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For the attention of:

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Prague, 26 June 2007

E.ON Czech Holding AG response on Public Consultation: Draft ERGEG Guidelines on Functional and Informational Unbundling (30 April 2007 - 26 June 2007) Ref: C06-CUB-12-04; Version 12; 30-Apr-2007

Dear Ladies and Gentlemen,

E.ON Czech Holding AG welcomes the opportunity to comment on the Draft of the ERGEG Guidelines on Functional and Informational Unbundling.

The attached remarks represent the position of E.ON Czech Holding AG and its affiliates in Czech Republic.

The response is according to the structure of the provided draft of ERGEG guideline and the raised questions on the topics of consultation.

Please do not hesitate to contact us in case of any question.

Yours sincerely,

E.ON Czech Holding AG

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Remarks on the Draft of ERGEG Guidelines of Good Practice on Functional and Informational Unbundling -

An ERGEG Public Consultation Paper

Ref: C06-CUB-12-04
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1 Introduction

- **General comments**

The Guidelines prefers the ownership unbundling for TSO and DSO. The Guidelines states that the second best solution which is provided by the EU-Directives is legal unbundling. According to the Guidelines, this would ideally entail network companies which own their assets, and do not share services with mother and sister companies. The goal of the Guidelines is to mimic as closely as possible the effects of ownership unbundling on TSO and DSO behaviour. The proposed Guidelines set out minimum requirements for legal and functional unbundling, which should – according to ERGEG in a subsequent step – be integrated into quality standards or Corporate Governance Codes (also answer for question 8.1).

The following main points have to be especially reviewed:

1. Fact is that only legal unbundling is part of the EU-Directives. The deadline for the implementation of the legal unbundling requirements is 1st of July 2007 at the latest. So the regulators shall first analyse the market situation and look after the results of legal Unbundling implementation according to the Directives before suggesting new measures (ownership unbundling, structural unbundling). Requiring the mimicking of "ownership unbundling" is not foreseen in the present law and so going far beyond the Directive and political decision. It shall not be attempted to "create virtual ownership unbundling" by putting formal rules or "minimum requirements" in place, before examining the functioning of the legally unbundled market.

2. Some of the measures recommended are also going far beyond the EU-Directives and the EU-Guidelines of Unbundling (January 2004). Examples:
– According to the EU-Guidelines the shared service model (e.g. common call centers) as well as the use of the same IT systems is under certain conditions taken for granted. The separations of those services would create additional costs without any benefit for the customers; in opposite they have to pay for it (G09).
– The recommendations concerning the restriction of supervisory law are not in line with company laws (G 16).

3. Some of the measures are increasing bureaucracy, e.g. the proposal that all information, data, processes and decisions have to be written down. This suggests that without a whole and extensive written documentation a non-discriminatory behaviour is impossible. Mental unbundling and properly trained employees are even more important. Concerning the planned subsequent steps of ERGEG it should also be up to the company if it is useful to integrate in a quality management system.

- **The importance of sufficient and effective unbundling**

According to existing EU and national laws, commercial incentives or preferential treatment of affiliated network customers is forbidden. By law, the communication and information flow has to be strictly controlled and operational Chinese walls have to be set up etc. So, the discriminating behaviour described below cannot be generalised, as this is not in compliance with EU regulation, national laws and utility policies still existing.

- **Discrimination through unequal access to information**

  There is no privileged access by law – in some countries like Germany new regulation for power plant connection is drafted. In case the Chinese walls are considered to be inefficient, they shall be improved. Shared physical location does not mean automatically the violation of unbundling. Even in case of separated locations violation of unbundling rules can take place. This is a question of IT tools and management separation and training of the staff.
  Operational unbundling means prohibited exchange of information between the companies. But the overall strategy and financial supervision has to be matter of the stakeholders and respective top management.

- **Higher grid charges due to cross subsidisation of the competitive business in vertically integrated companies**

  There is no cross-subsidisation since there is a cost audit on the tariffs setting and the procedure is supervised by the regulatory body. Furthermore, we have unbundling of accounts.

- **Increasing costs for rivals**

  The tariff process and grid connection charges can be supervised by the regulators and benchmarked to other connections; therefore unreasonable huge deviations are impossible.

- **Discrimination by preferential treatment of related companies in many respects, which cannot always be detected**

  - Regarding preferential treatment in nomination procedures, capacity allocations, access to available capacities on transit routes:

    There are standards set by the regulatory bodies, EU regulation e.g. on cross border tariffication, congestion management and by the utilities supporting e.g. auction offices.

  - Regarding longer waiting times for rivals to get grid connections, grid maintenance schedules or decisions on exact future grid configurations which are advantageous for related companies:

There are standard, transparent market rules (set by the regulatory body or national laws). The regulatory bodies are monitoring grid connection time and have to report to the EU-Commission.

- Regarding inappropriate or not properly functioning switching procedures or discriminatory conduct in switching procedures, lack of availability of accurate and timely information on actual and potential clients or complicated administrative procedures in this and transfer of the image of the grid company to the supply business:

  It is obvious that the grid company has his own image, however there are no hints, that this was attempted to be transferred to the supply business. Parallel, supply companies are also free to take any marketing actions within the legal frames. So, different branding is not necessary.

- **Discrimination relating to the outsourcing of activities by the network operator to related companies ("shared services")**

  - Regarding the risks, that "shared services" are not provided at market based costs:

    There is a cost supervision process at the grid companies, so only the appropriate costs shall and will be accepted as base of tariff setting by the regulators. Furthermore, in an incentive regulation regime, every utility is benchmarked by its costs. So for reasons of cost savings there is a natural internal pressure of increasing efficiency within shared service organisations.

  - Regarding the risks, that decision making power on network related issues is delegated to a related commercial company (through Service Level Agreements):

    This is not allowed according to EU-Directives: the work and labour management can be outsourced, but the decision power has to be within the DSO/TSO. So the DSO/TSO has to retain manpower that is professionally able to manage, delegate and supervise the tasks.

  - Regarding the risks, that a related commercial company, when performing services for the network operator, has access to confidential information on grid-users, rival companies as well

as strategic information on grid operation which is not available to the public (in this respect it must be ensured that only information that is strictly necessary is shared with these (sub)contractors under strict confidentiality clauses):

According to EU regulation and national laws there are rules about informational unbundling: related commercial companies should not have preferential access to information. If there is such an access, then there is a non-disclosure clause in all cases that provides the necessary legal security. This is part of the compliance programs or internal company rules. In case of shared or external service companies the proper behaviour with confidential information may be part of contracts or service level agreements.

- **Different models are possible to implement unbundling in practice**

As far as not even legal unbundling is in force in many countries, the demand for ownership unbundling is not useful. The results of the legal unbundling implementation should be proved first.

Management unbundling is mimicking ownership unbundling. Therefore the issue is not targeting to achieve the right points. There can be a separation of the management on the operational level, but above, in the holding there will be a supervisory power, however not interfering in daily business issues.

The stated goal of the draft "to mimic as closely as possible the effects of ownership unbundling on TSO and DSO behaviour" is not acceptable because the set aims and proposed stipulation in the daft are going far beyond the existing EU regulation.

2 Unbundling of functions

- G01: The management of the system operator shall work in a geographically separated structure from the competitive business structures.

A geographical separation is not necessary. Other measures such as access rights shall be considered as equal to physical separation. Moreover well trained staff and mental unbundling are the relevant preconditions and not separate locations.

- G05: The management of the system operator must neither own shares of the competitive businesses nor shares of the vertically integrated company as this would undermine his independence.

  The management of the system operator has very limited possibility to influence the share price. The whole issue is not expected to have a major impact on the success of unbundling. This is also the opinion of the EU-Commission (s. EU-Guidelines, January 2004): the possession of shares of the parent utility does not have any influence on the independence of the grid management.

- G06: Activities and rights of the mother company on the system operator have to be limited to secure her financial interest (supervisory function). Interference by the mother company outside this supervisory function in the network business and knowledge of the day-to-day network business is not allowed.

  Acceptable, as long as it is in line with national company laws.

3 Unbundling of professional interest

- G08 (b): Wages and incentives are exclusively based on the results of the system operator.

  It has to be ensured that the part of incentives and wages, coming outside the grid business, is not essential. Smaller amounts should be allowed.

- G08 (d): The management of the system operator shall not be dismissed without prior justification. The justification is based on network issues and shall be notified to the regulator.

  This notification is not necessary because the contract with the company is strictly confidential.

- G08 (f): For the implementation of point G08 (e), the employment contract shall foresee that if the employee had access to commercially sensitive information a period of work without access to such information shall be imposed. If necessary, some functions in the vertically integrated company can be temporarily forbidden depending on the task he will have to deal with.

G08 (e): The conditions of the return of an employee of the system operator to an affiliated company shall mention the problems related to the disclosure of commercially sensitive information acquired during his/her previous assignment.

This is far beyond the law: "temporarily forbidden depending on the task he will have to deal with" – could be ensured by other measures like confidential clauses in the contracts. Otherwise it has to be applied also for persons coming from other grid companies.

- G08 (g): If the duration of the assignment of the executive director of the regulated department/entity is modified, the modification must sent by the regulated department/entity to the regulator for an *a priori* opinion.

  Not acceptable, because it would mean deep interference to a private business and bureaucracy without added value.

  - Regarding additional measures to reinforce functional unbundling concerning customer relations:

    Customers shall be informed and not „convinced". Related question: will the household customer at the end really want to pay for additional information and business separation especially separated call centres, rebranding?

- G09: Network companies shall have their own identity; nothing shall imply a link from the system operator to the supply business. This involves clearly separate branding strategies, communication policies, and separate contact routes to the network and supply business such as separate telephone numbers, separate call centres and home pages (including transparent linking policies).

  Measures like rebranding are not necessary for the companies' identity.
  Further, more separate call centers or separate billing services for the distribution and sales part especially in the household customer sector cannot be accepted.
  The EU-Commission accepted shared services under certain conditions (informational unbundling, no subsidisation). Providing two systems would increase costs, bureaucracy without any benefit for the customers.
  The rules can be installed by compliance programmes and by internal, contractual rules.

4 Unbundling of decisions

- G10: All commercial and operational decisions related to the operation, maintenance and development of the network must be made within the network business, without involvement of the related supply business or holding company of the integrated company. Affiliated companies shall have no right to change decisions already taken.

  Operative decisions concerning day to day business have to be made by the management of the network company, but strategic decisions having severe impact on the financial supervision task of the parent company has to be taken by the management of the parent company.

- G12: Personnel leasing from an affiliated company should be strictly limited to pure maintenance work. The network company has to fully "manage" the work force which operates the grid. This shall include training, rewards, layoffs etc.

  Personnel leasing in general should not be restricted to certain areas. It is more important to ensure that the relevant non discriminatory rules apply for internal services providers.

- G13: If independent decisions of the network company imply certain actions by the parent company (for instance in case of assets owned by the parent company) the statutes of the parent company have to foresee an obligation to follow decisions taken by the network company. Compensation for any damages incurred by the network company has to be agreed by contract between the network company and the asset owning mother company.

  Legally not enforceable. It contradicts with ownership rights of the parent company as asset owner and the financial supervision rights.

- G14: It shall also have sufficient financial means available to fulfil its tasks to maintain and develop the network. Decision making rights which are sometimes limited by company law must be attributed to the management of the network company. At the same time the competencies of the supervisory boards have to be limited to financial supervision. Any day-to-day decision within the scope of the approved financial plans (or equivalent) must not be subject to further consultation or approval of the parent company.

  G15: The financial plan shall be proposed by the network company. Any refusal of that plan must only be based on a pre-defined risk adjusted return on capital in line with internal requirements and capital

market conditions. For investment under Third Party Access (TPA) the return on capital is usually set by the regulatory authority.

G16: The supervisory board may approve the global amount of investments but must not be consulted on any individual investment, whatever its cost.

The points G14, G15 and G16 are less comprehensible and may be contradictory, clearer formulation would be good. It is necessary that the network company receives the necessary financial sources and proposes the financial plan to the parent company. It is also right, that "sufficient financial means available to fulfil its tasks to maintain and develop the network" are necessary.

But having enough financial resources is also a matter of proper tariff setting of the regulatory bodies. Distribution revenues shall provide basis for the necessary OPEX / CAPEX elements.

Furthermore the parent company has certain financial supervision rights also by company law. So certain value limit shall be set, in order to avoid the endangering the prudent business as usual and therefore to avoid endangering the security and the quality of supply.

The point is also in contradiction with the implementation of the "trustee" position (s. question 8.3.).

5 Unbundling of Information

- G17: The grid operator shall define commercially sensitive information where third parties are data owners.

  The ex ante categorisation and definition of the all possible information is not a proper way to ensure informational unbundling. It is impossible to have a complete list of grid information as the required information may differ according to the application/answers. Well trained staff can take the decision on its own. If they have any doubts they will discuss it with their executives.

- G19: For such data he will define data collection, data processing as well as data access rules in a "data management system". This system will make sure that confidentiality is respected and that equal, well specified and non-discriminatory access of contract partners (or non-

discriminatory disclosure) is guaranteed. This involves equal treatment related to time, procedures, updating, cost and data quality.

Definition needed for "data management system", s. note to G 17: It is creating a huge bureaucracy.

- G20: The network company shall define commercially advantageous information on network business where the network company is the data owner.

  The ex ante categorisation and definition of the all possible information is not a proper way to ensure informational unbundling. It is impossible to have a complete list of grid information as the required information may differ according to the application/answers. Well trained people can take the decision on their own. If they have any doubts they shall discuss it with their executives.

- G22: All commercially advantageous information has to be included in the data management system which shall guarantee either non-disclosure or non-discriminatory disclosure of information. This involves equal treatment related to time, procedures, cost and data quality.

  S. note to G 19: bureaucracy – some kind of documentation yes, but not concrete rules about the handling.

- G23: All commercially advantageous and sensitive pieces of information have to be part of well defined information processes in written form, which have to be sent to regulators together with the compliance programme. These written processes have to be updated whenever a change occurs.

  This is going beyond the Directives. There is no requirement that defined information processes in written form either
  – have to be sent to the regulator
  – or have to be part of the compliance programme
  Parts of the compliance programme are the duties of the employees and the measurements how the unbundling requirements are fulfilled but no process descriptions.

- G24: The best practice to comply with these requirements would be to separate databases for the network and competitive business. This

would allow each market participant to have equal access to information.

Alternatively to the best practice method of "separate databases" other measures like access rights, confidential clause etc. in one database should be accepted.

6 Compliance programme

- **General comments**

According to law, addressees of the compliance programme are the employees dealing with the grid business within a company, but not external service providers (vertically integrated utilities cannot oblige external providers to internal management guidelines). The recommended extension is not necessary as confidentiality can be secured by confidential clauses in the contracts or within service level agreements.

An annually implementation of the compliance programme is neither foreseen in the EU-Directive nor useful for the comprehension and the training of the staff. So the contents of the programme (duties of the employees, general measurements) and the annually reports to the regulatory authority (reporting on progress of the unbundling implementation, some kind of process changes) should not be mixed. The processes should not be part of the programme (s. G 23).

So the compliance programme once implemented should only be changed, if relevant structural or organisational changes took place.

"The vertically integrated company as well as the system operator identify all processes" – Only processes which have a certain potential for discriminatory behaviour shall be defined.

"All processes have to be defined in written form": it is not necessary that all possibly discriminatory processes are written down in the compliance programme. This is confusing the employees for two reasons: the processes can be changed, employees don't have to know all possible processes but only those they are dealing with. So it may be much more helpful for the employees to have specific rules or notes written by the executives of their department than within the compliance programme.

- G28: The compliance officer sets objectives and creates a schedule for the measures to be taken to correct any deviations detected in attaining the planned results and continuing to improve the processes.

  According to the EU-Directives this is not the task of the compliance officer. Supervising and monitoring that is right, he/ she has also a suggestion right and can make proposals. The creation of schedules for implementation is in the responsibility of the executives of the relevant departments.

- G32: In order to monitor the compliance programme in an appropriate manner, the compliance officer shall receive the following competencies.

  The remuneration of the tasks and competencies of the compliance officer are important, but can be done and organised in different ways (instructions of new employees can also be delegated - not an originally task of the compliance officer). So his tasks and competencies can also be written down within the compliance programme or a side letter with the appointment etc. The proposals for implementation are too much detailed. E.g. *not only processes with potential for discriminatory behaviour should be investigated.*

7 Invitation to Interested Parties to Comment

n.c.

8 Recommendation and Issues for Consultation

- (1) Do you think that these Guidelines are sufficient to guarantee a level playing field in view of vertically integrated companies?

  The Guidelines would probably not ensure a sufficient playing field in the business, as in many cases they propose very detailed and extensive solutions without any obvious benefit to the customers. This could lead to an "overregulated" business environment that could generate additional burden for the market players in terms of organisation and costs (i.e. separated IT systems, if the shared service

idea is not allowed each business has to create his own service). See introduction.

- (2) Are unbundling requirements already today included in Corporate Governance Guidelines or your Quality Management Systems? Do you think that these measures may harmonize implementation of unbundling in Europe?"

  We support the aim that is having a harmonized implementation in Europe. In our view the question is not if the implementation shall be harmonized or not, but more: how shall it be done and which are the appropriate requirements that enable the proper and efficient implementation of unbundling. As long as legal unbundling is not in place there shall not be any rule implemented that mimics ownership unbundling in a hidden way. There are rules that shall be implemented in a proper way to make informational and structural unbundling working. Guidelines from the national regulators or ERGEG may be helpful.
  Further going steps like e.g. binding integration in quality management systems do not generate added value.

- (3)(a) Does unbundling in your view necessitate a restriction of information flows to the mother company further than those necessary for a pure financial investor?"

  No restriction shall be implemented with regard to additional information due to the fact that the mother company shall be able to take the financial strategic decisions to ensure the long term profitability of the company. The lack of the professionally correct strategy (which is not possible to formulate purely based on financial inputs) could be in conflict with company laws.

- (3)(b) Do you experience conflicts of governance regulations in your country with unbundling requirements?"

  In the CEE countries and Germany the E.ON companies are structuring their unbundling model compliant to the EU-Directives and with the national legislations.

- (3)(c) Would it be possible to install trustees who act on behalf of the mother company (investor) in supervisory boards and who are to protect financial interests of the investor without disclosing commercial information to the mother company?

  We see neither necessity nor sense for that. In case of such action, the rights of the investors would be seriously damaged and this can even turn out to be contradictory with some privatisation contracts where certain management rights were also granted to investors (i.e. not only the financial insight and power). Also, such measures could be in conflict with the applicable company law and would go far beyond what the relevant provisions of European and national energy laws require.

- (4)(a) Do you think that these rules can guarantee the independence of the management and employees?

  The question is if all these rules are really needed to achieve proper structural and informational unbundling. Some of the rules are going beyond the legal requirements and are against conditions of professional independence (dismissal, prolongation, incentives). Confidential behaviour or behaviour according to law is a precondition, part of every employment contract.

- (4)(b) Or do you think that the possibility for management and employees to be assigned to the network company and the back to the competitive business after some time as part of the internal career should be prohibited?

  Shift between network and competitive business is also possible between different owner groups and (also) for that reason it shall not be prohibited, much more the proper application of the appropriate rules stated in G/ 8/ f should be secured.

9 Next step

We can not accept that (e.g. on page 22) the proposed Guidelines could be integrated into Quality Management Processes e.g. ISO 9001 or Quality Standards as "applicable statutory requirement". This

should be within the decision of each company how – in detail – the binding rules are implemented and improved.

The Guidelines are not proportional to the EU-Commission's statement in the note on unbundling issued in 2004 as "additional measure" it goes far beyond the purpose of the regulation and the necessary actions.