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COMMISSION

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**COMMISSION OPINION**

**of 23.5.2013**

**pursuant to Article 3(1) of Regulation (EC) No 715/2009 and Article 10(6) of  
Directive 2009/73/EC – Ireland – Certification of BGÉ ITO**

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### I. PROCEDURE

On 28 March 2013, the Commission received a notification from the Irish national regulatory authority, the Commission for Energy Regulation (hereafter, "CER"), in accordance with Article 10(6) of Directive 2009/73/EC<sup>1</sup> (hereafter, "Gas Directive"), of a draft decision on the certification of the transmission system operator (hereafter, "TSO") for gas Bord Gáis Éireann's proposed independent transmission operator (hereafter "BGÉ ITO"), on the basis of the application by Bord Gáis Éireann (hereafter "BGÉ").

Pursuant to Article 3(1) Regulation (EC) No 715/2009<sup>2</sup> (hereafter, "Gas Regulation"), the Commission is required to examine the notified draft decision and deliver an opinion to the relevant national regulatory authority as to its compatibility with Article 10(2) and Article 9 of Directive 2009/73/EC.

### II. DESCRIPTION OF THE NOTIFIED DRAFT DECISION

BGÉ is a state owned vertically integrated undertaking which currently owns the transmission and distribution systems in Ireland, and is active in the wholesale and retail gas and electricity markets through its retail and production arm Bord Gáis Energy.

The Irish government has announced its intention to sell BGÉ's energy assets, i.e. Bord Gáis Energy, with the result that BGÉ will become a dedicated networks undertaking<sup>3</sup>. The preparations for this sale are well advanced and the transaction is expected to be completed by end 2013<sup>4</sup>. Following the completion of this transaction it is envisaged that BGÉ will apply for certification as a fully ownership unbundled transmission operator.

Nonetheless, in order to comply with the applicable European and Irish legislation requiring transmission system operators to be certified, BGÉ has chosen to apply for certification of BGÉ ITO under the Independent Transmission Operator (ITO) model, referred to in

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<sup>1</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, OJ L 211/94 of 14.8.2009

<sup>2</sup> Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, OJ L 211/36 of 14.8.2009

<sup>3</sup> The Irish Government announcement of the decision can be found at <http://per.gov.ie/2012/02/22/government-secures-substantial-reinvestment-in-economy-from-disposal-of-state-assets/>

Answer to Question 12871/12 by Mr Pat Rabbitte TD, Minister of Communications, Energy and Natural Resources Debate Priority Questions Sale of State Assets *Vol. 758 No. 2*

<sup>4</sup> The BGÉ announcement and related stock exchange announcement of the appointment of Royal Bank of Canada as advisors to complete the transaction [http://www.bordGáis.ie/corporate/cat\\_press\\_release\\_detail.jsp?itemID=544&n=0&p=0](http://www.bordGáis.ie/corporate/cat_press_release_detail.jsp?itemID=544&n=0&p=0) and <http://www.ise.ie/app/announcementDetails.aspx?ID=11489680>.

Article 9(8)(b) Gas Directive. This choice is available under the Irish legislation transposing the Gas Directive.

The legal documentation for the establishment of the ITO, including BGÉ ITO's memorandum and articles of association, as prepared, has a transfer plan to move all necessary network assets and associated equipment from BGÉ to BGÉ ITO. However, BGÉ ITO has not yet been incorporated nor has the transfer plan been affected.

Physical separation of premises and staff has already been implemented, and BGÉ states in its certification application that with full ITO implementation all staff associated with transmission (570 staff in 2012)<sup>5</sup> will be formally transferred to BGÉ ITO. IT separation has largely, but not yet completely been achieved.

BGÉ proposes to undertake the formal establishment of BGÉ ITO and the implementation of the transfer plan only if the planned sale of Bord Gáis Energy's assets is not completed as planned by the end of 2013.

Article 9 Gas Directive sets out rules on the unbundling of transmission systems and transmission system operators. Article 9(8)(b) therein provides that where on 3 September 2009, the transmission system belongs to a vertically integrated undertaking, a Member State may decide not to apply paragraph 1, provided that the Member State concerned complies with the provisions of Chapter IV, establishing requirements for independent transmission operators (Articles 17 to 23 Gas Directive).

CER has analysed whether and to what extent BGÉ ITO complies with the unbundling rules of the ITO model as laid down in the Irish legislation transposing the Gas Directive. CER is satisfied that the proposed arrangements submitted by BGÉ are in compliance with the requirements of Chapter IV of the Gas Directive. CER recognises that measures remain to be taken in order to ensure full implementation of the ITO model. CER states that it agrees to BGÉ's proposed delay on the basis that running a sale process alongside the full implementation of ITO would increase transaction costs (in particular as a result of requiring two sets of consents from lenders), increase transaction execution risk, and increase costs for network users as a result of the allocation of transaction costs to BGÉ ITO rather than Bord Gáis Energy.

CER's preliminary certification is contingent on the necessary measures to achieve implementation being carried out in accordance with a specified timetable<sup>6, 7</sup>. The deadlines in

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<sup>5</sup> BGÉ Certification Application Supporting Documents ITO Resources

<sup>6</sup> CER's preliminary certification decision of BGÉ specifically requires that: BGÉ provide written evidence to the CER, demonstrating that the leasing of car park facilities by the VIU from the ITO complies with market conditions; BGÉ cease offering Enhanced Pressure Service Agreements, unless approved by the relevant regulatory authority; BGÉ submit a programme for moving to a FOU model, which is envisaged will be completed by December 2013. In the unlikely event that BGÉ does not become fully ownership unbundled by December 2013, BGÉ will be required to rebrand the ITO; BGÉ to implement a policy of charging (at market rates) for the provision of intercompany loans between the VIU and the ITO Group; BGÉ to implement a policy, whereby no additional margin be applied to subsidiaries for external borrowing (i.e. all subsidiaries are subject to the average external borrowing cost of funds); BGÉ provide pro-forma financial statements to the CER, prior to final certification; BGÉ to provide evidence that the level of debt that is transferred to the ITO is consistent with the norms of an investment grade regulated utility; BGÉ to ensure that all ITO members financial interests in the VIU be terminated prior to the establishment of the ITO, and provide written confirmation to the CER; BGÉ/Supervisory Body to comply with Article 19(2) of the Gas Directive prior to final ITO certification; BGÉ/Supervisory Body to appoint a Compliance Officer, subject to the approval of the CER; BGÉ to complete the outstanding work items, following the CER's preliminary certification decision (subject to identified exceptions) within a 3 month timeframe; BGÉ VIU and the ITO Group to use separate internal financials auditors, from different firms; BGÉ to amend its Facilities Agreement,

the timetable have been set to align with the expected date of the completion of the intended sale of BGÉ's energy assets.

According to the schedule:

- a compliance officer meeting the requirements of the Gas Directive was to be appointed in April 2013,
- full separation of IT and telephony systems to be achieved by end of July 2013,
- separate auditors for BGÉ and BGÉ ITO to be identified by end July 2013 and appointed in January 2014,
- rebranding process defined from July 2013 to December 2014 and implemented in January to March 2014,
- incorporation of BGÉ ITO, appointment of management and supervisory board and implementation of transfer plans to be achieved in February and March 2014.

Compliance with these measures is formulated as a condition of the positive preliminary decision. Therefore, the non-compliance with the conditions set in the draft decision would lead to the annulment of the certification decision.

CER's preliminary certification decision has the effect that BGÉ will be fully compliant with either the full ownership unbundling model or the ITO model by 1 April 2014.

### **III. COMMENTS**

On the basis of the present notification the Commission has the following comments on the preliminary decision.

#### **1. Choice of the ITO model**

According to Article 9(8) Gas Directive, the ITO model may be applied in cases where, on 3 September 2009, the transmission system belonged to a Vertically Integrated Undertaking ("VIU"). The Commission agrees with CER in the present case that the choice for the ITO model is legitimate, considering that the transmission system concerned did belong to a VIU on the relevant date.

As the process of moving towards full ownership unbundling is well advanced BGÉ is likely to be an ITO only for a transitory period. During this period, the company is likely to complete the transactions necessary to ensure full ownership unbundling.

Certification under the ITO model and detailed timings set out in Annex 4 of the notified preliminary certification (whereby the full implementation of the ITO model would take place in stages with final completion by 1 April 2014) should be conditional on the on-going progress towards completion of the planned sale. If at any point in the interim it becomes clear that the planned sale of Bord Gáis Energy is likely not to proceed, then BGÉ should be required to immediately commence full implementation of the ITO model.

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to ensure that there is a definite action on the ITO Board to report on its financial resources to the regulatory authorities (i.e. BGÉ ITO Board shall on the request of the regulatory authorities, provide confirmation as to whether it that the ITO Group has sufficient required financial resources for the business; this shall be supported by third party verification, if required by the regulatory authorities).

7

The detailed timetable is set out in Annex 4 to the CER preliminary certification.

CER should satisfy itself that all conditions have been fulfilled such that the ITO model is fully implemented before the certification of BGÉ ITO is confirmed. This should occur by 1 April 2014 at the latest.

Additionally the Commission notes that upon the completion of the planned sale of Bord Gáis Energy, it will be necessary for BGÉ to have applied for certification under the full ownership unbundling model not later than 1 April 2014.

## **2. Financial relations between VIU and ITO and power to raise money on the capital market**

The provisions of the ITO model have the effect of obliging BGÉ to make available capital to BGÉ ITO on market conditions, but BGÉ ITO must also have the option to instead access the capital markets directly<sup>8</sup>. The interests of BGÉ should be protected by the Supervisory Board.

According to the notified preliminary certification, BGÉ will make available funds to BGÉ ITO through a special dedicated central funding model termed BGÉ Finco<sup>9</sup>. BGÉ Finco will be responsible for raising all new external debt for the BGÉ Group and will be responsible for lending to BGÉ ITO. BGÉ has stated that loans from BGÉ Finco to subsidiaries including BGÉ ITO will be charged at the average external borrowing cost of funds but also that alternative pricing arrangements are permitted if they are documented in a specific loan/facility agreement<sup>10</sup>. The application for certification states further that "in general, the ITO Group will seek and be provided with funds from BGÉ Finco". Only in the exceptional circumstances where the Group is unable to fund a regulated investment will the ITO seek to borrow externally<sup>11</sup>. Finally, BGÉ must be the sole shareholder in BGÉ ITO<sup>12</sup>.

The Commission considers BGÉ ITO should have the freedom to decide its own operational cash requirements and effective arrangements must be in place to ensure that cash flow difficulties in other undertakings in the BGÉ group do not have a negative impact on BGÉ ITO.

The Commission considers that differences between regulated networks undertakings and undertakings active on wholesale and retail electricity and gas markets are significant and result in differences in risk profile, appropriate financial structure and consequently financing costs. Such differences are reflected in normal market conditions for access to finance for network and production and supply companies. The effective ability of BGÉ ITO to choose to independently finance itself or increase its capital is important as a check to ensure finance is accessed on the most advantageous basis.

The Commission takes the view that it should be made explicit that the circumstances where the "Group is unable to fund a regulated investment..." relate to the ability to fund at a market based price commensurate with the risk profile of BGÉ ITO as an independent entity. Furthermore, it is for BGÉ ITO to make the assessment as to the appropriateness of the

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<sup>8</sup> Article 17(1)(d) Gas Directive requires that appropriate financial resources for investment projects be made available to the ITO; Article 18(1)(b) Gas Directive, requires the ITO to have the power to raise money on the capital market in particular through borrowing and capital increase; Article 18(6) Gas Directive requires that any commercial or relations between the vertically integrated undertaking and the transmission system operator comply with market conditions; Article 18(7) Gas Directive requires that all commercial and financial agreements between the vertically integrated undertaking and the ITO are approved by the national regulatory authority.

<sup>9</sup> These issues are addressed in Sections 2.9, 2.10 and 2.16 of CER's detailed scrutiny and commentary of BGÉ's certification application, in Annex 3 of the Preliminary Certification and in the associated documents contained in the application.

<sup>10</sup> BGÉ Certification Application Supporting Documents Illustrative Treasury Policy

<sup>11</sup> BGÉ Certification Application Supporting Documents ITO Group Funding Model

<sup>12</sup> Ibid.

arrangements offered by BGÉ, and whether a capital increase is the most appropriate means of securing finance, even if this involves taking on additional shareholders.

### **3. Compliance programme and compliance officer**

The notified preliminary certification by CER indicates that BGÉ should appoint a compliance officer in April 2013 fulfilling the requirements of the Gas Directive. The compliance officer will be required to advise on progress for the submission of an application for full ownership unbundling.

The Commission supports this requirement and invites CER to establish a clear date for BGÉ to submit a plan for the implementation of full ownership unbundling and a reporting schedule for the compliance officer to report on the transition to full ownership unbundling. The compliance officer should also report on the preparation of steps necessary to fully implement the ITO model if the timing of the sale of Bord Gáis Energy is at risk of delay.

## **IV. CONCLUSION**

Pursuant to Article 3(2) Gas Regulation, CER shall take utmost account of the above comments of the Commission when taking its final decision regarding the certification of BGÉ ITO, and when it does so, shall communicate this decision to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* national regulatory authorities on any other notified draft measures concerning certification, or *vis-à-vis* national authorities responsible for the transposition of EU legislation as regards the compatibility of any national implementing measure with EU law.

The Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. CER is invited to inform the Commission within five working days following receipt whether it considers that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which it wishes to have deleted prior to such publication. Reasons for such a request should be given.

Done at Brussels, 23.5.2013

*For the Commission*  
*Johannes HAHN*  
*Member of the Commission*

