

Ofgem's certification review of the Blue Transmission Companies

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On 4 February 2016 Ofgem published a decision reviewing the certification status of the Blue Transmission Companies (“**BTCs**”). The review follows two other previous Ofgem decisions. The reasoning of Ofgem and the EU Commission as contained in the decision, provides helpful clarification as to the circumstances in which Ofgem may exercise its discretion in the context of ownership unbundling. The decision (along with the corresponding European Commission opinion) provides detail on how Ofgem may exercise the discretionary powers it has under the Electricity Act 1989 (as amended by the Electricity and Gas (Ownership Unbundling) Regulations 2014 (the “**Regulations**”)) when considering the five certification tests. The exercise of Ofgem’s “unbundling discretion” is of particular interest to investment funds.

Background

The BTCs comprise four UK offshore transmission system operators (“**OFTOs**”). OFTOs constitute “transmission system operators” or “TSOs” for the purposes of the UK unbundling regime. The four BTCs are ultimately owned and controlled by the same persons, are part of the same corporate group, have the same sole business focus and were all previously certified by Ofgem as complying with the ownership unbundling requirements of the Regulations. As of 8 November 2013 (following 3i Group Plc’s (“**3i**”) acquisition of Barclays Infrastructure Fund Management Limited’s interest in the assets), the BTCs are jointly owned and controlled by Mitsubishi Corporation (“**Mitsubishi**”) and 3i with each holding a 50% equity interest.

The 2015 review of the BTCs certification status was precipitated by the notification to Ofgem by the BTCs of three changes in their circumstances. Firstly a Netherlands-based onshore windfarm in Mitsubishi’s portfolio (“**Q10**”) became ready for full operation in July 2015 (the board of Q10 to be under the joint control of Mitsubishi and Eneco Holdings NV). Secondly Mitsubishi added several EU-based electricity generation assets to its portfolio. Finally new appointments to the board of the BTCs were made.

It should be noted that the case did not consider whether or not either Mitsubishi or 3i had “control”, rather it was a question of whether Ofgem should exercise its discretion and deem certain of the unbundling tests satisfied.

The BTC case clearly confirms that when considering whether or not it is appropriate to exercise its discretion, Ofgem’s focus is on assessing whether there is a “risk of discrimination” (or in the language of the EU Commission, a “conflict of interest”). Ofgem needs to be persuaded that there is no incentive for a shareholder in the TSO to influence the TSO’s decision making in order to favour its generation, production and/or supply interest to the detriment of other network users.

Interest in a generation asset – The Q10 windfarm

Ofgem considered that Q10 did not provide any practical scope for discrimination against other network users. The lack of physical connection between the BTCs assets and Q10, as well as their geographical locations (the UK and the Netherlands respectively) in Ofgem's view reduced the scope for any conflict of interest.

Additionally the revenues for Q10 were of a "fixed nature" effectively isolating the generation asset from fluctuations in wholesale electricity market prices. Over 90% of the revenue came from a feed-in tariff subsidised by the Dutch Sustainable Energy Incentive (119.23MW of a total capacity of 129MW). The remaining capacity is subject to a 20 year fixed term PPA with the sole offtaker (Eneco Energy Trade BV). The lack of Q10's exposure to wholesale market price fluctuations reduced the incentive on the part of BTC to favour its generation asset. The European Commission agreed and in addition felt that the BTCs restricted responsibilities as an OFTO in relation to the overall UK transmission system further diminished the scope for discrimination.

Mitsubishi's Energy Asset Acquisitions

Ofgem, in its consideration of the acquisition of over 30 small generation assets by Mitsubishi, considered that none of those assets had a capacity which would necessitate the holding of an electricity generation licence were these assets located in the UK. The threshold for a generation licence in the UK is 50MW. None of the assets acquired had a capacity over 21MW. The small size of the acquired assets, in Ofgem's opinion, meant that the risk of discrimination against other network users was small.

The European Commission clarified that no such threshold exists under the Electricity Directive, rather the Electricity Directive simply refers to "generation" or "supply" in Articles 2 (1) and 2 (19) respectively and therefore the relatively small size of the assets should be considered only in the context of an *ad-hoc* analysis of potential conflicts of interest.

The assets acquired by Mitsubishi were not physically connected to the BTCs assets and were located in different geographies (being, variously, France, Bulgaria and Italy). As a result Ofgem and the European Commission applied the same logic in relation to these assets as they did to Q10 and determined that the risk of discriminatory behaviour towards other network users was highly unlikely.

Changes to the BTCs Board

The ascension to the BTC board of an additional Mitsubishi representative ran the risk of breaching the requirement that no TSO is allowed to be controlled by a person who also controls a relevant energy producer or supplier and / or the stipulation that senior officers of TSOs may not also be senior officers of any relevant energy producer or supplier.

Ofgem found that none of the Mitsubishi appointed board members were also senior officers in any Mitsubishi generation or supply asset (including Q10 and the acquired assets). Additionally the BTCs gave signed undertakings that during the term of their offshore transmission system operators licence they would not exercise, or cause to be exercised on their behalf, any shareholding rights in relation to a relevant producer or supplier that they might acquire.

Evidential Burden

A specific request must be made for Ofgem to exercise its discretion. Such an application carries a potentially onerous evidential burden on the part of the applicant. Applicants need to provide sufficient evidence to demonstrate that there is no real risk of discrimination – in other words that there is no risk of conflicts of interest arising which would lead to a TSO discriminating against other network users in favour of a relevant energy supplier or generator to whom the TSO is connected - or that a particular test has been satisfied.

It is worth noting that the requirement to provide relevant information does not cease once a positive decision has been issued. The EU Commission in its BTC opinions emphasised the need for Ofgem to comply with its ongoing monitoring obligations under the Electricity Directive (Article 10(4)). Ofgem is invited to continue its monitoring of the case, even after the adoption of the final certification, to satisfy itself that no new facts emerge which would justify a change of its assessment. TSOs should be aware of this and note that a positive final certification decision is not an end in itself.

Conclusion

The BTC cases demonstrate an openness on the part of Ofgem and the EU Commission to exercise their discretion and consider certain of the unbundling tests as satisfied where it can be clearly demonstrated that there is no real risk of discriminatory behaviour.

It is recognised that OFTOs have a limited role given the small size of the transmission assets, their restricted geographic scope and their limited responsibilities in relation to the overall operation of the UK transmission system.

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