

Brussels, 19. 12. 2008

SG-Greffe ( 2008) D/ 208582

C (2008) 8851

**Subject: Exemption decision on the East-West Cable Project**

Dear Sir,

I am writing with reference to the decision adopted by Ofgem granting exemption from certain parts of the Electricity Directive 2003/54 and the Electricity Regulation 1228/03 for the East-West-Cable Project notified as received by the European Commission on 30 September 2008.

The Commission has now completed its analysis of the decision and supporting material. The conclusion of this analysis is that the Commission requests the modification of the exemption decision. The details are set out in the Annex to this letter. Please inform the Commission about compliance with the present request within a period of four weeks after receiving it.

Yours sincerely,

For the Commission,

Vladimir ŠPIDLA



Annex

Lord Mogg  
Chairman  
OFGEM  
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## ANNEX

### Procedure

1. On 30 September 2008, the Irish Commission for Energy Regulation (hereinafter "CER"), as well as the Office of Gas and Electricity Markets (hereinafter "Ofgem"), the UK regulator, notified to the European Commission (hereinafter "the Commission") their respective national decisions to grant IMERA Limited (hereinafter "IMERA"), pursuant to Article 7 of Regulation No. 1228/2003/EC (hereinafter "the Regulation"), an exemption of 25 years for the EastWest One interconnector project and of 20 years for the EastWest Two interconnector project from Articles 20 and 23(2), (3) and (4) of Directive 2003/54/EC (hereinafter "the Directive") and from Article 6(6) of the Regulation.
2. On 17 October 2008, the Commission published a notice on the notification of CER's and Ofgem's exemption decisions inviting third parties to comment within two weeks. The Commission has not received any comments.
3. On 27 October 2008, the Commission requested additional information from CER. The request triggered the extension of the deadline for the treatment of the case by a period of one month as provided for in Article 7(5) of the Regulation. The Commission received the requested information on 24 November 2008.

### Description of the project

4. IMERA is a special purpose company established to develop electricity interconnection between Ireland and Great Britain on a merchant basis (i.e. not as part of the transmission system covered by Articles 20 and 23 (2), (3) and (4) of the Directive and Article 6 (6) of the Regulation). IMERA is a holding company and owns two subsidiaries called East West Cable One Ltd and East West Cable Two Ltd. IMERA is the applicant on behalf of its two subsidiary companies.
5. IMERA are proposing to construct 2 sub-sea high voltage direct current (hereinafter "HVDC") electricity cables between the Republic of Ireland and the United Kingdom. The first cable will be laid between Arklow in Ireland and Pentir in Wales, United Kingdom, with a capacity of 350 MW (EastWest One). The second cable will be between Great Island in Ireland and Pembrokeshire in Wales also with a capacity of 350 MW (EastWest Two). These are to be treated as a single project for the purposes of assessing the exemption request, although each project will be the subject of an individual decision (order) to exempt it under Article 7 of the Regulation.
6. There is currently no electricity interconnection between the Republic of Ireland and Great Britain. However, EirGrid, the Irish Transmission System Operator, is planning to construct, in parallel with the IMERA interconnectors, an interconnector known as the EirGrid interconnector. CER reassured the Commission<sup>1</sup> that it had no intention of reassessing its support for the EirGrid

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<sup>1</sup> Letter from CER to Commission dated 20 November 2008 (CER Ref 37676)

interconnector. The Commission considers this continuing support to be of relevance to the decision in relation to the IMERA interconnectors. The impact of this project is considered in more detail in the assessment of the exemption criteria.

#### **Assessment of the exemption criteria of Article 7**

7. Exemptions for new interconnectors according to Article 7 of the Regulation constitute an exception to the general rules on regulated third party access in the Directive and the general rules on congestion management in the Regulation. When granting an exemption, the regulatory authority therefore needs to accurately justify its exemption decision and to limit its scope and duration to what is strictly necessary.
8. In relation to the specific criteria set out in the Article 7(1)(a)-(f), the Commission has made the following considerations.
  - a) *The investment must enhance competition in electricity supply*
9. The construction of a new interconnector between two electricity systems is expected to increase competition. It increases the transmission capacity between Ireland and Great Britain and therefore the range of choices available to market participants to source energy, and to cover the risk that their own plant will not be available. In a small market such as Ireland, individual plants meet a non-trivial proportion of total demand. Thus the market impact of unforeseen plant unavailability can be significant. By facilitating generators' risk management interconnectors can enable new generators to compete more effectively in the market. This should lead to a positive impact on competition, resulting in efficiency gains.
10. There should also be ongoing benefits, as the new investment allows opportunities to be exploited which would not otherwise have been feasible. The significant potential for wind energy in Ireland could be difficult to integrate with its relatively small system due to the intermittent nature of wind power generation. Greater interconnection creates export opportunities for the resource, and allows the Irish system to cope more easily with the impact of the variability of wind. This facilitates competition in generation by broadening the range of available generation sources. At present both the British and Irish markets are dominated by conventional thermal generation.
11. At present Ireland only has interconnection with Northern Ireland – with which it shares a wholesale market – and indirectly thereby with Great Britain via the 500 MW Moyle<sup>2</sup> interconnection, operated by Northern Ireland Energy Holdings, which connects Islandmagee, County Antrim, Northern Ireland with Auchencrosh in Ayrshire, Scotland. The interconnectors which IMERA propose to build, and for which it has requested an exemption, would represent a significant increase in the volume of interconnection available.

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<sup>2</sup> The export capacity from Northern Ireland to Scotland is limited to 80MW.

12. IMERA will own and operate these interconnectors, but will not be involved in either the Irish or British generation or supply markets. IMERA plans to allocate capacity initially by an open season process for long term rights, and afterwards facilitate a secondary trading facility. IMERA also proposes to impose Use It or Lose it (hereinafter "UIOLI") conditions on interconnector capacity.
13. The Commission agrees with CER and Ofgem that the proposed IMERA interconnectors between Ireland and Great Britain has the potential to enable market players to participate in each others markets, facilitating the emergence of a regional market. The Commission also agrees that, as noted by Ofgem<sup>3</sup>, the proposed investment has the potential to facilitate the exploitation of renewable generation, to the advantage of competition. This is not affected by EirGrid's separate plans to construct an interconnector, discussed in more detail below.
14. Any aspects or specific conditions of the marketing of the capacity of the IMERA interconnectors which might be detrimental to competition are considered in the analysis of condition (f) below.
15. The Commission is satisfied that this condition is met.
  - b) *the level of risk attached to the investment is such that the investment would not take place unless an exemption is granted*
16. Under the Regulation an exemption can be granted only if the level of risk attached to the project is such that the investment would not otherwise take place. In order to balance, the objectives of promoting infrastructure investment and ensuring competition through fair, non-discriminatory access to infrastructure (a key principle of energy market liberalisation, and the internal market) the assessment of a proposed exemption must, necessarily, take account of the level of existing interconnection, and the potential for competing infrastructure.
17. Under Article 9 of the Directive, each Transmission System Operator is responsible for ensuring the long-term ability of the system to meet reasonable demands for electricity, and contributing to security of supply through adequate transmission capacity and system reliability.
18. Of particular importance in the context of this exemption request is Ireland's stated target of meeting 40% of electricity demand from renewable generation. This will be predominantly met from wind generation. The intermittent nature of wind generation increased the need for interconnection to facilitate wind export and importing when there is a shortage of wind.
19. The necessary investments to achieve this should, in principle, be realised by Transmission System Operators provided that the ensuing costs are adequately compensated for by regulated tariffs. Regulators have to provide tariff incentives and appropriate economic signals to encourage these investments.

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<sup>3</sup> Ofgem Consultation 94/08 Section 3.10. This consultation took place between 2 July 2008 and 12 August 2008. The Consultation paper and associated documents can be found at [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

- The Government White paper *Delivering a sustainable energy future for Ireland*<sup>4</sup> specifically mentions "*supporting the progressive development of a regional electricity market...underpinned by new interconnection*" as an action under Strategic Goal 1: Ensuring that Electricity Supply consistently meets demand.
  - Interconnection is identified as being of critical strategic importance in Ireland's National Development Plan<sup>5</sup>.
  - In the note of 2 February 2007 *Commission and EirGrid moving forward with East West Interconnection Project*<sup>6</sup>, CER wrote, "*The government and the Commission [CER] are convinced that the interconnector will bring long term benefits to the Irish consumer.*" It went on to note the potential to develop the renewables sector in Ireland.
20. There is therefore accepted need for increased interconnection between Ireland and Great Britain and the Irish authorities consider that the ensuing costs can be adequately compensated for by regulated tariffs.
  21. IMERA considers, nonetheless, that an exemption for their project is necessary to cover the asymmetric risk that a requirement to return profits in good years would not be balanced by a guaranteed income in bad years. In order to cover their risks, IMERA argues it needs flexibility to determine the transport tariffs to sell the capacity in long-term contracts of at least 10 years.
  22. In principle, there is no reason why a well designed regulatory scheme could not cover such eventualities by, for example, reckoning allowed revenues over an extended time period. Moreover, the fact that EirGrid is, as explained above, planning to construct an interconnector, which will be subject to the provisions of the Directive and the Regulation without any exemption, and which is located in the same area and will connect the same markets, would seem to indicate that the risks of the IMERA project are not so high that they require an exemption according to Article 7 of the Regulation. The risks involved in the IMERA project generally apply to major construction projects and are regularly incorporated into the regulatory regime for such projects.
  23. However, if the IMERA interconnectors are built *in addition to* the Eirgrid interconnector, the EirGrid interconnector will already satisfy some of the market demand, and additional interconnector projects will thus be riskier because it is less certain that there is sufficient additional market demand to make their construction profitable.
  24. The analysis of CER specifically states that condition (b) is met due to the fact that the EirGrid interconnector is expected to come into operation in 2011<sup>7</sup>.

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<sup>4</sup> [www.dcenr.gov.ie/Energy/Energy+Planning+Division/Energy+White+Paper.htm](http://www.dcenr.gov.ie/Energy/Energy+Planning+Division/Energy+White+Paper.htm)

<sup>5</sup> [http://www.ndp.ie/docs/NDP\\_Homepage/1131.htm](http://www.ndp.ie/docs/NDP_Homepage/1131.htm)

<sup>6</sup> [www.cer.ie/GetAttachment.aspx?id=10a536d6-b929-48f6-b497-d00717570f76](http://www.cer.ie/GetAttachment.aspx?id=10a536d6-b929-48f6-b497-d00717570f76)

<sup>7</sup> Consultation Paper CER/08/096 Section 5.2 This consultation paper was on 20 June 2008 and closed on 18 July 2008. The consultation paper and associated documents can be found at [www.cer.ie](http://www.cer.ie)

Likewise the Ofgem consultation states that “*the risk to interconnector revenues from the competing development of the EirGrid interconnector*” indicates that without an exemption the IMERA project might not be funded<sup>8</sup>.

25. Only with such an exemption would IMERA be able and willing to assume the significantly higher economic risk of the IMERA project in the presence of the competing EirGrid interconnector. The significantly higher economic risk of the IMERA project in the presence of the regulated EirGrid interconnector therefore justifies the granting of an exemption.
26. However, if the EirGrid interconnector is not available to users, the prevailing environment for the proposed IMERA project, from a technical and a market viewpoint, would be materially different.
27. On this basis, the Commission is satisfied that this condition is met, provided that the EirGrid interconnector proceeds, and that it is available to users as an alternative to the IMERA interconnectors.
  - c) *The interconnector must be owned by a natural or legal person which is separate, at least in terms of its legal form, from the system operators in whose systems that infrastructure will be built.*
28. According to information provided by IMERA, and by CER and Ofgem, IMERA is independent of the system operators in Great Britain and Ireland. There is neither a legal nor an ownership link between, on the one hand, IMERA and East West Cable One Ltd and East West Cable Two Ltd and, on the other, the TSOs for Great Britain National Grid and for Ireland EirGrid.
29. The Commission is therefore satisfied that this condition is met.
  - d) *Charges are levied on the users of that interconnector.*
30. The charging structure set out by IMERA in its application for an exemption makes clear that the users of the interconnector will be charged for the use of the interconnector, and that no portion will be paid for by general transmission or distribution charges. A minimum reserve price<sup>9</sup> will be set which according to IMERA will correspond to the revenue stream that IMERA needs to be able to proceed with the project. In the absence of any supply interests, IMERA has every incentive to sell the capacity at a market price.
31. The Commission is therefore satisfied that this condition is met.

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<sup>8</sup> Ofgem Consultation 94/08 Section 3.34

<sup>9</sup> The reserve price is the minimum price which IMERA will accept in the open season process. IMERA state that this will be "reflective of IMERA's operating costs, debt servicing requirement and fair/reasonable rate of return (IMERA Application for an Exemption, Section 1.7)

e) *Since the partial market opening no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnection.*

32. As the proposed IMERA interconnectors are new investments, and there is no relationship to the Transmission System Operators, or transmission asset owners in either Great Britain or Ireland, no part of the capital or operating costs has been recovered from of charges made for the use of transmission or distribution systems linked by the interconnection.

33. The Commission therefore considers that this condition is met.

f) *The exemption is not to the detriment of competition or the effective functioning of the internal electricity market, or the efficient functioning of the regulated system to which the infrastructure is linked.*

34. This criterion applies to the effects of granting an exemption, rather than to the investment itself. This assessment of the criterion can be broken down in three separate parts. It requires that granting an exemption not be to the detriment of (i) competition; (ii) the effective functioning of the internal market; or (iii) the effective functioning of the regulated system to which the interconnector is linked.

*(i) Competition*

35. This part of the condition is similar to condition (a), but here the emphasis is on whether granting an exemption would itself act as a barrier to competition. The expectation that new infrastructural investment would increase competition was discussed in relation to condition (a). However, these gains may not be realised if new investment allows a dominant undertaking to consolidate its position or otherwise forecloses the market. The potential for these circumstances to prevail is related to:

- The market structure prior to the new investment,
- The ownership structure on the new investment, and
- The rules governing access to the new investment.

36. The prevailing market structure in Great Britain is broadly competitive, with several similarly sized undertakings competing with each other in both the wholesale and retail markets. The analysis conducted by Ofgem on the competitive impact of the interconnector suggest that their size relative to the market makes it unlikely that control of the interconnector, either when importing or exporting, would significantly and adversely alter the competitive balance in Great Britain.

37. However, the size of the interconnector relative to the Irish market is much more significant. Moreover, there are important dominance concerns in the Irish

market, which are acknowledged by CER.<sup>10</sup> As a consequence, concerns about the ownership of the interconnector, and control of interconnector capacity, are particularly pertinent.

38. The Commission accepts that there is no relationship between IMERA and existing participants in either the Great Britain or Irish electricity markets. Therefore it has no direct interest in anti-competitive use of interconnector capacity. Nonetheless, a dominant player might be in a position to pay more for capacity, effectively offering to share the rents from control of the capacity with IMERA.
39. The application by IMERA provides reassurance to the Commission in this regard in so far as IMERA commits to (a) allocate capacity initially using an open season process; (b) limit the share of interconnection capacity available to individual participants; and (c) facilitate congestion management through effective secondary trading and UIOLI arrangements.

*i.a) Open season process*

40. The Commission accepts that an open season process is an appropriate method of allocating capacity. In relation to the duration of the capacity allocation, and the fact that the entire capacity allocation will be auctioned, the Commission accepts IMERA's contention that this is necessary to secure financing, and is acceptable subject to secondary trading arrangements and UIOLI being implemented (see paragraphs 45 to 50 below).
41. IMERA has proposed a reserve price on the initial capacity allocation. The Commission accepts this approach provided that the reserve price is set no higher than necessary to ensure the financial viability of the investment. The Commission notes Ofgem's point<sup>11</sup> that they may re-examine the exemption after the initial allocation is completed. Consequently the exemption remains conditional on the outcome of the open season process.

*i.b) Limitation on share of capacity*

42. IMERA has proposed to limit the share of capacity on the interconnector which the Electricity Supply Board (hereinafter "ESB") may hold to 40%<sup>12</sup>. CER have stated that this should instead be applied to any participant deemed to be dominant by CER, acting in consultation with the Northern Ireland Authority for

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<sup>10</sup> See, e.g. *Market Power Mitigation in the SEM – Decision paper (AIP/SEM/31/06)* 7 April 2006 available at [www.allislandproject.org](http://www.allislandproject.org).

<sup>11</sup> Ofgem Consultation 94/08 Section 3.10

<sup>12</sup> ESB is the vertically integrated former monopoly electricity provider in Ireland. The ESB Group consists of *inter alia* ESB Power generation, which owns the generation assets of the former monopoly, ESB Customer Supply the former Public Electricity Supplier, ESB Networks which owns the transmission and distribution networks and acts as Distribution System Operator, and ESB International which owns generators and supply companies which participate in the Irish market as well as interests outside the island of Ireland. IMERA's application is not clear as to the level at which the proposed cap would have operated.



Utility Regulation – with whom it jointly regulates the Single Electricity Market on the island of Ireland<sup>13</sup>. All other market participants will be limited to a maximum of 70% share of capacity in accordance with the information provided as part of IMERA's application.

43. In considering exemptions, the Commission considers that the new infrastructure should have the effect of diluting the market power of any dominant undertaking. The share of capacity held by a dominant undertaking in the new infrastructure has to be significantly lower than its market share. Currently, ESB has market shares in the Irish electricity retail and generation markets which are significantly higher than the 40% capacity cap imposed on dominant undertaking in the East-West-Project. Consequently, the European Commission considers that the 40% cap proposed by IMERA is, if applied to all existing or future dominant<sup>14</sup> participants, sufficient.
44. As interconnector users can be both generators and suppliers, and as the cross jurisdictional nature of an interconnector necessarily means that separate legal entities may make use of the capacity despite being part of the same undertaking, the Commission considers that the test for dominance must be carried out at the group level. This is line with the usual commission practice of considering companies from the notion of undertaking, i.e. all entities controlled by a single entity.<sup>15</sup>

*i.c) Congestion management*

45. In the application, IMERA committed to facilitating secondary trading and including effective UIOLI provisions with capacity rights. Both CER and Ofgem have stated that they intend to monitor the effectiveness of UIOLI as implemented by IMERA.<sup>16</sup>
46. However, IMERA acknowledges in their application that current provisions in The Single Electricity market (SEM) Trading and Settlement Code which applies in Ireland<sup>17</sup> (hereinafter the "Trading and Settlement Code") hinder the effective application of UIOLI in practice. Effective implementation of UIOLI with respect to netting (where contractual flows in either direction cancel each other out, additional capacity can then be made available to the market) on the interconnectors may therefore be expected.
47. CER acknowledge this but consider that the forum to correct any defects in the Trading and Settlement Code is through the Trading and Settlement Code

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<sup>13</sup> Consultation Paper CER/08/096 Section 5.6

<sup>14</sup> The cap should apply at least to any undertaking which has more than 40% share in a relevant market

<sup>15</sup> A similar capacity cap at group level was required by the Commission in the case of the first Austrian Nabucco decision. See the Commission's amendment decision concerning the exemption of the Austrian section of the Nabucco pipeline of 8 February 2008.

<sup>16</sup> CER Consultation Paper CER08/096, section 5.6, Ofgem Consultation 94/08 Section 3.100

<sup>17</sup> Available at <http://www.allislandmarket.com/MarketRules/>

Modifications Committee.<sup>18</sup> They also state that they will work with market participants to achieve this end.<sup>19</sup>

48. The Commission considers it to be essential that market rules are in place which allow for an efficient congestion management. If that condition is not met, an exemption will be detrimental to competition because efficient congestion management counter-balances the adverse effects on competition of long-term capacity allocation as envisaged by IMERA.
49. The Congestion Management Guidelines<sup>20</sup> set out the obligations on regulators and Transmission System Operators to ensure that cross border capacity is used. They require that explicit auction procedures be designed in such a way as to allow bidders to participate in the daily sessions of any organised market in which they are connected. At present the Trading and Settlement Code requires participants to submit their commercial offer data to the market operator and Transmission System Operator before 10 AM on the day before the relevant trading day. These commercial offer data cover the entire trading day (which runs from 6 AM to 6 AM). This effectively precludes the use of the proposed interconnectors in daily sessions in the British market, either to buy electricity to sell in Ireland, or to sell electricity bought in Ireland.
50. The Commission therefore considers that an exemption can be granted only if the congestion management guidelines can be fully applied, so as to ensure efficient congestion management, by the time the first IMERA interconnector becomes operational. To that end, the Commission assumes that the Trading and Settlement Code will be amended through the relevant national procedure.

*ii) Effective functioning of the internal market*

51. Increased inter-connection facilitates trade of electricity between member states, thus enhancing the functioning of the internal market. This is particularly relevant for Ireland as at present inter-connection is only possible via Northern Ireland. The planned increased wind energy (discussed at paragraphs 9-15 above in relation to condition (a)) also requires access to the internal market through interconnection capacity available on fair terms to ensure its viability. Regulated Third Party Access rules ensure such access.
52. However, the commitment by IMERA to implement secondary trading and UIOLI arrangements, as well as the availability to users of the regulated EirGrid interconnector as an alternative to the IMERA interconnectors, leads the Commission to conclude that an exemption to regulated Third Party Access should not be to the detriment of the internal market in this case.

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<sup>18</sup> See Letter from CER to Commission dated 20 November 2008 (CER Ref 37676) for an explanation of how the Modifications Committee operates

<sup>19</sup> Decision Paper CER/08/185. Section 2.0

<sup>20</sup> "Guidelines on the management and allocation of available transfer capacity of interconnections between national systems", Annex to the Regulation.

*iii) Effective functioning of the regulated system(s)*

53. IMERA has agreed to sign up to and abide by all relevant codes - including Grid Codes applicable in both jurisdictions, the Trading and Settlement Code (in Ireland), and the Balancing and Settlement Code (in Great Britain) - and will be bound by licence provisions obliging it to do the same. Commissioning of the interconnectors will be subject to final connection offers from the TSOs in both Great Britain and Ireland. This should ensure that the exemption is not detrimental to the effective functioning of the regulated system in either Great Britain or Ireland.

*Conclusion of the assessment of criterion (f)*

54. The Commission considers that condition (f) can be met, provided that (i) the regulated EirGrid interconnector is available to users as an alternative to the IMERA interconnectors, (ii) effective measures are in place to prevent control of the IMERA interconnectors by any dominant market player, (iii) effective congestion management is implemented, in line with the Congestion Management Guidelines, and (iv) steps are taken to ensure that the secondary trading and UIOLI provisions, designed to ensure access to capacity on the interconnector to all potentially interested parties, are effective.

**Conclusions**

55. The Commission considers for the above mentioned reasons, in particular the availability of the EirGrid interconnector as an alternative to the IMERA interconnector, that the decisions to exempt the IMERA interconnectors pursuant to Article 7 of the Regulation can be accepted if certain additional conditions are fulfilled.
56. CER and Ofgem are therefore requested to amend their exemption decisions to include the following conditions:
- a) A capacity cap of 40% applies to any dominant party, in either generation or supply (as defined in the Directive) in either system or market to which the interconnector is connected. For the calculation of the capacity cap, undertakings belonging to the same group shall be considered together.
  - b) Before the first IMERA interconnector is made available to system users, effective congestion management can be fully implemented, in accordance with the Congestion Management Guidelines, allowing intra-day trading on interconnectors by individual market participants.
  - c) CER and Ofgem will assess the effectiveness of the secondary trading and UIOLI provisions in ensuring access for all potentially interested parties within six months of the first twelve months the first IMERA interconnector is made available to system users.
57. Therefore by virtue of the third subparagraph of Article 7(5) of the Regulation the Commission hereby requests CER and Ofgem to amend their exemption decisions

accordingly within four weeks upon receipt of the present letter and to inform the Commission of this action.

58. CER and Ofgem should inform the Commission within two weeks of the receipt of the present decision whether the decision contains business secrets or other confidential information which should not be published. In the absence of any information, the Commission assumes that the decision can be published in its entirety.