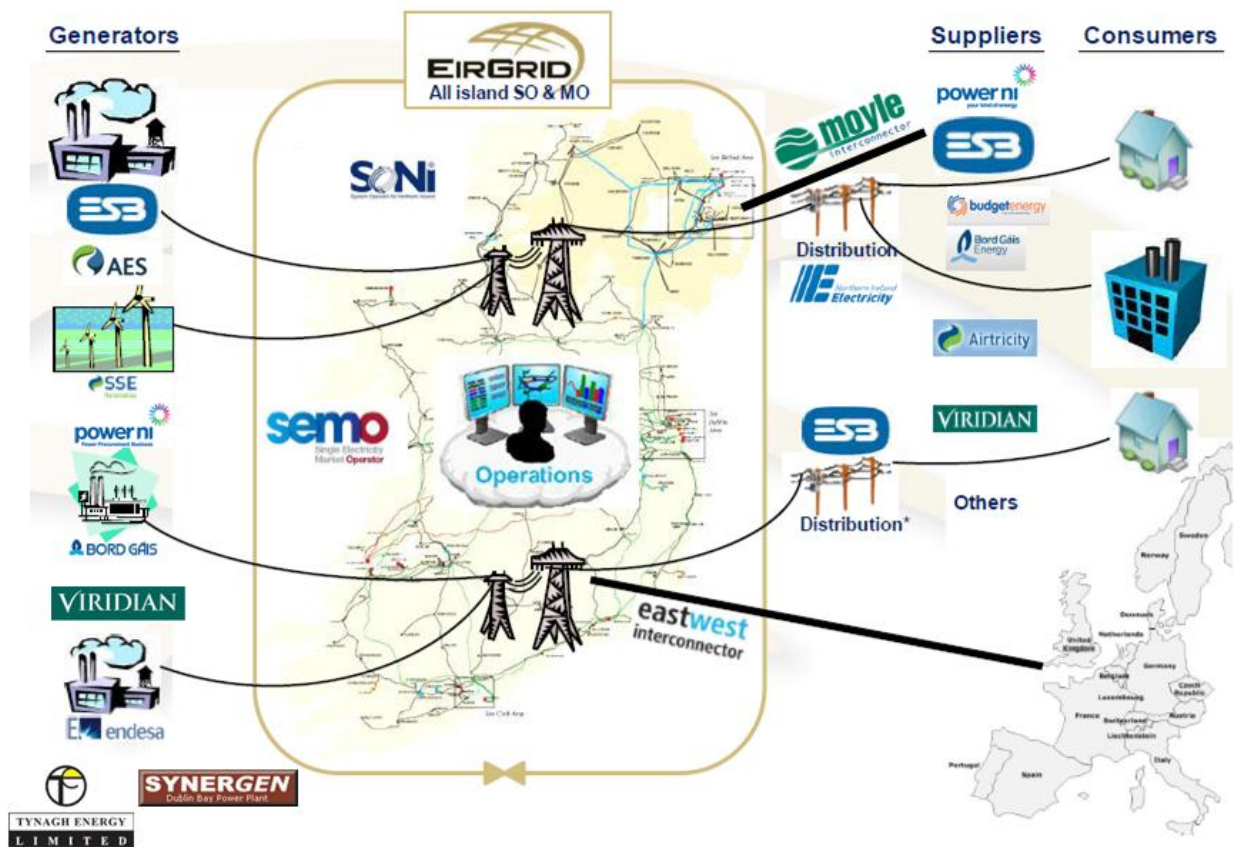
- (1) The 3<sup>rd</sup> Internal Markets in Electricity Directive (Directive 2009/72/EC) requires that Transmission System Operators (TSOs) are unbundled from generation and supply interests. A TSO must be certified under the Directive and a number of grounds for certification are provided for. The Directive provides for three models of unbundling. Full ownership unbundling (FOU), Independent System Operator (ISO) and Independent Transmission Operator (ITO). The ISO and ITO models only apply to transmission systems owned by vertically integrated utilities (VIUs) on 3<sup>rd</sup> September 2009. In addition where the existing arrangements provide for greater independence than the ITO model the Member State is not required to establish the FOU, ISO or ITO models but may apply the grounds stated in Article 9(9).
- (2) Northern Ireland Electricity Limited (NIE) has applied for certification under the grounds of Article 9(9) of the Directive, that the transmission system belongs to a vertically integrated undertaking and there are arrangements in place which guarantee more effective independence of the TSO than the provisions of Chapter V, which provide the requirements of the ITO model.
- (3) Under the current arrangements within Northern Ireland, which also existed at 3 September 2009, the transmission system is owned by NIE. NIE is responsible for the TSO tasks of planning, development and maintenance of the transmission system while these tasks are discharged in cooperation with the System Operator for Northern Ireland (SONI). This cooperation is managed under a Transmission Interface Agreement (TIA) between the two companies within which either can refer any dispute over the discharge of their respective tasks for determination by the Utility Regulator, which is the National Regulatory Authority in Northern Ireland. SONI is responsible for the operation of the transmission system and for cooperating with NIE under the TIA in the discharge of NIE's responsibilities for planning, development and maintenance.
- (4) The execution of the tasks of development and maintenance of the transmission system is primarily the responsibility of the staff of NIE Powerteam Limited, which is a separate legal company wholly owned by the same VIU which owns NIE. NIE Powerteam is a subsidiary of the VIU providing services solely to NIE.
- (5) NIE underwent a change of ownership after the date of qualification from one VIU, which was Viridian Group to another, which was ESB. This raises the question whether certification under the grounds of Article 9(9) of the Directive is available. Following consideration the SEM Committee has concluded that this change of ownership does not preclude application under Article 9(9).
- (6) The SEM Committee has undertaken a purposive assessment of the arrangements which has included, but not been limited to, a line by line comparison of the current arrangements with the provisions of Chapter V of the Directive. This assessment has therefore also had regard to the aims of effective unbundling; the pillars of such unbundling and the requirement of the arrangements to ensure fair competition, sufficient access for new entrants and the integration of electricity markets. It was also

considered that the arrangements should not create an overly onerous regime for the national regulatory authority.

- (7) The SEM Committee has proposed improvements on the grounds that while the arrangements have to date provided more independence than the provisions of the ITO model, there is some lack of certainty as to how they will continue to provide this assurance in the future. A number of specific improvements are proposed aimed at providing this assurance. These include, among others, the transfer of responsibility for the complete planning function to SONI and the application of all ring fencing measures to the tasks and resources which are currently executed and employed by NIE Powerteam. The latter may be achieved through integration of the resources and tasks of NIE Powerteam into NIE. This assessment has been arrived at having regard to the arrangements as a whole.
- (8) The SEM Committee concludes that the existing arrangements have provided more effective independence of the transmission system operator than the provisions of Chapter V of the Directive and, with the improvements proposed, would clearly guarantee this into the future. On this basis the decision of the SEM Committee is to grant the application by NIE for certification, subject to the implementation of the proposed improvements and to the decision of the Commission under Article 9(10) of the Directive.
- (9) In reaching its decision the Committee is conscious of the fact that SONI, along with NIE, exercises the functions of a transmission system operator in Northern Ireland within the meaning of article 2(4). However, as at the date of this decision, no application has been submitted for the certification of SONI. Were such an application to be properly made, the Committee would give it careful consideration.

## 2 Existing Arrangements and the Certification Process

### 2.1 Northern Ireland Arrangements



- (9) To assess the transmission arrangements in Northern Ireland in the context of the Directive and the certification process, it is useful to consider the wider industry context in which they sit. Therefore this section will give a brief overview of the structure of the Electricity Market.
- (10) The wholesale market, the Single Electricity Market (the SEM), is a mandatory gross pool market for the island of Ireland (i.e. a single market including Northern Ireland and Ireland). This market is operated by an independent entity licensed by both Regulators as the Market Operator, known as SEMO (the Single Electricity Market Operator). SEMO is a joint venture between the two licensed TSOs – SONI for Northern Ireland and EirGrid for Ireland. EirGrid and SONI are both part of the EirGrid Group.
- (11) The SEM is designed to, inter alia, produce the most efficient wholesale market price in each half hour and eliminate the exercise and potential for market power by generators. The Bidding Code of Practice prescribes the calculation generators use in offering their bids into the SEM. Each generator bids in its short run marginal cost and a merit order based on market bids is established for each half hour of the trading day. The market operator schedules generators in order of lowest to highest marginal cost, and the SEM's market price (the "SMP") is the marginal cost of the marginal generator in that half-hour required to meet demand. Therefore the marginal unit earns an inframarginal

rent of zero while all other scheduled plant earn an inframarginal rent of the SMP minus their short run marginal cost. Generators with a short run marginal cost above that of the marginal plant required to meet demand are not run (though in practice “out-of-merit” units can be run for system security reasons e.g. for reserve purposes or due to transmission system constraints although they do not receive inframarginal rent). Therefore it can be seen that generators are incentivised to increase their efficiency in order to run more often and have no power to artificially raise the wholesale price of electricity. All electricity suppliers are obliged to buy their power from the SEM at the SMP.

- (12) The electricity market in Northern Ireland has been open to competition to domestic customers since 2007. However, there were no competing suppliers in the domestic market until 2010. Electric Ireland, a member of the ESB Group, has been active in the business market for over 10 years and in the domestic market since 2011. In June 2010 Airtricity entered the market for domestic credit customers and in 2011 entered the market for domestic keypad customers. In 2011 Budget Energy entered these markets. Industrial customers became eligible to change supplier from 1999 and from 2005 this was also possible for small and medium businesses.

### 2.1.1 Role of the National Regulatory Authority and the SEM Committee

- (13) In relation to all SEM matters decisions are taken by the SEM Committee. The Utility Regulator, CER and an independent member (with a deputy) make up the SEM Committee. The Utility Regulator, CER and the independent member each have one vote. The chair of the SEM Committee rotates every six months.
- (14) Generally speaking, all wholesale market issues relating to the SEM are “SEM matters” but there is also an increasing number of transmission issues which are being addressed on an all-island basis (in the absence of a single all island transmission system) and as such can be considered SEM matters. Examples include the treatment of transmission loss factors, generator TUoS charging, Harmonised Ancillary Services and Other System Charges (HAS & OSC) and this Certification procedure is itself a case in point.
- (15) Regulatory issues which are not SEM matters are determined solely by the Utility Regulator. These issues include licensing of energy undertakings, matters relating to security of supply and emergencies, retail market issues, distribution matters, connection policy and the regulation of NIE and SONI under price control mechanisms.
- (16) The powers and duties of the Utility Regulator are set out in various pieces of legislation. The main legislative basis for the electricity industry is The Electricity (Northern Ireland) Order 1992 and the Utility Regulator draws its powers from this legislation as amended by The Energy (Northern Ireland) Order 2003 and the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 . It should be noted that the Utility Regulator has a strong degree of independence in the discharge of its powers including direction under legislation in addition to its licensing powers.
- (17) Therefore it can be considered that the totality of the arrangements in place under current legislation (including those which are the subject of this paper) falls within the

regulatory oversight of the Utility Regulator and may be subject to modification where the Utility Regulator (or the SEM Committee in relation to SEM matters) is of the view that the requirements of the legislation should be better met through such modification.

### 2.1.2 Transmission arrangements

- (18) The Northern Ireland electricity grid comprises a number of interconnected networks of overhead lines and underground cables. There are approximately 2,100km (110kV and 275kV) of transmission network, of which some 80km are underground, and approximately 42,900km of the distribution system, of which some 13,100km are underground. There are more than 800,000 customers connected to the distribution system, which links the three power stations and external interconnectors to 30 main substations.
- (19) At 3 September 2009 NIE was part of a Vertically Integrated Undertaking with generation and supply interests in Northern Ireland and Ireland. Viridian Group Holdings Limited owned 100% of Viridian Group Limited (NI) which was the immediate holding company of NIE. Viridian Group Limited (NI) also owned supply interests in Northern Ireland and NIE Powerteam which provided construction services solely to NIE. Viridian Group Holdings Limited was also 100% owner of subsidiary companies involved in generation and supply in Ireland. In 2010 ownership of NIE and NIE Powerteam was transferred to ESB. Through its wholly owned subsidiary, ESBNI Limited, ESB owned 100% of NIE and NIE Powerteam at the date of application for certification. NIE Powerteam continued to provide construction services solely to NIE. ESB owns supply and generation undertakings in Northern Ireland and Ireland.
- (20) SONI directs the output of each generating unit on the NI system to match supply to demand taking into account exchanges with other interconnected systems and ensuring the availability of ancillary services. The transmission and distribution assets belong to NIE who are responsible for planning, developing and maintaining the transmission system in Northern Ireland. NIE and SONI are required to agree a transmission development programme; SONI is required to provide planning assumptions to NIE including a seven-year Transmission System Capacity Statement and NIE is required to prepare a seven-year Transmission Investment Plan. In respect of maintenance NIE prepares and maintains Asset Maintenance Policies and an Asset Management Plan and SONI has the right to submit requests for changes and to refer to the Utility Regulator a dispute in event of disagreement. NIE is responsible for making the transmission system available to SONI to allow it to carry out its function of directing electricity across the system and for providing SONI with the information needed by SONI to co-ordinate this task. Both SONI and NIE are subject to Utility Regulator Price Controls and to Licence requirements including those requiring non-discrimination in the carrying out of their obligations. NIE holds the NIE Plc Transmission & Distribution licence and SONI holds the Transmission System Operator Licence under the Electricity (NI) Order 1992 as subsequently amended.
- (21) SONI is the contractual counterparty for connection and use of the transmission system by generators and suppliers. Offers to those seeking connection are made by SONI which also receives construction offers from NIE setting out the works to be made, the

date by which any works may be completed, the charges for such works that are to be levied and the principles on which these are based. Any disputes over the connection offer may be referred to the Utility Regulator.

- (22) The transmission and distribution business derives its revenue principally through Use of System (UoS) charges levied on generators and suppliers that use the transmission and distribution systems. The Statement of Charges for Use of the Northern Ireland Electricity Transmission System are published annually by SONI after receiving the Utility Regulator's approval while the Statement of Charges for Use of the NIE Electricity Distribution System are published by NIE and also subject to the Utility Regulator's approval. Charges are also applied for the System Support Services (SSS).
- (23) The Transmission Interface Agreement (TIA) governs the cooperation between SONI and NIE in discharging their duties including transmission planning, maintenance and connections. It sets out their respective responsibilities and duties to ensure that these tasks are discharged efficiently. The TIA allows for referral by NIE or SONI of specific disputes to the Utility Regulator, which may also adjudicate on any issue of dispute within the TIA. The decision of the Utility Regulator, subject to judicial review, is binding in all cases.
- (24) NIE has been a separate, wholly owned subsidiary company of a vertically integrated undertaking (VIU) with generation and supply interests both at 3 September 2009, under the ownership of Viridian, and at the date of application, under the ownership of ESB. SONI is a separate legal entity, fully unbundled from any interest in generation or supply and is licensed as the transmission system operator. The SEM Market Operator (SEMO) is a joint venture between SONI and EirGrid (the TSO in Ireland). SONI is a company within the EirGrid Group.
- (25) NIE's responsibility for maintenance and development of the network is to a significant degree carried out by NIE Powerteam Limited, which is a separate legal company, unlicensed and a wholly owned subsidiary of the VIU, providing services solely to NIE. NIE Powerteam was set up as a separate company under a written agreement with the Utility Regulator and the arrangements for its operation are specifically addressed in the NIE Transmission and Distribution Licence. NIE Powerteam staff have primary responsibility for execution of maintenance and development of the network. NIE Powerteam therefore receives its revenue through the expenditure incurred by NIE on these tasks, which is in turn subject to Price Controls determined by the Utility Regulator. The Executive Directors of NIE are Directors of NIE Powerteam and reporting of the activities of NIE Powerteam to the VIU is primarily through NIE.
- (26) The Utility Regulator is the National Regulatory Authority and has regulatory oversight and legally enforceable powers of direction over the companies, their duties, their contractual relationship and interactions.

## **2.2 Purposive Approach**

- (27) The SEM Committee considers that a purposive approach is the most appropriate means of assessing an application for an Article 9(9) certification. The purposive approach involves assessing whether the transmission arrangements in place meet or



exceed the intent of the unbundling provisions of the Directive, in particular by guaranteeing greater independence than the ITO model. The SEM Committee considers the intent or purpose of the Directive to be broadly summarised by Recital 12 of the Directive:

*The national arrangements 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.*

(28) In adopting a purposive approach the SEM Committee has been cognisant of the aim of the unbundling rules of the Directive (taking particular account of the recitals) and of the roles and tasks of the TSO set out in the Directive. In this context it is noted that the European Commission made particular reference to Recitals 12 and 19 and to Article 12 in its decision on the Scottish Arrangements. The SEM Committee has also considered areas that are, in its view, core to the independence of the TSO.

(29) Accordingly the SEM Committee has assessed the Existing Arrangements relative to the ITO against the following criteria:

- Core issues of independence (SEM Committee Guidance paper and additional considerations);
- Aims of effective unbundling (Recitals 12 and 19); and
- Pillars of effective unbundling through an ITO (Recital 19).

These analyses were also informed by a line-by-line comparison of the Existing Arrangements with Chapter V (the ITO model).

(30) In its Guidance Note SEM-11-103 the SEM Committee highlighted four areas of being of particular importance when considering an Article 9(9) application. These areas are:

- Resources
- Organisation, governance and incentives
- Information
- Regulation

Additional issues also considered were market operation, system operation, access and connection to the system, system charging, and system planning.

(31) With regard to the aims of unbundling, the Existing Arrangements relative to the ITO have been assessed taking the following into consideration. Any system of unbundling should remove conflicts of interest and ensure:

- fair competition;

- sufficient investment;
  - access for new entrants;
  - integration of electricity markets; and
  - should not create an overly onerous regulatory regime for national regulatory authorities.
- (32) When comparing the existing arrangements against the requirements for an ITO the following pillars of the ITO model have been considered:
- organisational measures and measures relating to the governance of transmission system operators;
  - measures relating to investment, connecting new production capacities to the network and market integration through regional cooperation; and
  - inter alia, certain ‘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.

### **2.3 Eligibility**

- (33) The change in identity of the VIU from Viridian to ESB raises the question whether an Article 9(9) certification is available under changed ownership of NIE and the transmission system. This question was raised in Guidance issued by the SEM Committee in SEM-11-103 where it was stated that Article 9(9) grounds may be available only in respect of a transmission system which remains within the ownership of the same vertically integrated undertaking which owned it on 3 September 2009. The SEM Committee also wrote to the European Commission to determine its views.
- (34) The European Commission has stated that the purpose of Article 9(9) is to allow Member States to retain particularly effective arrangements which were developed to their specific circumstances prior to Directive 2009/72/EC coming into force. The relevant question is therefore whether these arrangements remain in place and guarantee more effective independence than the ITO model notwithstanding the change in ownership. The change in ownership does not therefore preclude application of this provision of the Directive in Northern Ireland.

### **3 NIE's Four Key Arguments**

(35) In their application NIE presented four key reasons why the existing arrangements guarantee more effective independence of the transmission system operator than the ITO model:

1. The structural separation of SONI TSO Tasks
2. Ring-fencing of Co-ordinated TSO Tasks is comparable to the ITO model
3. SONI's Oversight of the Co-ordinated TSO Tasks
4. Transparent Regulatory Structure

#### **3.1 Structural Separation of SONI TSO Tasks**

(36) NIE argues that SONI is exclusively responsible for the operation of the transmission system, the scheduling and dispatch of all connected parties onto the transmission system and the connection of all users to the transmission system. SONI is the sole contractual counterparty for connection and use of the transmission system by generators and suppliers and accordingly SONI, rather than NIE, is the repository of confidential user specific information. As SONI is structurally independent of all parties in the market-place because it is not part of a Vertically Integrated Undertaking (VIU), it follows by definition that the execution of the SONI tasks in the existing arrangements is more independent than would be the case if those functions were carried out through a ring-fenced subsidiary company of a VIU, as would be the case under an ITO model.

(37) SONI argues that this is not the case for two reasons. Firstly, that SONI is not exclusively responsible for operation of the system. SONI states that in a number of significant areas it is dependent on NIE for conducting transmission operations. This includes, inter alia, NIE responsibility for specifying the capability of the transmission system and setting the Transmission and Distribution System Security and Planning Standards. It also includes SONI reliance on the provision by NIE of information to allow SONI to calculate and collect transmission use of system charges and provision of accurate and timely information allowing optimum efficient operation of the system. Secondly, SONI argues that the necessity for independence means more than structural separation or effective ring-fencing. SONI argues that it must also entail effective decision-making rights with respect to the assets necessary to operate, maintain and develop the transmission system. Within the Northern Ireland arrangements SONI is not independent in the performance of its system operation functions and is dependent on NIE to maintain, plan and develop the system.

(38) SONI has made a number of statements regarding the efficiency of the arrangements and the split of the TSO tasks set out in the Directive. It has stated that the level of cooperation required for efficient operation of the network has not been forthcoming from NIE and that the Transmission Interface Agreement (TIA), which is the regulatory

document that governs this cooperation, is not adequate to regulate properly the relationship between SONI and NIE. This aspect of the arrangements is reviewed in examination of NIE's key reason 3 supporting its application.

- (39) The SEM Committee considers that the arguments adduced by SONI have some merit in that while the independence provided by the arrangements has not so far been compromised there is some uncertainty as to how this may be guaranteed in the future. Dependence on the part of SONI for information or assets required to operate the system does not diminish the clear Licence responsibility of SONI to operate, coordinate and direct the flow of electricity onto and over the transmission system and to do so in accordance with the Transmission and Distribution System Security and Planning Standards. SONI's Licence requires that it has sufficient resources to enable it to carry on the Transmission System Operator Business and comply with its legislative and Licence obligations. SONI has not demonstrated that it has been unable to carry out its system operation obligations under its Licence in the absence of complete decision-making rights with respect to all the assets necessary to operate, maintain and develop the transmission system. NIE's Licence requires that it provide the means, including information, to allow SONI to carry out its system operation tasks. The NIE and SONI licenses also make provision for both to ensure that they have the resources necessary for efficient and effective managerial and operational independence. A split responsibility model inevitably involves interdependencies between the parties involved and it is the responsibility of the parties to ensure that these work efficiently and economically for the benefit of consumers. It is nevertheless the case that SONI's Licence responsibilities do not include either planning or supervision of planning and that it therefore does not have the resources to carry out these roles. This has been identified as an area for improvement. The SEM Committee therefore considers that while the existing arrangements have provided for the independence of the TSO some improvement to the split accountability model is required to assure this independence in the future. This measure is set out below at 5.4 and at (6), (7) and (8) of Annex 1.
- (40) The Article 9(9) test is whether the arrangements guarantee more effective independence than the ITO model. The SEM Committee recognises that single company performance of all tasks of a TSO would avoid some of the issues of cooperation which SONI has claimed are features of the current arrangements. Against this however the SEM Committee recognises that structural separation and performance of some tasks, particularly operation, by an independent TSO removes the incentive for discrimination on behalf of VIU interests. The SEM Committee therefore agrees with the argument of NIE that the current arrangements whereby SONI carries out certain TSO tasks clearly adds a layer of independence that would not exist in the ITO model. It also considers that these arrangements could be improved in such a way as to provide assurance of this independence in the future. These improvements have been set out at 5.4 and at (6), (7) and (8) of Annex 1.

### 3.2 Ring-fencing of Co-ordinated TSO Tasks

- (41) NIE state that in accordance with their licenses, NIE and SONI are required to jointly perform the functions of transmission planning and development and the function of maintenance. In consequence of its substantive role in the execution of these tasks, NIE state that its Licence imposes comprehensive ring-fencing requirements prohibiting it from unfairly advantaging itself or any affiliate and from unfairly discriminating against any other person. This ring-fencing provides for the full managerial and operational independence of NIE within the VIU and covers areas such as availability of resources, management separation, financial separation and the management of protected information. NIE state that these ring-fencing arrangements are comparable to the requirements of the ITO model. When account is taken of the proportionate role of NIE under the existing arrangements as compared to a TSO under the ITO model, it is argued that, combined with key reason 3 and 4, the arrangements guarantee more effective independence of the co-ordinated TSO tasks than would exist under the ITO model. These ring-fencing arrangements were in place at 3 September 2009 and at the date of application.
- (42) SONI has argued that the requirement of independence necessitates that one company carry out all the tasks of a TSO and has all the resources independent of a VIU in order to do this. Notwithstanding this position SONI argues that NIE is inadequately separated from its VIU and the arrangements fall significantly short of the ITO model. SONI argues that this is made clear by a line-by-line comparison with the ITO requirements of Chapter V of the Directive setting out the requirements of the ITO model. In making such an analysis SONI argues that there is inadequate management separation, inadequate separation of identity and inadequate separation of IT. SONI states that NIE relies on personnel external to the transmission business through secondments and common services provided by the VIU and that NIE and the Viridian Group, its VIU at September 2009, also shared premises and auditors.
- (43) The SEM Committee would note that the planning function is at the heart of TSO independence and it is concerned to assure this independence in future so that the arrangements within Northern Ireland continue to guarantee greater independence than the ITO model. While it is NIE, through its Licence, that currently shall plan, develop and maintain the total system and has responsibility for these tasks the SEM Committee considers that improvement to the arrangements such that licensed responsibility for the planning function is transferred to SONI would provide assurance of independence into the future. NIE currently discharges its responsibilities in accordance with the TIA and SONI shall implement and comply with the TIA arrangements. This means that there are significant TSO functions which require ring-fencing and will continue to require effective ring fencing in future in order to achieve the level of independence required by the Directive. The SEM Committee agrees with the argument of NIE that account must be taken of the proportionate role of NIE under the existing arrangements as compared to the TSO under the ITO model. The SEM Committee notes that this approach has been adopted by the European Commission Decision of 14 May 2012 on the application of Article 9(9) to transmission operation in Scotland. The SEM Committee has also had regard to the salience of key reasons 3 and 4 advanced by NIE, which are reviewed below at sections (47), (49), (52) and (53). The view of the SEM Committee having

carried out an assessment of the ring fencing of NIE, the detail of which is set out in Sections 5.1.1, 5.1.2 and 5.1.3, is that this is clearly comparable to that required by an ITO model, subject to the improvement measures, including those regarding NIE Powerteam set out in 5.4 below.

### **3.3 SONI's Oversight of the Co-ordinated TSO Tasks**

- (44) NIE state that the tasks of planning, development and maintenance are jointly performed by NIE and SONI on a co-ordinated basis. This requirement for co-ordination with SONI coupled with SONI's right of challenge over all aspects of the planning, development and maintenance processes, and entitlement to refer disputes over prospective NIE decisions to the Utility Regulator, whose decision is binding, provides a much greater and more rigorous scrutiny of these functions than would be achieved if they were taken within a ring-fenced subsidiary of a VIU. This provides an additional layer of independence through the oversight by the structurally independent SONI of the discharge by NIE of these functions. This means that NIE cannot, in performing its defined and limited role in relation to planning and development of the transmission system, discriminate in favour of the generation and supply interests of the VIU. NIE refers to the TIA as the basis for this oversight and its specific stipulation of 28 areas relating to planning and connection matters which may be referred to the Utility Regulator. The Utility Regulator may also agree to resolve any other dispute not listed.
- (45) SONI reject the role ascribed to them by NIE. In relation to planning SONI state that while both it and NIE are required to agree a transmission development programme, the development of a Transmission Investment Plan based on the programme is the responsibility of NIE alone, subject only to SONI's right to submit planning assumptions and to refer matters as a dispute to the Utility Regulator. In respect of maintenance SONI state that the Asset Maintenance Policies and Asset Management Plan are NIE documents to which it has the right to submit requests for changes and to refer to the Utility Regulator as a dispute in event of disagreement. In relation to development SONI acknowledges that responsibility for determining the timing and conduct of the process is shared between SONI and NIE rather more equally than planning and maintenance. SONI state that a right of oversight does not amount to a right to make decisions, that the oversight role is very weak and does not amount to joint responsibility. SONI state that they do not have the resources to carry out the role of effective scrutiny and review. It rejects the option of referral to the Utility Regulator of disputes as not practical because of its perceived heavy-handedness and the cost and delay involved. As noted in section (38) above, SONI does not consider the TIA as adequate to properly regulate the SONI and NIE relationship. It has stated that the TIA was not designed to carry out the role of coordination between two separate companies for which it is now employed.
- (46) NIE has argued that the TIA provides SONI with an independent oversight and decision making role in respect to the relevant TSO functions that would not be found in the ITO model. The SONI right of oversight is not relevant to its making independent decisions but rather ensures that NIE is not able to make decisions that favour its VIU. NIE argues that SONI has a major role in planning, maintenance and development of the transmission system. It notes that SONI's Licence requires that it implement the TIA, which is designed to ensure the efficient discharge of the obligations imposed on it by

Licence and legislation. The Licence requires SONI, in common with NIE as transmission owner, to review the TIA to ensure that it achieves its objectives and report the outcome of the review to the Utility Regulator. NIE notes that SONI has not done this. NIE also notes that on the question of asset maintenance SONI has not escalated any dispute between the two companies to CEO level. NIE states that although the TIA was drafted as an inter-company arrangement it was written to meet Licence obligations that are currently placed on both companies.

- (47) The SEM Committee notes that it is NIE, through its Licence, that shall plan, develop and maintain the total system, has responsibility for these tasks and takes the lead role in discharging them. It shall do so in accordance with the Transmission Interface Arrangements and SONI shall implement and comply with these Arrangements. SONI has brought no disputes under the TIA to the Utility Regulator regarding the functions discharged under the Agreement. The resources available to both companies reflect these different roles and it is therefore NIE that must have the resources to discharge its predominant role in these tasks. NIE in its submission has argued that SONI does however have a level of oversight that would prevent discrimination by NIE in favour of its VIU. The SEM Committee is of the view that the involvement of SONI in performance of the tasks of planning and maintenance is one that clearly adds independence to the arrangements that would not exist in an ITO model, providing some protection against discrimination on behalf of VIU interests. However the SEM Committee is also aware of the limited role and resources of SONI in this respect and that the absence of Licence responsibility for the planning function and consequent limitation of resources do not provide assurance as to continuation in the future of the independence provided by the arrangements. The SEM Committee therefore considers that certainty as to the strength and continuing role of this independent element of the arrangements should be provided by the improvements provided for in section 5.4 whereby complete responsibility for the planning function is transferred to SONI.
- (48) NIE has stated that SONI is exclusively responsible for connection of all users to the transmission system, is the sole contractual counterparty for connection and use of the transmission system by generators and suppliers and that accordingly it is the sole repository of confidential user specific information. NIE acts as a sub-contractor to SONI for delivery of the connection works so that the arrangements do not allow for any direct contact between NIE and a generator or supplier. The SEM Committee considers SONI cannot be said to have exclusive responsibility for connection to the system in the same manner as its responsibility for scheduling and dispatch, as claimed by NIE, and NIE cannot simply be considered a sub-contractor given its responsibilities for setting the costs and timescales for connection works. It considers however that this independent role is currently greater than that involved in planning and maintenance of the system even while it considers that this role is overstated in the NIE application.
- (49) The SEM Committee agrees that there is some merit in the NIE argument that the involvement of SONI as an independent company outside the VIU adds an additional element that would not exist within the ITO model and that this provides a measure of protection against discrimination in favour of the VIU. The SEM Committee is nevertheless of the view that, while this role has provided enhanced independence from

the VIU that would not exist in an ITO, it also considers that this role should be improved to guarantee independence into the future.

### **3.4 Transparent Transmission Arrangements**

- (50) NIE argues that the existing arrangements allow for a substantial degree of regulatory transparency which would not exist under an ITO model and that this makes it less onerous for the Utility Regulator to perform its role. This is the result of the structural independence of SONI and the relationship between it and NIE, governed through the TIA. This allows greater transparency than would exist through ring-fencing within the VIU. The TIA provides a mechanism for SONI to challenge NIE decisions and refer disputes to the Utility Regulator. Issues become more readily apparent and the Utility Regulator has greater insight into the actions of both NIE and SONI. Taken together with the powers vested in the Utility Regulator over Licence holders, including the power to issue financial penalties, the arrangements provide incentives to both companies to comply comprehensively with regulatory requirements. This provides a far superior guarantee that transmission decisions are taken completely independently than would be achieved under an ITO model where decisions are wholly taken and accounted for within the bounds of a subsidiary company of the VIU.
- (51) SONI argues that the existing arrangements incorrectly attribute transmission functions to a person other than the transmission system operator, involve inadequate ring-fencing of the transmission owner within the VIU and rely on weak oversight through a complex TIA. Given the fundamentally flawed character of these arrangements no amount of regulatory oversight can guarantee the requirements of the Directive and it cannot be left to regulatory action to fill gaps in the structure of the arrangements.
- (52) The SEM Committee notes that it is not the existence of strong regulation that is argued provides the reason why the arrangements guarantee more effective independence than the ITO model but the structure of the arrangements that provide transparency for regulation that is not available in the ITO model. The SEM Committee would note that each of the certification models have different requirements for regulatory oversight and intervention and that the question is the appropriate role for regulation in the particular model. It is not therefore the case that regulatory action is being asked to fill gaps in the structure of the arrangements. The argument is that the nature of existing arrangements add transparency which makes it less onerous for the Utility Regulator to perform its role. The soundness of this argument rests on evaluation of the arrangements as set out in key reasons 1, 2 and 3. The performance of significant TSO tasks by a company independent of the VIU, particularly operation, reduces both incentives for discrimination and the burden of regulatory oversight that would be required to monitor against this. As noted in section (43) dealing with Key reason 2, NIE continues to perform significant TSO tasks which require ring-fencing. This includes monitoring of Licence requirements, including a Compliance Plan, and involves extensive reporting requirements. The involvement of SONI in the tasks of planning, maintenance and development clearly adds a layer of oversight to the arrangements that would not exist in an ITO while recognising that this role does not provide complete transparency and requires strengthening in order to guarantee the independence of the arrangements in the future.



- (53) The SEM Committee is of the view that the requirement for ring-fencing of NIE coupled with the complexity of the relationship between NIE and SONI in the tasks of planning, development and maintenance require strong and effective regulation. Strong and effective regulation is required notwithstanding the role of SONI as transmission system operator and its role in planning, development and maintenance. Nevertheless it is clearly the case that performance of significant TSO tasks by a company independent of the VIU, particularly operation, has reduced the burden of regulatory oversight. While SONI oversight of the tasks of planning, maintenance and development could reduce the regulatory burden, the relative weakness of such supervision may not assure its continuation into the future. There is thus overall a reduction to the burden on regulation consequent to the existing arrangements in relation to that which would exist in the ITO model but there remains some uncertainty as to the future burden .

### **3.5 Conclusion**

- (54) Concluding on the four key reasons advanced by NIE in support of its application for certification requires that they are judged in the round. The salience of each of the reasons varies and an overall judgment must be considered by taking into account the weight of each reason and the overall impact. The SEM Committee considers that the argument advanced in key reason 1, the independent performance of TSO tasks, particularly operation, by SONI is an important argument in favour of the independence of the existing arrangements albeit that improvement to the split accountability model is required to assure this independence in the future. It considers that the arguments advanced in key reason 3, the oversight of SONI of the tasks of planning, development and maintenance also have merit. The SEM Committee however is of the view that this oversight is limited and that the role of SONI in planning should be strengthened such that the arrangements would provide assurance of the independence provided into the future. It considers that the argument advanced in key reason 4, the effect on regulation of the transparency introduced by split accountability in the arrangements, has also resulted in a reduction to the burden on regulation that would not exist in the ITO model, albeit with some reservation as to the assurance of this into the future. The SEM Committee is of the view that the implementation of the improvements set out in 5.4 would provide this assurance. The SEM Committee agrees with the argument of key reason 2, that the ring-fencing of NIE within the VIU is comparable to that of the ITO model. In this respect however the SEM Committee notes that the position of NIE Powerteam is an anomaly within this ring fencing and that this aspect of the arrangements must be improved such that these measures are certain in their effect. This may be achieved by the integration of NIE Powerteam into NIE. It has also noted a number of other improvements that should be made in 5.4. In assessing these reasons as a whole the SEM Committee therefore considers that, while the arrangements have additional elements of independence that would not exist in an ITO model, certain improvements should be made to provide assurance that this independence will continue in the future.

## **4 SONI's Key Arguments**

- (55) SONI, as a related licensee, was able to make representations on the application for certification by NIE and it submitted its representations on 17 February 2012. In the course of examining the NIE application and the SONI submission a further information request was made to SONI and this was received on 25 May 2012. The arguments advanced by SONI are reviewed in this part of the Preliminary Decision paper.
- (56) In their submissions SONI presented a number of reasons why the existing arrangements were not certifiable under the Directive:
1. Certification should be of the transmission system operator.
  2. The TSO must carry out all functions and have all related resources for effective independence.
  3. Evaluation of the NIE application must include a line-by-line analysis with reference to the provisions of Chapter V of the Directive.
  4. The ring-fencing of NIE falls short of the ITO model.
  5. The change of ownership of NIE from one VIU to another means the Article 9(9) certification is unavailable to NIE.

### **4.1 Certification of the System Operator not System Owner**

- (57) SONI state that it is not open for NIE to be certified because it is not a transmission system operator but is rather a transmission system owner. It states that the definition of a TSO in the Directive at Article 2(4) and Article (12) requires the certified TSO to be responsible for operating the system. NIE argue that SONI has misunderstood the requirements of the Directive when interpreting the meaning of transmission system operator. The transmission system owner can be certified as a transmission system operator for the purposes of the Directive. NIE state that this is supported by, inter alia, the Directive itself; Article 10B of the Electricity Order, as amended by the IME Regulations, and the decision of the European Commission in its certification of arrangements in Scotland. The SEM Committee shares the understanding of the requirements of the Directive and agrees that the evidence adduced in support of this understanding is conclusive. Nevertheless the SEM Committee acknowledges that there is scope for confusion as to the respective roles of NIE and SONI as the certified and licensed TSO respectively. The SEM Committee therefore proposes to make licence modifications to clarify and protect these roles. Further detail is set out at Annex 1 1.1

### **4.2 Requirement to carry out all functions**

- (58) SONI argues that the requirement for effective independence of the TSO requires that the system operator must not only be structurally separated from generation and supply

interests but that it must also have all the resources, responsibilities and decision-making powers required to carry out its TSO functions effectively, without being dependent on another market participant for any of these resources or powers. Following on from its argument at section (37) above, SONI states that it does not have these resources or powers and that therefore the arrangements cannot be certified.

- (59) NIE argue that effective independence does not require structural separation as is manifested by the availability of the ITO and Article 9(9) options. The Directive does not require the transmission system operator to have the resources, responsibilities and decision making powers required to carry out the system operator functions without being dependent on another market participant for any of these resources or powers. NIE state that this is supported by the Directive itself, by the Department for Enterprise, Trade and Investment through its IME Regulations and the decision of the European Commission in its certification of the arrangements in Scotland.
- (60) The SEM Committee view is that the SONI interpretation would not allow for a split accountability model with the inevitable interdependencies that this involves. The Article 9(9) option clearly envisages that arrangements differing from the full ownership unbundling, ISO and ITO options should be considered for certification provided that they demonstrate that they can clearly guarantee more effective independence of the TSO than the provisions of Chapter V of the Directive. This understanding has been confirmed by the European Commission in its application of Article 9(9) of the Directive to the transmission system operator arrangements in Scotland. The separate legal existence of NIE provides the effective grounds for the ring-fencing of its activities and possibility of satisfying the provisions of the Directive at Chapter V, which set out the requirements of the ITO model.

### **4.3 Requirement to carry out a line-by-line analysis**

- (61) SONI state that the Commission, in its interpretative note on the unbundling regime, requires that the effectiveness of the existing arrangements must be assessed by reference to the provisions of Articles 17 to 23 of the Directive (Chapter V). This requires a line-by-line check between the existing arrangements and the requirements of the ITO model. Where the requirements of a particular provision are not satisfied there must be some other mechanism that not merely achieves the same objective but does so more effectively. SONI argue that this was confirmed in the SEM Committee Guidance Paper. SONI state that the opinions of the European Commission (EC) demonstrate that the requirements of Chapter V must be applied strictly. SONI argues that a purposive approach extends the requirements of the Directive and could not paper over gaps in ring-fencing admitted by NIE. SONI acknowledges that use of Chapter V as a checklist does not mean that each of the requirements must be satisfied in the same way as in an ITO model but that they must be satisfied and any departure specifically justified.
- (62) NIE agrees that the existing arrangements must be assessed by reference to Chapter V. It agrees with the Guidance Paper issued by the SEM Committee on 5 December 2011 that where the applicant is not able to meet any individual requirement of the ITO checklist and Directive, it would be expected that the applicant would provide evidence

showing that the arrangements in place are nonetheless such as to guarantee more effective independence of the TSO. NIE does not agree that the requirements of the Directive can be extended by a purposive approach or that it has admitted to gaps in ring-fencing. It does not accept that EC opinions expressed in relation to the ITO model can simply be read across to applications under Article 9(9).

- (63) The purposive approach adopted by the SEM Committee was explained in the Guidance Paper published on the all-island website on 5 December 2011. The SEM Committee would draw attention to the following in its Guidance Paper; that in undertaking the task of assessing applications under Article 9(9) regard will be taken not only to the provisions of Article 9(9) and Chapter V but also to the surrounding context as articulated in the preamble to the Directive (and in particular recitals (11), (12), (16) and (19)) and also the Commission's own Staff Working Paper on The Unbundling Regime dated 22 January 2010. The SEM Committee therefore views the line by-line-analysis within this context. The European Commission view the purpose of the Directive having been fulfilled when the arrangements under an Article 9(9) application clearly guarantee more effective independence of the transmission system operator than the provisions of Chapter V. The provisions of the ITO model are thus central to this evaluation. Both the satisfaction of the specific provisions and any departure from them will thus be evaluated on a purposive basis. The SEM Committee therefore agrees with SONI that this approach does not involve accepting gaps in ring-fencing; that each of the requirements of Chapter V do not have to be satisfied in the same way but that they must be satisfied and any departure specifically justified. This last requirement has the same meaning as that set out in the SEM Guidance Paper which is supported by NIE: that where the applicant is not able to meet any individual requirement of the ITO checklist, it would be expected that the applicant would provide evidence showing that the arrangements in place are nonetheless such as to guarantee more effective independence of the TSO. The arrangements will thus be judged as a whole just as it is the arrangements as a whole which are presented for certification.

#### **4.4 The ring-fencing of NIE falls short of the ITO model**

- (64) SONI has argued that NIE is inadequately separated from the VIU. In particular at 3 September 2009 its executive management consisted of an executive who had immediately before been an executive of the VIU, contrary to the provisions of Chapter V of the Directive. Its current Managing Director is also a former senior manager of the VIU. NIE fails to meet the separation requirements of Chapter V in terms of its IT, personnel, premises, branding and auditing. SONI also states that NIE recognises that it has failed to meet the separation requirements in these respects.
- (65) NIE disagrees with the conclusions drawn by SONI and rejects that it has accepted that it has failed to meet the separation requirements. NIE states that it believes that the ring-fencing requirements in the existing arrangements are comparable to the independence requirements of the ITO model. In its response to the specific issues of ring-fencing raised by SONI NIE has argued that these have been addressed in the NIE application. NIE argue that on a purposive basis the relevant requirements have been met.

- (66) The SEM Committee is of the view that the separate legal existence of NIE provides an effective basis for ring-fencing. It does not accept SONI's contention that NIE has accepted that it has failed to meet the separation requirements. NIE refer to the European Commission decision on the Scottish transmission arrangements at paragraph 51 which states that "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** . . . ." This statement is endorsed by the SEM Committee and sits comfortably within the general purposive approach set out section in (63) above. The approach of the SEM Committee in evaluating the ring-fencing arrangements has been to determine compliance with the particular requirement of the ITO model, which may sometimes be satisfied directly through relevant Licence provisions or, if not, determine whether any other aspect of the arrangements provide for comparable or additional independence of the TSO. Thus on any particular aspect of ring-fencing regard has been had to the specific requirements of the Article of the Directive and to alternative aspects of the arrangements that might address the same requirement. The significance of any particular weakness of the ring-fencing in place has been evaluated given the overall arrangements and where improvements are possible that would copper fasten assurance against them or guarantee them into the future these have been identified. The detailed assessment of the ring-fencing of NIE is set out in Sections 5.1.1, 5.1.2 and 5.1.3 and, subject to introduction of relevant improvement measures set out in 5.4, which will provide assurance of the independence provided by the ring-fencing into the future, is judged as comparable to that required by an ITO model.

#### **4.5 The change of ownership of NIE from one VIU to another**

- (67) SONI notes that NIE is not owned by the same VIU that owned it on 3 September 2009. It states that the Directive permits the continuation of existing rights of ownership, but not the creation of new rights and that this means that NIE is not entitled to rely on the grounds of Article 9(9)/(10) of the Directive for its application.
- (68) The SEM Committee has considered this question and sought the views of the European Commission (EC). The EC has stated that the purpose of Article 9(9) is to allow Member States to retain particularly effective arrangements which were developed to their specific circumstances prior to Directive 2009/72/EC coming into force. The relevant question is therefore whether these arrangements remain in place and guarantee more effective independence than the ITO model notwithstanding the change in ownership. The SEM Committee is therefore of the view that the change in ownership does not preclude application of this provision of the Directive in Northern Ireland.

## 5 SEM Committee Analysis

(69) This section of the paper carries out a substantive assessment as to whether the arrangements in place clearly guarantee more effective independence of the transmission system operator than the provisions of Chapter V.

### 5.1 Assessment against the provisions of Chapter V

(70) In its Guidance Paper the SEM Committee set out the areas that it will have regard to in its assessment of the effectiveness of the arrangements in place, which are addressed below. These include:

- Resources
- Organisation, Governance and Incentives
- Information
- Regulation

#### 5.1.1 Resources

(71) The ITO provisions of the Directive at Chapter V require that TSOs shall be equipped with all technical, physical and financial resources necessary to fulfil their obligations under the Directive and for carrying out the activity of electricity transmission. Periodic Price Controls carried out by the Utility Regulator are the primary means by which both NIE and SONI are provided with the resources required to discharge their obligations under Licence and legislation. The Licence provides for a number of measures which ensure that the TSOs have these resources and that this position is visible to the Utility Regulator, including the requirement to submit independently audited statutory and regulatory accounts accompanied by a statement by the auditors. NIE's Licence requires that the Utility Regulator must approve before NIE may dispose of any relevant asset. The Licence requires NIE to act at all times in a manner calculated to secure that it has sufficient resources to enable it to comply with its legislative and regulatory obligations. It requires that NIE take all appropriate steps to ensure that it obtains and maintains an investment grade credit rating and it has confirmed that it had such a rating at 3 September 2009 and at the date of application. Further evidence of financial strength is required by submission of a report to the Utility Regulator on its financial gearing. Such reports were provided for the year ended March 2010 and March 2011. NIE must procure an undertaking from its ultimate controller that it shall refrain from any action which would be likely to cause it to be in breach of its Licence and such undertakings from its ultimate controller were provided by Arcapita Bank B.S.C. (c) at 2007 and ESB for 2011.

(72) The carrying out of NIE's responsibility for maintenance and development of the network is to a significant degree carried out by NIE Powerteam Limited which provides services solely to NIE. Its staff has primary responsibility for execution of maintenance and development of the network. NIE was therefore not directly equipped with all resources

required to carry out its tasks. NIE has argued that on a purposive basis this particular ITO provision of the Directive is met because Powerteam is not a generator or a supplier and there is no breach of the mischief which the Article seeks to protect against. It argues that its four key reasons, including the independent role of SONI, means that this method of resourcing relates only to a limited range of TSO functions. NIE states that NIE Powerteam is an integral part of the Transmission and Distribution (T&D) Business alongside NIE and that NIE's Licence ring-fences the T&D Business from the rest of the VIU. It states that NIE and NIE Powerteam together form a single regulated business. As noted in (25) above NIE Powerteam was set up under a written agreement with the Utility Regulator and its role is specifically addressed in the NIE Licence. NIE states that while it performs certain back office support functions for NIE Powerteam, these should be regarded as activities that are internal to the T&D Business. No distinction is made by an NIE employee between an activity carried out for NIE and one carried out for NIE Powerteam. The SEM Committee would note that the existence of cross-Directorships between NIE and NIE Powerteam, see (83) below, effectively means that NIE Powerteam reports to the VIU through NIE itself lending support to the argument that no material breach of the independence of NIE is involved.

- (73) NIE was also provided with a range of common services by its VIU at 3 September 2009, which included finance; company secretarial and legal services; human resources; IT and insurance services. This had a combined value of £2.05m during 2009/10. NIE argues that on a purposive basis the requirements of the ITO provisions of the Directive are met because the provision of the services is strictly bound by restrictions protecting information; the services are not provided by businesses of the VIU undertaking generation or supply; the services are not management or operational but of a corporate nature, and that because of the role of SONI in the overall arrangements the role of these common services relate only to a limited range of TSO functions. The SEM Committee notes that the provision of common services to NIE is subject to the provisions of a Compliance Plan which sets terms for their delivery. The Licence and Compliance Plan also make provision for the non-disclosure of information and avoidance of cross-subsidies.
- (74) The ITO provisions of the Directive at Chapter V require that the TSO shall not share IT systems or equipment, physical premises and security system access with any part of the VIU or use the same consultants or external contractors for IT systems or equipment. It also requires that the accounts of a TSO shall be audited by an auditor other than that auditing the VIU or any part thereof. Compliance Reports have noted that a number of locations were shared by NIE with another business of the VIU. At September 2009 the Managing Director and Regulatory Team of NIE shared premises with the Chairman of Viridian Group and Directors of NIE Energy with additional security controls in place in such premises including electronic pass control restrictions. Some IT systems were shared with the NIE supply business but no transmission related IT systems were shared with VIU companies engaged in generation or supply. At 3 September 2009 the same IT company provided outsourced services to the Viridian Group and to NIE. At date of application this company had separate contracts with NIE and Powerteam Electrical Services Limited, a company that is part of the VIU. The same audit company that carried out the audit of NIE also carried out the audit of Powerteam Electrical Services, another company within the VIU.

- (75) NIE has stated that in relation to the relevant Articles of the Directive its requirements are met by the current arrangements. Specific non-compliances have reduced in number, such as shared premises, and alternative controls have been put in place. No business carrying out any generation or supply activities shared any transmission related IT systems or equipment with NIE. NIE is required to report to the Utility Regulator as part of its annual Compliance Plan in relation to sharing of premises with Associated Businesses, which excludes the VIU holding company and NIE Powerteam, including the additional access controls which are in place. Separate contracts with the IT services company impose stringent confidentiality obligations on the company to ensure NIE information could not be disclosed outside of the NIE T&D Business. In relation to the use of the same auditor for audits of both NIE and other companies within the VIU, separate audit teams and audit partners were employed and the provision of such services is strictly bound by restrictions protecting information.
- (76) The Directive also requires that the TSO shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the VIU or any part thereof. In respect of identity, at September 2009, the Northern Ireland supply business of the VIU was known as NIE Energy Supply and the 'Flying E' logo was shared between NIE and NIE Energy Supply. The Power Procurement Business and supply business was branded as NIE Energy. Following the acquisition of NIE by ESBNI in December 2010, none of the brands or trade names used by NIE are shared with the VIU with the exception of NIE Powerteam Limited.
- (77) The SEM Committee notes that there has been an improvement in the arrangements and their satisfaction of the particular requirements of the Directive in respect of the ITO model. It is recognised that arrangements imposed by Licence are also in place such as the Compliance Plan and that others, such as separate audit teams, are in operation. These provide alternative controls safeguarding the independence of NIE and assuring availability of the resources NIE requires to carry out its functions. The SEM Committee does not consider that an issue arises as to the adequacy of the resources available to SONI to carry out the system operation tasks for which it has responsibility but that there is uncertainty as to the adequacy of resources with respect to effective oversight of the planning function. The arrangements in so far as they affect the area of resources have been evaluated in conjunction with the arrangements as a whole in order to determine whether these meet the requirements of the Directive. The assessment of the SEM Committee is that the arrangements include assurance and protection of the independent disposal of resources by NIE through the provisions of the Licence including Compliance Plan; the regulatory price control process and alternative arrangements from those envisaged by the ITO model including access controls, contract specifications for outside service provision and separate audit teams. The resources of NIE Powerteam also potentially provide assurance that the arrangements as a whole provide for sufficient resources to discharge the TSO functions. It is recognised that the assurance of independence should be copper-fastened and the transparency of the arrangements improved through a number of improvements. These include ensuring that the ring fencing that is in place also clearly applies to the resources disposed of by NIE Powerteam. This may be achieved by these resources becoming the responsibility of, and being directly deployed by, NIE. It shall also be necessary that the provision of NIE corporate services move towards compliance with Article 17 of



Chapter V. To assure the transparency and certainty of the independence of NIE within the arrangements in the future the provision of NIE corporate services by the VIU must be phased out and their provision regularly market tested. These improvement measures are set out in section 5.4 below.

### 5.1.2 Organisation, Governance and Incentives

- (78) The ITO provisions of the Directive at Chapter V require that the TSO has effective independence in decision making reflected in the governance structure of the TSO, in its management composition and decision making powers. The ITO provisions include the requirement for the TSO to have a separate legal form, a Supervisory Body; effective decision making rights including the power to raise money in the capital markets; protection against discrimination and independence of its management and staff. This section reviews how the existing arrangements compare to the requirements of the ITO model.
- (79) NIE exists in a legal form in accordance with Article 17(3); does not have a Supervisory Body or an equivalent as part of its Governance structure which shall protect the value of the shareholders' investment while providing a degree of independence from the VIU. In its application NIE has referred to alternative arrangements which guarantee more effective independence of the TSO due to the fact that the Board of Directors of NIE consists of a majority of independent non-executive Directors. An independent non-executive Director means a person who has not been employed by NIE, its ultimate controller or any affiliate or related undertaking of NIE within the last five years and who does not have a material business relationship with NIE, its ultimate controller or any affiliate or related undertaking of NIE. The governance role of the VIU Holding Company is limited by the NIE Licence and Compliance Plan which are enforced by the Utility Regulator. SONI is a separate legal company independent from any VIU with Licence requirements as to its operational and managerial independence.
- (80) No Subsidiary of a VIU performing functions of generation or supply has any direct or indirect shareholding in NIE and NIE has neither any direct or indirect shareholding in any subsidiary of the VIU performing functions of generation or supply, nor receives dividends or any other financial benefit. The day-to-day management of NIE is carried out by an Executive Committee and is supervised by a Board of Directors. Directors may not at the same time also be a Director of an Associated Business engaged in supply or generation and are required by the Compliance Plan and subject to company law, to act solely in the interests of NIE. Under Licence, NIE is required to have procured from its ultimate controller a legally enforceable undertaking to the effect that its ultimate controller will refrain from any action that would cause NIE to breach any of its legal and licence obligations. NIE shall also procure a legally enforceable undertaking in favour of NIE that the relevant holding company will not exercise its corporate governance role other than in a manner calculated to ensure that such exercise does not restrict, prevent or distort competition in the supply or generation of electricity on the Island of Ireland. Decisions for which it is responsible relating to the operation, maintenance and/or development of the system are to be taken by those persons who are Directors of NIE or who are employed by, and are engaged in, the operation and management of, the T&D Business. The relevant holding company may approve NIE's

capital expenditure budget but it shall exercise its corporate governance role in a way calculated to ensure that it does not restrict, prevent or distort competition. The NIE Compliance Plan at 3<sup>rd</sup> September 2009 stated that NIE will ensure that Viridian Representatives may participate in the corporate governance of NIE only to the extent needed in order for Viridian to comply with its legal duties and obligations as a holding company and to ensure that Viridian's economic and management supervision rights in respect of the return on NIE's assets are protected. Such protections are to apply equally to ESB. NIE will not accept or agree to accept, any limits or restrictions on its financial plans which would, or would be likely to, prevent it from undertaking its licensed activities. NIE has the power to raise money in the capital markets and its financial powers are limited by delegated limits beyond which approval by the holding company is required. Under Viridian ownership NIE's annual budget required approval by the holding company as did borrowing facilities greater than £25m. Under ESB ownership the annual financial plan requires ESB approval, which is also required for loans in excess of £20m.

- (81) Independence of the TSO is required in order to provide protection against discrimination. The NIE Licence requires that it shall not unduly discriminate in meeting its obligations and the aims of the TIA include effective competition in the generation and supply of electricity on the Island of Ireland. As part of the requirement not to discriminate the provisions of Chapter V require that commercial and financial relations between the VIU and TSO comply with market conditions and shall be submitted for approval to the regulatory authority. Although there is no requirement in the existing arrangements for all commercial and financial agreements with the VIU to be submitted for approval by the Utility Regulator the NIE Licence requires that it shall procure that no separate business gives any cross-subsidy to, or receives any cross-subsidy from, any other business of the Licensee or of an affiliate or related undertaking. The Licence also places restrictions on NIE's financial transactions to ensure that they are not entered into otherwise than on an arm's length basis and on normal commercial terms.
- (82) In order to secure the independence of the TSO the provisions of Chapter V of the Directive require independence of the TSO's management and staff. This requires that decisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of office of the management of the TSO are taken by the Supervisory Body of the TSO. These must be notified to the regulatory authority whose approval is required. No professional position or responsibility, interest or business relationship, directly or indirectly, with the VIU or any part of it or its controlling shareholders other than the TSO shall be exercised for a period of three years before the appointment of a majority of the persons responsible for the management of the TSO. The management and employees of the TSO shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the VIU or with its controlling shareholders. The persons responsible for the management, and employees of the TSO, shall hold no interest in or receive any financial benefit, directly or indirectly, from any part of the VIU other than the TSO. Their remuneration shall not depend on activities or results of the VIU other than those of the TSO. Effective rights of appeal to the regulatory authority shall be guaranteed for any complaints by the persons responsible for the management of the TSO against premature terminations of their term of office. After termination of their

term of office, the persons responsible for its management shall have no professional position or responsibility, interest or business relationship with any part of the VIU other than the TSO, or with its controlling shareholders for a period of not less than four years.

- (83) The arrangements in place at 3 September 2009 and at date of application allow that Directors of NIE are appointed and removed by the VIU, which may detail the terms under which they shall hold office. NIE may otherwise seek the approval of Viridian for appointing or dismissing a Director (other than an alternate) or relieving the Chairman, Managing Director or Finance Director of their duties. Under its Licence NIE is required to demonstrate to the satisfaction of the Utility Regulator, prior to any proposed appointment of a Director, that the proposed appointment will not cause NIE to breach the requirement for a majority of independent non-executive Directors on its Board. At 3 September 2009 the Executive Director of the NIE Board of Directors, comprising one executive and two non-executive Directors, was employed by Viridian Group Limited and was a Director of NIE Powerteam. This Director also sat on the Executive Committee of NIE as Managing Director. One other member of the Executive Committee was employed by NIE Powerteam and all his employment costs were incurred by NIE Powerteam. The Managing Director of NIE and the member of the Executive Committee above were the Directors of NIE Powerteam.
- (84) The holding company of the VIU determines the remuneration of the Directors of NIE and this may be linked only to the performance of NIE and NIE Powerteam. At 3 September 2009 the Managing Director of NIE employed by Viridian approved the remuneration of the other members of the Executive Committee. The Utility Regulator is not required to approve the conditions governing the term, the duration, termination of office or remuneration of the persons responsible for the executive management of NIE. There is no guaranteed right to appeal to the Utility Regulator for any complaints against premature terminations of the term of office. At 3 September 2009, immediately prior to his appointment to the NIE Board in July 2009, the Managing Director of NIE was Group Managing Director of Viridian Power and Energy within the Viridian Group. Immediately prior to their appointment to the NIE Board in March 2008 each of the non-executive directors had been independent non-executive directors of Viridian Group Limited. In relation to the NIE Executive Committee at 3 September 2009, consisting of 5 places (6 individuals due to a job-share), three members were in the employment of NIE Powerteam within three years prior to appointment.
- (85) The NIE License limits those who have ceased to be engaged in the management or operation of the T&D Business from being engaged in the activities of any Associated Business that is engaged in the generation or supply of electricity until the expiry of an appropriate time. An appropriate time being in respect of those previously engaged in management, a period of at least 3 months; and in respect of those previously engaged in operation, a period of 3 months or as otherwise specified in the Compliance Plan, which states a period of 3 months or otherwise agreed on a case-by-case basis with the Utility Regulator.
- (86) A number of Directors, members of the Executive Committee and other staff participated at September 2009 in the Viridian Group Senior Executive Bonus Plan, which in some cases was dependent on the performance of NIE Powerteam. In addition at 3

September 2009 under a carried interest share scheme arrangement the Executive Director had an interest in a holding company of the VIU, with the potential of a financial benefit in the event of a sale of the VIU. No benefit was ever received under the arrangement. The Executive Director participated in another arrangement, offered by Viridian, to entitle him to a one-off transaction success bonus in the event that certain corporate transactions were achieved, including the sale of NIE. A payment was made to the Executive Director in December 2010, with the cost being incurred by NIE. This arrangement was determined by Viridian. The Executive Director of the Board, each of the Executive Committee members and vast majority of NIE employees were members of the Viridian Group Pension Scheme (VGPS). The executive Director of the Board was in receipt of a pension from the VGPS from June 2009 upon reaching age 60. The NIE Compliance Officer was a trustee of the VGPS.

- (87) At the date of application one of two Executive Directors of the NIE Board of Directors was seconded to NIE from ESB, which determines his remuneration. He continued to be paid by ESB which was reimbursed by NIE for this cost. This Executive Director sat on the Executive Committee and both he and one other member of the Executive Committee were seconded to NIE from ESB. Each of the Executive Directors of the Board and four other members of the Executive Committee, which comprised seven in total, were Directors of NIE Powerteam. In respect of one of these, all his employment costs were incurred by NIE Powerteam. At date of application the two secondees, as beneficiaries of the ESB Employee Share Ownership Trust (ESOT), which holds 5% of the capital stock of ESB, are entitled to a proportion of dividends corresponding to their allocation of that stock. Where the Directors of ESB declare a dividend, the qualifying employees of ESB are collectively entitled to a maximum of 5% of such dividend. NIE report that typically the amount paid to an individual under this scheme in any given year, if any, would be an amount in the order of €500.
- (88) The SEM Committee has noted that alternative controls directed to ensuring the independence of the management and staff of NIE are in place. NIE Directors may not at the same time also be a Director of an Associated Business engaged in supply or generation and are required by the Compliance Plan and subject to company law, to act solely in the interests of NIE. The Directors and management directly employed by the VIU owe their duties to NIE, which incurs their cost. Membership of the Group pension scheme is not considered to introduce a conflict of interest into the management and staff responsible for acting on behalf only of NIE. These staff have additional restrictions imposed on them by the Compliance Plan, including the duty to comply with protection of information. Decisions for which it is responsible relating to the operation, maintenance and/or development of the system are to be taken by those persons who are Directors of NIE or who are employed by, and are engaged in, the operation and management of the T&D Business, which includes NIE Powerteam, and the majority of the NIE Board must consist of independent non-executive Directors. The ultimate controller must enter an undertaking that it shall not cause NIE to be in breach of its Licence and a similar requirement is included in contracts for Executive Directors. The arrangements in so far as they affect the area of staff and management independence have been evaluated in conjunction with the arrangements as a whole.

- (89) The SEM Committee is of the view that these arrangements provide alternative assurance of the independence of the management and staff of NIE and of the decisions which they may take that is comparable to that which would be provided by the provisions of Chapter V of the Directive provided that a number of measures are taken which clarify and copper fasten the independence provided into the future. In order to clarify that the duty of NIE Directors and senior staff is solely to NIE all Directors and senior Executives shall be directly employed by NIE. They shall have their contract of employment solely with NIE and shall not have any contractual entitlements by virtue of their employment with any other company. The SEM Committee considers that the alternative arrangements that are in place, subject to the stated relevant improvements going forward in 5.4, would provide transparent protection against conflicts of interest and incentives to discriminate in favour of the VIU. As a company structurally independent from a VIU the independence of the management and staff of SONI in performance of the tasks for which SONI is responsible is considered greater than would exist were these tasks performed in a VIU.

### 5.1.3 Information

- (90) This section covers both the requirement of the TSOs to provide information to each other to ensure that the respective tasks for which they are responsible are carried out efficiently and that information is protected. NIE is required by its Licence to provide the Transmission System Operator, SONI, with information that the latter requires to enable it to carry out its task of directing electricity onto and over the transmission system. Both the SONI and NIE Licences require compliance with the TIA designed to ensure that information is shared in a manner that allows both companies to discharge their Licensed responsibilities. The SEM Committee is satisfied that the arrangements provide for both TSOs to have the information necessary to carry out their TSO tasks.
- (91) The ITO provisions of the Directive at Chapter V require that there are arrangements which prevent the VIU from obtaining access to information relating to the performance of TSO functions. The structural independence of SONI in the discharge of the tasks for which it has responsibility, particularly operation, is of particular significance in protection of information.
- (92) The provision of services by the VIU to the TSO is strictly bound by restrictions protecting information, including the provisions of legislation and its Licence, which are monitored and enforced by the Utility Regulator. The ultimate controller is required to give an undertaking that it will not cause NIE to be in breach of its Licence and Viridian and then ESB have entered into further undertakings required by Licence relating to disclosure of information and its use to obtain any unfair commercial advantage. The contracts of employment of all staff require compliance with the terms of the Licence, including its provisions on protection of information, and with the Compliance Plan.
- (93) Chapter V of the Directive sets out the requirements of the ITO model with respect to the need for a Compliance Plan and a Compliance Officer. The Compliance Plan must be approved by the regulatory authority and implemented by a Compliance Officer whose appointment shall be subject to regulatory approval. The Compliance Officer shall monitor and report on the Compliance Plan and notify the regulatory authority of any

substantial breaches with regard to the implementation of the compliance programme. The conditions governing the mandate and employment conditions of the compliance officer shall be subject to approval by the regulatory authority. Those conditions shall ensure the independence of the Compliance Officer, including by providing him with all the resources necessary for fulfilling his duties. During his mandate, the Compliance Officer shall have no other professional position, responsibility or interest, directly or indirectly, in or with any part of the VIU.

- (94) NIE has a Compliance Plan and a Compliance Officer charged with monitoring and reporting on its implementation. The Compliance Officer is required to notify the Utility Regulator immediately of any breaches to the Licence condition setting out the requirements for independence of NIE. The approval of the Utility Regulator is not required for appointment of the Compliance Officer or for his conditions of employment. The NIE Licence requires that the Compliance Officer has the resources required to carry out his tasks and NIE has confirmed that he has had no other professional position, responsibility or interest, directly or indirectly, in or with any part of the VIU.
- (95) The SEM Committee's view is that in so far as the requirement for a Compliance Plan and a Compliance Officer is concerned the existing arrangements substantially satisfy the requirements of the provisions of Chapter V of the Directive. This element of the arrangements allied with other NIE Licence requirements, contracts of employment and role of SONI in system and market operation mean that the SEM Committee considers that the arrangements in Northern Ireland provide greater protection of TSO information than would exist in an ITO model and, subject to the improvements identified, would continue to provide this in future. The satisfaction of the requirement for protection of information has been evaluated in conjunction with the arrangements as a whole.

#### 5.1.4 Regulation

- (96) The SEM Committee Guidance paper set out questions related to the role of regulation that form one area against which assessment of the arrangements must be made. How effective are the arrangements in terms of producing a regulatory regime which is transparent and efficient and not overly onerous for the National Regulatory Authority?
- (97) The arrangements are regulated by the Utility Regulator based on its powers and duties set out in legislation. This is primarily carried out through regulatory oversight of the NIE and SONI Licenses and through the Transmission Interface Agreement. The Utility Regulator has strong powers to monitor and enforce the requirements of these regulatory documents.
- (98) NIE has argued in its application that the structural separation of SONI from NIE, both in performance of SONI tasks and through cooperation in the tasks governed by the TIA, provides greater transparency than would be available in an ITO model. The TIA allows the right of parties to refer disputes to the Utility Regulator which encourages self-regulation and thus reduces the regulatory burden. SONI's oversight of NIE's involvement in the tasks of planning, development and maintenance adds additional protection ensuring transparency and efficiency.

- (99) The SEM Committee considers that the separation of SONI does introduce a significant degree of transparency into the arrangements and reduces the regulatory burden by structural separation of tasks from the VIU. The remaining tasks of planning, maintenance and development are the responsibility of NIE and are governed by the TIA which provides for the cooperation of NIE and SONI in the performance of these tasks. The SEM Committee considers that the role of SONI in these tasks also introduces a degree of transparency into the arrangements and reduces the regulatory burden while also recognising that, to ensure that such transparency will continue into the future, this arrangement should be improved by the requirement for SONI to have complete responsibility for this task.

### 5.1.5 Other Issues

- (100) In addition to the areas set out in the SEM Committee Guidance Paper a number of other areas of relevance were considered in assessing the application. These must be considered in an overall assessment of the arrangements.

#### 5.1.5.1 Market Operation

- (101) Market operation is performed by SEMO which is a joint venture between SONI in Northern Ireland and EirGrid in Ireland. The administration and operation of the market outside a VIU is an important element of independence that would not exist in an ITO model and flows from key reason 1 advanced by NIE, which is the structural separation of SONI's TSO tasks.

#### 5.1.5.2 System Operation

- (102) System operation is a task of central importance to the market and its performance by SONI, a company structurally separated from the VIU, is a feature of the arrangements which provides superior assurance of independence than would ring-fencing of the task within a VIU.

#### 5.1.5.3 Access and Connection to the System

- (103) Under the TIA, which outlines the procedure for connection, it is SONI that issues offers of connection to users, which must be backed by a Construction Offer from NIE indicating the costs of connection, which are calculated by NIE. NIE is exclusively responsible for constructing the connection and determining the cost and timescale for connection. SONI and NIE are required to cooperate in the development of construction offers and any dispute can be referred to the Utility Regulator. Licence requirements on both NIE and SONI require that they are not entitled to refuse access to the system and that the charging statement, upon which costs levied for connection is based, is subject to regulatory approval. The TIA allows any dispute over the connection process to be referred to the Utility Regulator.
- (104) The SEM Committee considers SONI cannot be said to have exclusive responsibility for connection to the system in the same manner as its responsibility for scheduling and dispatch and NIE cannot simply be considered a sub-contractor given its responsibilities for setting the costs and timescales for connection works. However the SEM Committee

does consider that the role of SONI in the process of connection is a significant additional element of independence that would not exist within an ITO model.

#### 5.1.5.4 System Charges

(105) System support services charges and transmission use of system charges are calculated and collected by SONI and subject to the approval of the Utility Regulator. (NIE calculate and collect the distribution use of system charges also subject to the approval of the Utility Regulator.) This task flows from key reason 1 advanced by NIE, which is the structural separation of SONI's TSO tasks. The SEM Committee considers that the involvement of SONI is an element of independence that would not exist in an ITO model.

#### 5.1.5.5 System Planning and Development

(106) System planning and development are tasks that sit under key reason 3 argued by NIE in their application. The review and assessment set out in sections 3.3 above are therefore relevant. In summary, NIE is responsible for planning and development of the system to which SONI must provide planning assumptions including provision of a seven-year Transmission System Capacity Statement. The overall investment planning of NIE is subject to the approval of the Utility Regulator in the periodic Price Control process.

(107) The SEM Committee considers that the role of SONI in planning and development, while an additional element of independence that would not exist within an ITO model, is limited and that the arrangements in this respect should be improved by the transfer to SONI of full responsibility for this task. This would copper fasten the independence of the TSO arrangements and provide assurance of the certainty of this independence in future,

## 5.2 Assessment against Aims of Effective Unbundling

(108) The application has been assessed taking the following into consideration. Any system of unbundling should remove conflicts of interest and ensure:

- Fair competition
- Sufficient investment
- Access for new entrants
- Integration of electricity markets and
- Should not create an overly onerous regulatory regime for national regulatory authorities



### 5.2.1 Fair Competition

- (109) The arrangements in place should deliver fair competition in the market or at the very least facilitate fair competition. In so far as the process of TSO unbundling is concerned this will be achieved by guaranteeing the independence of the tasks of the transmission system operator such that there is an absence of discrimination.
- (110) The tasks of the TSO are split in the current arrangements so that the task of operation is the responsibility of SONI, a company structurally separate from the VIU. This is an important element of independence that would not exist in an ITO model, providing no grounds for incentives to discriminate against any market participant.
- (111) The tasks of planning, maintenance and development are the responsibility of NIE, a company within a VIU with generation and supply interests on the island of Ireland and which is protected by ring-fencing measures that, subject to identified improvements, would be comparable to an ITO. These tasks are performed in cooperation with SONI and this independent role in the carrying out of these tasks is an element of independence that would not exist in an ITO model. Although the arrangements therefore provide protection against discrimination that would not exist in an ITO model the SEM Committee considers that the transfer of the planning function to SONI would copper fasten the independence of the arrangements and provide certainty as to their continuation in future.

### 5.2.2 Sufficient Investment

- (112) The arrangements in place should encourage or at least facilitate sufficient investment which fosters competition, encourages renewable generation and ensures security of supply. NIE is currently able to finance investment through borrowing in the capital markets and its investment plans are subject to approval by the Utility Regulator through the price control process. The current arrangement whereby the TSO responsible for planning and development of the system is also owner of the transmission system clearly provides incentives for investment in the network.
- (113) The tasks of planning, maintenance and development are the responsibility of NIE, which is subject to ring fencing within the VIU. These tasks are performed in cooperation with SONI and this role provides an independent element of oversight that would not exist in an ITO model. The arrangements thus provide incentives for sufficient investment and, subject to the improvements identified, would provide protection against conflicts of interest and incentives which would militate against efficient and non-discriminatory investment in the network.

### 5.2.3 Access for new Entrants

- (114) The arrangements in place should encourage or at least facilitate new entrants into the market, enhancing achievement of the objectives of increased competition, the development of renewable generation and security of supply. The TIA sets out the respective tasks of NIE and SONI and the cooperation required between the two companies. Evaluation of these arrangements is set out in section 3.3 above.

- (115) Offers of connection to those seeking connection to the transmission system are made by SONI which also receives construction offers from NIE setting out the works to be made; the date by which any works may be completed; the charges for such works that are to be levied and the principles on which these are based. Any disputes over the connection offer may be referred to the Utility Regulator.
- (116) The role of SONI is an important element of independence in the arrangements that would not exist in an ITO model. As a company structurally separate from the VIU it has no incentive to discriminate on behalf of VIU interests and against any other market participant. The arrangements therefore provide assurance that they will at the very least facilitate new entrants into the market.

#### 5.2.4 Integration of Electricity Markets

- (117) The arrangements in place should encourage or at least facilitate the integration of electricity markets, enhancing achievement of the objectives of increasing competition and security of supply. The SEM is already an all-island market integrating the wholesale electricity markets of Northern Ireland and Ireland. Further work on regional integration of the SEM with the electricity markets of Great Britain and France is currently being undertaken by the SEM Committee.
- (118) The existing arrangements allow participation in the process of regional integration at the European level through SONI participation in ENTSO-E. The regulatory authorities in the SEM Committee can also participate through membership by CER of the Agency for the Cooperation of Energy Regulators and through observer status of the Utility Regulator as part of the UK membership. The existing arrangements involve increasing the existing connection with the Great Britain electricity market and work on implementation of the European target model. The existing arrangements have therefore provided no barrier to regional integration and are considered effective for continuation of this work.

#### 5.2.5 Regulatory Burden

- (119) The Directive at Recital (12) states that the arrangements facilitate a regulatory regime which is transparent and efficient and not overly onerous for the National Regulatory Authority. The role of regulation in the current arrangements is set out in section 5.1.4 above.
- (120) The SEM Committee considers that the role of SONI in system operation and market operation within the arrangements introduces a significant degree of transparency and reduces the regulatory burden by structural separation of tasks from the VIU. The remaining tasks of planning, maintenance and development are the responsibility of NIE and are governed by the TIA, which sets out the cooperation required of NIE and SONI to ensure these tasks are performed efficiently. The involvement of SONI therefore introduces elements of independence and transparency that facilitates regulation that would not exist in an ITO model and it is considered that the measures to improve the arrangements proposed at 5.4 would provide certainty to the future operation of these arrangements.

### 5.3 Assessment against the Pillars of Effective Unbundling

(121) When considering the existing arrangements against the requirements for an ITO model the following pillars of an effective ITO model must be considered

- 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, certain '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

#### 5.3.1 Governance: Organisational Measures

(122) The ITO organisational measures essentially consist of separating the TSO from the VIU to a substantial degree while still permitting the VIU's ownership of the TSO and transmission system, and protection of its property rights and its return on investment. The inherent conflict between VIU control and TSO independence is managed through formal separation of the ITO, ring-fencing, strict regulatory oversight and a formalisation of the permitted interactions between the VIU and the ITO.

(123) Comparing this to the Northern Ireland arrangements requires the SEM Committee to focus on these requirements in light of their aims.

(124) In the Northern Ireland arrangements the tasks of the TSO are split between SONI and NIE. SONI has responsibility for operation of the transmission system while NIE, which is the transmission asset owner, has responsibility for the tasks of planning, maintenance and development of the transmission system. NIE is a separate company and therefore in compliance with the requirement of Article 17(3) of the ITO model within the Directive as to its legal form. In discharging its responsibility for these tasks NIE cooperates with SONI through the Transmission Interface Agreement. The assessment of these organisational measures must therefore take account of the weight of the tasks discharged by SONI, a company separate from the VIU; the weight of the tasks for which NIE has responsibility and the ring-fencing arrangements that act on the performance of these tasks; and finally the respective roles of SONI and NIE in the tasks governed by the TIA.

(125) The performance of the key task of operation of the transmission system by a company structurally separate from the VIU clearly guarantees more independence than the performance of this task by a ring-fenced TSO inside a VIU. The tasks of planning, maintenance and development of the system are also key tasks of a TSO and are the responsibility of NIE, a company within a VIU. This requires a pillar of measures to manage the inherent conflict between VIU control and TSO independence. The measures in place in the current arrangements include the existence of a separate legal entity governed by Licence conditions on its independence; ring-fencing measures

dealing with the adequacy of resources available independently from the VIU; powers available to NIE to make decisions and requirements for independence of those making decisions. In addition the performance of the tasks of planning, maintenance and development requires the cooperation of SONI, which provides an independent element of oversight. While the SEM Committee recognises that the SONI role is limited it considers that this provides some protection that would not exist in an ITO model and that improvement to the arrangements should provide assurance of this protection in the future.

- (126) Taking the current governance and organisational measures as a whole as assessed in section 6.1 above the SEM Committee considers that, subject to the relevant improvements set out in 5.4, the existing arrangements provide greater independence than those that would exist under an ITO.

### 5.3.2 Investment, Connections, Regional Integration

- (127) Chapter V contains specific requirements in relation to the second pillar of the ITO model. This involves preparation of a ten-year network development plan based on existing and forecast supply and demand and taking into account investment plans for regional and Community-wide networks. This plan shall be subject to monitoring and evaluation by the National Regulatory Authority, which shall ensure that a planned investment is carried out where otherwise it may not be made. Activities necessary for the preparation of this plan are to be excluded from the decisions falling under the remit of the Supervisory Body provided for in Chapter V. These provisions also set out the requirement for efficient and non-discriminatory connection to the transmission system.
- (128) The arrangements in Northern Ireland provide for SONI to prepare planning assumptions and a Seven-year Transmission System Capacity Statement and for NIE to prepare a seven-year Transmission Investment Plan. While NIE will take into account the planning assumptions provided by SONI it is NIE's responsibility to plan the network. The Utility Regulator through the Price Control process will approve and ensure delivery of the investment considered necessary. This paper has noted the additional element of independence in the current arrangements introduced by the role of SONI. The SEM Committee has therefore viewed the independence added by this SONI role as an additional element of protection against incentives to investment which unduly benefit the VIU which, if subject to the transfer of the planning function to SONI, would guarantee in the future greater independence of the arrangements than an ITO.
- (129) In so far as connection to the system is concerned, the existing arrangements are set out and assessed in section 5.1.5.3 above. The SEM Committee considers that the role of SONI in the process of connection is an additional element of independence that would not exist within an ITO model.
- (130) The existing arrangements allow participation in the process of regional integration at the European level through SONI participation in ENTSO-E. The current arrangements have allowed increased connection with the Great Britain electricity market and work to have begun on implementation of the European target model. The existing arrangements have therefore facilitated regional integration and are considered effective for continuation of this work.

(131) Taking the existing arrangements as a whole as they relate to investment, connections and regional integration, the SEM Committee considers that, subject to the improvements identified, they provide greater independence than those that would exist under an ITO, due to the ring-fencing of NIE, SONI's independent role and its lead role in providing connections to the transmission network.

### 5.3.3 Governance: Staff ring-fencing and Transfers

(132) The final pillar of the ITO contains various measures to ensure the independence of the management of the TSO and in particular prevent information obtained in the ITO being used in the VIU. These measures are in addition to the organisational separation making up the first pillar. The measures require that the management of the ITO do not have interests or involvement with the VIU and that there are in place significant "cooling-off" periods before a member of the executive management team may have professional involvement with the VIU.

(133) The requirements of this pillar are closely linked to those of the first pillar and the details of the ring-fencing in place as it relates to management interests or involvement with the VIU have been noted in assessment of this pillar. This assessment is based on the analysis presented in sections 5.1.2 above. The arrangements also include provisions governing the transfer of employees to the VIU, which are set out in the NIE Licence and Compliance Plan. These include the requirement for a register of all persons engaged in the Transmission and Distribution Business and restriction on their transfer to associated businesses of NIE that are engaged in generation or supply of electricity.

(134) This pillar is also specifically concerned with the requirement for significant "cooling-off" periods. The provisions of Chapter V require that no professional position within the VIU shall be exercised for a period of three years before the appointment of a majority of the persons responsible for the management of the TSO. This period is reduced to six months for the relevant remaining staff. These provisions also require that after termination of their term of office, the persons responsible for its management shall have no professional position or responsibility, interest or business relationship with any part of the VIU other than the TSO, or with its controlling shareholders for a period of not less than four years. The arrangements in place as set out in sections (84) and (85) above do not provide for this specific protection against the transfer of information to the VIU. They do however provide alternative controls including requirements of legislation and its Licence which place obligations on NIE and its ultimate controller regarding protection of information. This is supported by contracts of employment of staff requiring protection of information and compliance with the Licence. This is enforced by the Utility Regulator through a Compliance Plan and Compliance Officer. The structural separation of SONI and its roles in system operation, market operation and connection are also important safeguards of information.

(135) Taking the existing arrangements relating to staff ring-fencing and transfers as a whole, the SEM Committee's analysis is that, subject to the relevant improvements identified in 5.4, these would provide assurance in the future that they are comparable to those that would exist in an ITO model.

## **5.4 Proposed improvements to the Northern Ireland Arrangements**

- (136) In the assessment of the arrangements against the various criteria above the SEM Committee has identified a number of steps which would improve the Northern Ireland arrangements so as to assure their continued greater independence into the future. These would include streamlining accountability for planning and copper fastening the existing practice of the T&D Business with legal certainty as to the position of NIE Powerteam.
- (137) Two improvements would therefore involve the transfer of responsibility for the complete planning function to SONI and clarification that the ring fencing applied to NIE also apply to the tasks currently executed and resources currently applied by NIE Powerteam. This may be achieved through integration of the resources and tasks of NIE Powerteam back into NIE. While not materially affecting the independence of NIE and the ring fencing in place these steps would more clearly set out the respective responsibilities of NIE and SONI and ensure that the legal form within the VIU remains consistent with the TSO responsibilities set out in the Directive.
- (138) Further clarity and added certainty to the arrangements in so far as they affect the ring-fencing of NIE have been identified. These include measures which clarify the duty of NIE Directors and Executives solely to NIE. This includes the requirement that all Directors and senior Executives be directly employed by NIE, have their contract of employment solely with NIE and therefore shall not have any contractual entitlements by virtue of their employment with any other company.
- (139) The use by NIE of common services provided by the VIU is to be prohibited. NIE should provide or source independently all of its corporate services and will be required to submit a detailed plan setting out the implementation of this requirement. Such plan should ensure and clearly demonstrate that these services are provided or sourced independently and efficiently through market testing with regular review thereafter.
- (140) The review of the NIE Licence to ensure the requirements it contained remained appropriate upon NIE's acquisition by ESB identified a number of measures that would assure the continuing robustness of the Licence. These measures included steps which would require additional and more explicit information from the VIU to be monitored through the Compliance Plan.
- (141) Annex 1 provides more detail on the scope and nature of the improvements proposed that would copper fasten, and provide assurance in the future of the independence afforded by the existing arrangements.

## **5.5 Overall Assessment against the Purposive Criteria**

- (142) The SEM Committee has assessed the existing arrangements on a purposive basis in order to determine whether they clearly guarantee more effective independence of the transmission system operator than the provisions of Chapter V of the Directive.
- (143) The SEM Committee considers that the ring-fencing arrangements of NIE are commensurate with the requirements of the ITO model. This is supplemented by the

independent role of SONI in performance of the tasks for which it is solely responsible, that of system operation and market operation. SONI also plays an independent if limited role in the tasks of planning, maintenance, development and connection to the network. These roles also bring some benefits to regulation consequent to the additional transparency brought to the arrangements. The SEM Committee therefore judges that, while the arrangements have to date provided more independence than the provisions of the ITO model, there is some lack of certainty as to how they will continue to provide this assurance into the future. Specific improvements are required and are proposed, aimed at providing this assurance. This assessment has been arrived at having regard to the arrangements as a whole.

- (144) The SEM Committee concludes that the existing arrangements have provided more effective independence of the transmission system operator than the provisions of Chapter V of the Directive and, with the improvements proposed, would clearly guarantee this into the future. On this basis the decision of the SEM Committee is to grant the application by NIE for certification, subject to the implementation of the proposed improvements and to the decision of the Commission under Article 9(10) of the Directive.

## **5.6 Note in relation to SONI**

- (145) In reaching its decision the Committee is conscious of the fact that SONI, along with NIE, exercises the functions of a transmission system operator in Northern Ireland within the meaning of article 2(4). However, as at the date of this decision, no application has been submitted for the certification of SONI. Were such an application to be properly made, the Committee would give it careful consideration.

## Annex 1

- (1) The SEM Committee has concluded that while the arrangements in Northern Ireland have to date provided more independence than the provisions of the ITO model, there is some lack of certainty as to how they will continue to provide this assurance into the future. The SEM Committee has therefore proposed a number of improvements which will provide this certainty and which will allow recommendation of certification of the Northern Ireland arrangements. These improvements will be enacted through changes to Licence and will not require legislative amendment. The purpose of this Annex is to set out at a high level the improvements that are required to be made.

### 1.1 Identity of the TSO

- (2) Certification of NIE in the manner proposed in this document will result in the designation of NIE by the Department as an electricity transmission system operator for the purposes of Article 10(2) of the Directive.
- (3) Given the division of functions between NIE and SONI under the Northern Ireland regulatory framework, the designation of NIE would create the possibility of confusion as to the respective roles of NIE and SONI in performing the functions allocated to the transmission system operator under the Directive or other EU law measures such as the Electricity Regulation.
- (4) The SEM Committee therefore proposes to modify the conditions of each of NIE's and SONI's licences to incorporate provisions designed to avoid that confusion and to ensure that SONI is in a position to play the fullest possible role in this context. This would include important matters such as network code development and engagement with the ENTSO-E. These provisions would also be designed to ensure that SONI's leading role could be maintained in the event of changing circumstances, e.g., in the event of developments in the EU or domestic regulatory regime.
- (5) It is envisaged that these modifications would focus on Licence Condition 17 in NIE's licence and Licence Condition 18 in SONI's licence which deal with the Transmission Interface Agreement. The modifications would be designed to have the following effect (either themselves or via amendment to that Agreement):
  - The licensees would be required to establish and maintain in force provisions which ensured SONI's leading role in the exercise of transmission system operator functions.
  - Performance of any particular functions exercisable by NIE in its capacity as designated transmission system operator would (except with the consent of the Utility Regulator) be delegated to SONI or, where permitted, to SONI personnel.
  - NIE would be required to take all available steps to facilitate the leading role of SONI and to cooperate fully with SONI and to provide it with access to information so as to permit it to play that role effectively.

The Utility Regulator would be entitled to require the relevant provisions to be revised from time to time by the licensees so as to reflect changes in circumstances.



## 1.2 Transfer of Planning function to SONI

- (6) NIE Licence Condition 19 currently states that “The Licensee shall plan, develop and maintain the total system.” This Licence condition shall be amended to remove the responsibility of NIE for planning the transmission system. Amendment will also be made to the Licence definition of the Transmission Owner Business to clarify the exclusion of the function of transmission planning as part of the Business of the Licensee. The NIE Licence shall require that it develop and maintain the transmission system in accordance with the SONI development plan providing all necessary cooperation to allow SONI to perform its new licensed responsibilities including timely provision of information required to prepare the plan and setting out the measures by which it proposes to implement it. Condition 17 sets out the requirement of NIE in common with the TSO to prepare, implement and comply with arrangements (Transmission Interface Arrangements) whereby, among other things, the transmission system is planned by the Licensee. This Condition shall be amended to clarify the respective roles of the Transmission Asset Owner and Transmission System Operator in the planning function to remove this responsibility from the Licensee.
- (7) The SONI Licence shall be amended to clearly identify its responsibility for planning the transmission network. This shall include, but may not be limited to, the following. The definition of the Transmission System Operator Business shall include the obligation to undertaking planning of the transmission system. Condition 18 of the SONI Licence which sets out the requirement of SONI in common with the Transmission Owner to prepare, implement and comply with arrangements (Transmission Interface Arrangements) whereby, among other things, the transmission system is planned by the Transmission Owner shall be amended to clarify that it is SONI as the Transmission System Operator that shall have responsibility for planning the transmission system. SONI shall be required to plan the transmission network in such a way that it minimises the overall costs of the generation, transmission, distribution and supply of electricity to final customers. A new Licence Condition shall be included in the SONI License setting out its responsibility for preparation and submission to the Utility Regulator of a ten-year network development plan in accordance with Article 22 of Directive 2009/72/EC.
- (8) NIE in its Licence Condition 17 and SONI in Licence Condition 18 are required to implement and comply with the arrangements set out in the Transmission Interface Agreement. This Agreement sets out the arrangements by which both companies shall co-operate in discharging their respective Licence obligations. It therefore sets out the lead role of NIE in planning the transmission system and Section C of the TIA records that “NIE agrees to plan and develop the Transmission System in accordance with NIE’s Transmission Licence and this TIA.” In transferring responsibility for planning the transmission system to SONI it will be necessary to comprehensively review and where appropriate amend the Transmission Interface Agreement so that it reflects the new transmission planning responsibilities. It will be necessary that it clearly identifies and sets out the respective duties and tasks of SONI and NIE, which shall ensure their co-operation and the efficient and economical discharge of their amended licensed responsibilities.

- (9) The transfer of Licence responsibilities will necessarily be reflected in the resources required to discharge the obligations of NIE and SONI and this will be reflected in their respective Price Control allowances determined by the Utility Regulator.

### **1.3 Ring fencing of resources and tasks of NIE Powerteam**

- (10) In order to clarify the legal form and responsibilities of the NIE Transmission and Distribution Business and to make certain the application of all ring-fencing and regulatory requirements to this business it shall be necessary that the ring fencing applied to NIE shall also clearly apply to the resources and tasks of NIE Powerteam.
- (11) This shall require the removal of NIE Powerteam from those companies excluded in the definition of an Associated Business within the NIE Licence. It shall also require removal within of the definition of Powerteam that it “exclusively undertakes a business providing services to the Transmission and Distribution Business in relation to its licensed activities.” The NIE Licence shall also exclude within the formula for calculation of transmission and distribution charges reference to any adjustment in respect of NIE Powerteam. The Transmission and Distribution Business shall be defined to clarify that it consists solely of NIE.
- (12) The NIE Compliance Plan shall exclude references to NIE Powerteam, including those related to its exclusion from the definition of an associated Business and the linking of the remuneration of NIE Directors to NIE Powerteam performance.

### **1.4 Independence of NIE Directors and Executives**

- (13) In order to copper fasten and provide certainty to the independence of Directors and Executives of NIE and clarity as to their duty solely to NIE all Directors and Executives employed by NIE shall have their contract of employment only with NIE.
- (14) This shall require that Directors and Executives of NIE be directly employed by NIE and shall not have any contractual entitlements by virtue of their employment with any other company.
- (15) These requirements shall be effected through changes to the NIE Licence.

### **1.5 Provision of corporate services**

- (16) The provision of NIE corporate services by its VIU, for example, IT, HR, procurement, financial, auditing, Treasury and legal shall not be permitted. This requirement shall be effected through amendment to the NIE Licence.
- (17) NIE shall prepare and submit for approval by the Utility Regulator a detailed plan setting out its implementation of this requirement. The plan shall set out how these services are to be provided demonstrating independence and best value in their provision through market testing and regular review. Such plan shall require approval by the Utility Regulator and shall be subject to monitoring by the Compliance Officer through revision to the NIE Compliance Plan.

## **1.5 Licence Review upon ESB acquisition of NIE**

- (18) The SEM Committee reviewed the NIE Licence and other regulatory documents upon the purchase of NIE by ESB. While the SEM Committee considered the existing Licence structure robust and that it dealt satisfactorily with many issues raised by the purchase it nevertheless identified a number of areas for improvement. These focused on the requirement for additional information and making more explicit and transparent existing requirements. The SEM Committee considers that these measures are wholly consistent with improvements required to assure into the future the independence of the existing arrangements and permit a preliminary decision recommending certification.
- (19) The additional Licence requirements include additional information to be provided on expectation of availability of sufficient financial resources, additional information in the Licence on the nature of these resources and in the Compliance Plan on the availability of resources considered more widely.