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ERGEG - Draft Guidelines of Good Practice on functional and informational Unbundling

The Norwegian Electricity Industry Association (EBL) is an industry association representing approximately 260 companies with a yearly production of approximately 117 TWh (99% of the total generation in Norway), suppliers and distributors with 2,1 million network customers (92 % of the countries total network customers). The main purpose of EBL is to deal with industry-related economic and political issues on behalf of its members, to provide a good framework and conditions for the industry in respect to financial, legal and technical issues.

We welcome the opportunity to state our views on these very complex and important issues. EBL supports, on a general basis, the Commissions ambitions of a well functioning and further integrated European power market.

EBL has to main policy positions regarding ownership unbundling:

- EBL supports ownership unbundling at TSO-level
- EBL does not support ownership unbundling in the DSO-level

Ownership unbundling at the TSO level has in Norway been considered as a prerequisite for developing efficiently working wholesale markets. Key issues are neutrality in terms of giving customers access to the grid, system operation, reinforcing the grid where congestions tend to arise and secure adequate interconnection capacity with neighbouring countries.

Ownership unbundling on the DSO level is a far more complex matter that from a Norwegian point of view is very hard to justify. The Norwegian regulator (NVE) has since the market liberalisation started in Norway in 1991 introduced a number of measures securing a competitive market even where companies are vertically integrated. We would also like to emphasize that there in Norway are many small utilities operating in a geographically wide area where the density of the population is very low. Splitting such small companies can hardly be justified.

We will in the following give our remarks and comments to those, in our view, most important issues concerning the guidelines and statements that are found in the "draft" from ERGEG.

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EBL comments to ERGEG – "Introduction" on ownership unbundling

In this paper ERGEG takes the position that lack of ownership unbundling between monopolies and competitive activities is the main reason why there is no effective competition in the electricity market and, at the same time, a hindrance to the liberalisation of the energy market. In EBL's opinion this approach is too simple. Norway and the Nordic countries are probably the best example in Europe of a well functioning electricity market despite the fact that there are several vertically integrated companies operating in this market. Even with several vertical integrated companies, the liberalisation process in Norway is well advanced. Ownership unbundling will generate substantial challenges for the whole value chain regarding financial optimality and technical development.

The draft does not seem to take into account the benefits associated with vertical integration such as the sharing of common services and thereby reducing costs and tariffs for the customers. Our general opinion is that the lack of competition in the electricity market stems from other sources such as small price differences, customer awareness etc. and not from vertical integration. To the extent ERGEG is willing to enforce ownership unbundling, they should also consider the disadvantages and make sure there is social economic evidence to support that ownership unbundling will give more advantages than disadvantages or costs.

ERGEG states that the main problem created by lack of ownership unbundling, is the network companies discriminating customers of the networks (production and output) with regard to access to the networks. In Norway, this is already regulated by laws and guidelines, and in addition all network customers have a right to complain to the regulator, NVE, and other authorities. Henceforth, Norwegian network companies can not discriminate their customers, and it should therefore be possible to enforce similar regulations in other European countries without ownership unbundling. ERGEG also states that cross subsidies and access to information between the monopoly and competitive sectors in the vertically integrated companies are one of the reasons why ownership unbundling should be enforced. In our opinion this can be solved through laws and regulations (such as NVE's restrictions against cross subsidies and regulations related to neutrality) and controlled by the national regulator.

General comments

EBL strongly supports the ambition of a well functioning common European power market. In our opinion, the Second Electricity Directive, Directive 2003/54/EC, (hereinafter referred to as " directive "), forms a good basis to further rationalise and improve the functionality of the market. We would like to draw attention to the "ESA sector investigation Inquiry Concluding Report", dated 10. January 2007, which supports the fact that the common Nordic energy market is well functioning and is an effective market both for production, consumption, commercial- and end-user sales

In Norway there are, per example, only a limited number of vertically integrated energy companies with more than 100.000 net customers. Such companies will, according to the recommendations in the Guidelines, have to carry financial and administrative costs unlike the greater majority of vertically integrated energy companies with fewer than 100.000 customers. This will of course be counterproductive to the "level playing field"- target in the Norwegian electricity market. We concede the situation may be different in other European countries with larger companies and population structures.

EBL is sceptical to the use of the term "Corporate Governance Codes" or "Quality Standards" as these terms now are legal terms used in company law. Such terminology will cause unnecessary stigma for companies that, for whatever reason, choose not to comply with (all) the recommendations. The recommendations should therefore use the term "guidelines".

The "draft" presented to us is, in our opinion, fare more complex and detailed than necessary to achieve the goals of the directive. The draft does not take into account the fact that network companies are organised differently and have different government guidelines for operations. Furthermore, there are considerable differences between the various companies in terms of size and complexity. In our opinion it is paramount for both the industry and individual companies that the guidelines are not so rigid that they halt development. EBL is concerned that the cost involved by introducing the proposed guidelines will greatly exceed the possible benefits for the end users and that the level of detailed control will put both the marked development and the consumer at a disadvantage.

Guidelines versus Directive

ERGEG states in the hearing document, point 1, that the proposed Guidelines intend to fall within the frames stated in the current regulation. For the electricity sector this means El-directive II 2003/55/EF (hereafter known as "the directive") where the relevant regulations for regional networks and distribution networks are mentioned in article 15 and 16.

Having read the proposed recommendations carefully we would like to point out that several of them significantly exceeds what can be read from the directive's articles No 15 and No 16, please note our comments to G05 below. It is incorrect when ERGEG states that the recommendations are merely an accuracy of the current regulation. In reality the guidelines increase the companies' obligations and may be viewed as an attempt by ERGEG to introduce a regulation with ownership unbundling.

Detailed comments regarding some of the proposed guidelines:

G01: It is hard to understand the extent of the proposed regulation. The term "geographically separated structures" requires a definition. We would like to point out the importance of not demanding a further segregation then what can be assumed to produce sensible benefits. The benefits derived from a complete geographical segregation, ie. a system operator cannot physically be in the same building as a competitive business, is in our opinion rather dubious. Other industries have handled this issue with more flexibility.

G04: According to the recommendation the top management in the network companies can not participate in "internal group activities" in the vertically integrated companies where the exchange of information can provide competitive advantages. In our opinion the extent of the recommendation is unclear and too general, whilst it at the same time seems to go further than the directive's article No 15. Article 15 (2) a) states that restrictions only relate to top management in net companies being involved in company structures that directly or indirectly are responsible for day to day management of competitive activities. Information flow is regulated by the directive's article No 16 and other recommendations, particularly G17. Such conditions should therefore not legitimise a general restriction against participating in discussions within a vertically integrated energy company not responsible for day to day management of the competitive activities.

G05: In our opinion the term "The Management" requires definition. We believe it would clarify and improve the guidelines if lines were drawn between "shares" and other types of instruments and derivatives and the possible limitations regarding bonuses and other incentive programmes that can be used effectively to establish a good staff development and recruitment policy.

G06: The recommendation gives an inaccurate representation of Article No 15. According to the recommendations G14 and G16 there is reason to believe this inaccuracy is not a coincidence. Limiting the mother company's competence to "supervision" and knowledge of day to day management is not in accordance with the directive. It is clear from the directive article no 15 (2) c) final sentence, that the mother company also can maintain the right to instruct/make decisions on individual decisions exceeding the amounts stated in the financial plans for the network companies.

G07 and G08: The recommendations relate to both management and other employees. Regarding the regulation of non-management employees we recommend these points to be deleted. Directive Article No 15 only relates to management. In our view the directive does not legitimise, or otherwise make necessary the use of such an extensive and detailed regulation of non-management employees (including employee contracts). The relationship with employees (both management and others) are dealt with in the directive's and the recommendations demand for neutrality, flow of information and confidentiality agreements, the compliance program, ie article no 15 (2) d) and recommendation G25.

G09: We can not see the need for such rigid regulations. In reality, the proposed guideline greatly exceeds the directive. From a Norwegian and Nordic point of view, this guideline is "a cure for a non existing illness". The proposed guideline may lead to substantial cost increases for the network companies, poor customer relations and confusion in the marked.

In our opinion this is very close to ownership unbundling. For a vertically integrated energy company this will lead to increased costs when all functions must be carried out by the net company. Additional costs will incur through the necessary establishment of new company names, brand names etc. As mentioned under point 3 above this vastly exceeds the directive's article no 15 (1) and is not acceptable.

G12: In our opinion it is unclear why it is deemed necessary to limit this to "strictly limited to pure maintenance work". We assume such a limitation has been included by editorial error. On the other hand any number of people and functions in a complete and well run network company can be hired without posing a threat to "independent effective decisions".

G13: As this guideline proposes nothing new, we suggest that it is removed from the directive.

G14: The recommendation regulates the competencies of a "Supervisory Board" in relation to management. This is formally related to countries with a supervisory board structure in its company law. We assume that in relation to the relevant Norwegian company law (which is without this function of supervisory boards) this will have the same meaning for the mother company's instructions and voting rights as at the AGM (Annual General Meeting). In our opinion this is in conflict with article no 15 (2) c) last sentence, to only give the mother company the right to exercise financial control. According to the directive mentioned above, the right to instruct and make decisions in separate cases exceeding the financial plan as agreed for the network company, can be preserved for the mother company. The recommendation is stricter than the directive and therefore not acceptable.

G16: This guideline is unclear and not in compliance with the most common principles of corporate governance. It is not reasonable and clearly unacceptable that a CEO should not be able to ask detailed questions about multi-million Euro investments, or details of alternative investments in the network company he is responsible for. Limiting the CEO, Chairman of the board or other competent persons' opportunity to express views or concerns only in relation to "Global amount of investments" is simply unacceptable. As the CEO reports to the board and is under obligation to the company owners, this guideline is inappropriate in its current form.

As mentioned in our comments to G14 the greatly exceeds the demands of the directive and is therefore unacceptable.

G32:

This guideline appears far too detailed. In our opinion it would be sufficient to repeat the statement from the directive about such a programme. On the other hand, a detailed list could be helpful and work as a voluntary checklist for some companies. It is essential that a "compliance program" becomes a useful tool to improve business practices, not a bureaucratic hindrance.

Final remarks

We could like to point out that the "draft" would have benefited from more elaborate preparations prior to distribution. The document has clearly been subjected to several editorial committees and lacks a final proofreading and tidy-up. Henceforth, several guidelines are repeated more than once. In some parts sentences are not completed and therefore appear to have little or no meaning.

EBL would like to put forward a request that the proposed guidelines are subjected to a quality control to ensure they are in accordance with the directive and subsequent "working notes".

EBLs comments will directly and indirectly give ERGEG the necessary responses to the questions listed in chapter 8.

Should you require any further information, please do not hesitate to contact us.

Best regards
Norwegian Electricity Industry Association / Energibedriftenes landsforening

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