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ERGEG Consultation on Draft Guidelines of Good Practice on Functional and Informational Unbundling (C06-CUB-12-04)

Comment by RWE Energy AG

Dear Sir or Madam,

We thank you for the opportunity to comment on the "Draft Guidelines of Good Practice on Functional and Informational Unbundling" published on 30 April 2007.

RWE regards effective unbundling of both transmission and distribution system operators as a necessity for ensuring functioning competition in the electricity and gas markets. This is the only way for network operators to fulfil their role as a platform for competition with neutrality and without discrimination. To achieve these objectives, the present regulatory framework is fully adequate though. What is decisive is that the unbundling requirements are effectively implemented and monitored in the member states by legislators and regulatory authorities.

Specific interpretation provisions on informational and functional unbundling may help to ensure harmonised implementation in the member states and to create a level playing field. What is critical in our view, however, is that some of the proposed guidelines violate existing laws and moreover go far beyond the leeway for interpretation provided by the Internal Electricity and Gas Market Directives.
When discussing new energy market mechanisms it must be taken into account that European energy laws and subordinate regulations as well as national implementation acts (Internal Market Directives, Energy Act) are incorporated within the framework of general laws and must not contradict them. These include, in particular:

- The general rights of freedom also guaranteed by European law (freedom of ownership, profession and movement)
- The provisions of company law (ownership and third-party proprietary rights such as provisions on control and transparency in companies and accounting law regulations)
- Provisions on data protection developed from individual protection rights in national laws
- Employee protection rights in labour law, for instance.

An isolated view of energy-related issues without taking account of the full regulatory framework would be incomplete and is inadmissible. Individual, exclusively

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monofunctional regulatory recommendations which do not take account of this regulatory framework and the resulting ambivalences are thus not appropriate to meeting the objectives in hand.

Moreover, it must be noted that the rules for implementing the unbundling requirements set down in EU directives and regulations must also be covered by the latter: the leeway for interpretation is limited by the text of the current energy law.

In this connection we would like to point out that RWE Energy group with its German subsidiaries started to adjust its corporate structure to meet the legal and organisational unbundling requirements of the Internal Market Directives in 2003, i.e. even before the expiry of the deadlines for implementing the Internal Electricity and Gas Market Directives into national law. For this purpose, legally independent network companies were demerged for transmission and distribution networks both in the electricity and gas sectors, among other things.
The network companies of the RWE Energy group Germany are appropriately and adequately sized in terms of both staff and finance. Both managing directors and executive staff are members of the respective network companies under labour law, too. The rest of the network companies' staff are formally still assigned to the previous employment company, not least due to the request by the employee representatives, but are fully integrated into the network companies in disciplinary terms. In contrast, transmission system operators are full-function companies, with only a few functions being outsourced. Accordingly, they have approx. 100 (RWE TSO Gas GmbH) and 300 (RWE TSO Strom GmbH) own employees respectively.
For four years now, RWE has very successfully applied the unbundling approach laid down in the European Internal Market Directives and meanwhile implemented into national law to ensure the transparency and non-discriminatory planning and execution of network operation. This is independent of whether these activities are carried out within the network operator or as other activities outside the network operator.
All employees who carry out activities for network operation are bound by the compliance programme, which is also entrenched in labour law, to fulfil their tasks in all areas by taking heed of these principles and observing the legal provisions of the Energy Industry Act.
The permanent goal is to achieve a relationship with all market participants that is non-discriminatory and based on trust, and thus to contribute to a functioning competition in the markets downstream or upstream of network operation. The companies of the RWE Energy group Germany regularly inform the Federal Network Agency and the public in their compliance reports about any measures taken in this respect.
There have been no complaints from market participants regarding discriminatory behaviour by the network operators of the RWE Energy group Germany.

In general, we endorse the necessity of introducing interpretation provisions on informational and functional unbundling. However, we are of the opinion that some of the proposed guidelines go far beyond the interpretation leeway provided by the Internal Electricity and Gas Market Directives.

Our detailed comments on the present draft guidelines are as follows:

Re: 1 – Introduction

(GL p. 3 / p. 7 middle)
It must be pointed out that neither in countries with ownership unbundling nor in countries with structural separation of system operation - the draft mentions the US and Britain as examples - was it possible to identify a connection between these measures and a possibly greater opening of the market to competition. Due to strong structural differences between the markets considered in the draft and existing European markets, market models cannot be transferred arbitrarily in the hope of producing comparable effects. Moreover, the two markets mentioned show that ownership unbundling of transmission system operators does not necessarily result in an expansion of electricity networks. It is interesting to note that four of the five EU countries with the largest problems in developing interconnectors already have ownership-unbundled transmission system operators.

In our view, there is no empirical proof for electricity and gas networks to be cheaper, better or just less discriminatory after implementation of ownership unbundling. Moreover, a politically ordered ownership unbundling of networks, separating them from other units of the relevant energy supply utility, would amount to an expropriation and would thus quickly reach its limits on constitutional and European law grounds. Another critical issue is that network operators which are publicly owned would not be affected by ownership unbundling even if the public sector was at the same time engaged in generation and distribution activities. This would be a blatant case of unequal treatment which could not be justified. All in all, the proposed measure is obviously out of proportion regarding the depth of interference and the dubious progress for competition. Besides, the tacitly assumed hypothesis that ownership unbundling leads to more competition is also doubted by European experts, such as Prof. Brunekreeft, from the scientific point of view.

(GL pp. 5/6/7)
ERGEG presents various risks entailed in discriminatory conduct by vertically integrated companies. ERGEG rightly points out that this conduct could be encountered especially where unbundling requirements are insufficiently implemented and monitored. It is therefore the task of national legislators to provide for adequate implementation of these requirements while the national regulatory authorities must monitor their compliance. We expressly reject the allegation that even if legal and organisational as well as informational unbundling are properly implemented, companies would still act against the law and yield to incentives for preferential treatment.

Informational unbundling explicitly provides for employees to have access to commercially sensitive information only when dealing with network tasks. Wherever employees participate in the production, processing and assessment of commercially sensitive information and relevant publication decisions, the provisions of the compliance programme shall apply. In such situations, which are explicitly governed by law and properly monitored, employees will then be ex-

pressly and efficiently restricted in their obligations and/or opportunities to provide information, e.g. to other employees in competitive areas.

Moreover, network charges are subject to regulation; there are clear rules for network connection and customer churn processes. It is the task of the regulatory authorities to define uniform standards for these topics which will apply to all network operators irrespective of the utility involved and to assist in their application, possibly in response to complaints from market participants. This obligation would also exist in case of ownership unbundling.

The demand for the network operator's full independence in its decisions interferes with the relationship between the parent company and the network operator which is protected by basic law. A parent company on the one hand exercises its ownership rights and on the other hand assumes the obligations towards authorities and third parties under commercial and company law, for true and full reporting, for instance. The European regulations and unbundling provisions of the Energy Industry Act (EnWG) rightly provide that general corporate governance measures be maintained.

Both the Internal Electricity and Gas Market Directives and the implementation provisions in the German Energy Industry Act which are based on them expressly permit the operation of shared service organisations. The competent regulatory authority – i.e. the Federal Network Agency for transmission system operators and major distribution system operators – ensures that competitive prices are offered for these services when controlling network charges.

Re 2 – Unbundling of functions

G01 – A geographical separation of the network operator must generally be seen as a "cosmetic measure". The objective of non-discrimination is served much better by an effective compliance programme than by separate buildings. As both cases actually occur within the RWE Energy group, we are in a good position to judge from practical experience. The two largest distribution system operators, for instance, are located in Wesel and Recklinghausen. They are thus geographically separated from the RWE Energy AG headquarters in Dortmund and the two responsible regional companies in Dortmund and Essen. RWE TSO Strom GmbH has its legal domicile in Dortmund; most of its staff, however, works in Brauweiler (Rhineland). RWE TSO Gas GmbH is domiciled in Dortmund, but in a building separated from the RWE Energy AG headquarters. We cannot see any differences in the unbundling-compliant behaviour of the network operators in this variety of cases.

G02 – „The system operator must have ENOUGH financial and personnel resources [...] ". Basically, we think that it is right that the network operator must be able to make independent decisions within its sphere of responsibility. The ERGEG formulation, however, does not make it clear what ENOUGH resources are explicitly. Moreover, it must be taken into account that decisions by the network operator must not violate the ownership rights of the parent company. Thus, a conflict with G07 – the right of the parent company to decide on the financial planning of the network operator – must be excluded.

G04 – A general exclusion of system operator employees from group activities is unacceptable. This demand represents a wrongful interference with the rights and career opportunities of these employees. The prohibition to pass on confidential data which is ensured within the framework of the compliance programme applies irrespective of their participation in events and programmes.

G05 – To prohibit the management from owning shares is an inadmissible interference with the freedom of ownership. As far as asset formation through employee shares is concerned, which is a usual and admissible procedure under German labour law, the persons concerned are discriminated and limited unproportionately.

G06 – G06 rightly refers to the securing of the parent company's financial interests by the supervisory bodies concerned. The wording, however, ignores that especially according to the risk monitoring obligations under European law and the commercial law obligations the supervisory body is entitled and obliged to monitor the proper management of business also with regard to the fulfilment of legal obligations.

Re 3 – Unbundling of professional interest

G08 – The measures generally required for employees in this section go widely beyond the regulatory framework of the directives on organisational unbundling without differentiation. The rules mentioned do only apply to employees with managerial tasks assigned by the network operator.
Moreover, the requirements specified in G08 c) inadmissibly interfere with the labour law sphere between the employee and the assigning Group company. It cannot be excluded that an employee of a Group company can be dismissed by his or her employer, for instance, if the employee harms colleagues of the Group company outside network operations in a way that would have criminal law relevance (for reasons that are not connected with network operation).
Conversely, the application of an employee from network operation for a position (which is higher or desirable for other, e.g. family reasons) cannot be made dependent on the network operator's approval.
The transmission of dismissal reasons to the regulatory authority (as required in G08 d) should cause considerable concern with regard to data and personal protection rights. In Germany, in any case, it is up to independent courts to decide whether a dismissal is permissible and thus valid, however only if the employee concerned takes legal action. The passing on to the authority of reasons for a dismissal with probable cause should itself be a criminal offence.
The a priori opinion on a modified duration (longer or shorter) (as required in G08 g) of the assignment by the regulatory authority cannot be of significance for the above-mentioned reasons. A regulatory approval of a contract extension does not seem reasonable. Should the executive employee be unsuitable, the general supervisory rights of the regulatory authorities should be sufficient to complain about the employee's lack of suitability. The regulatory rejection of an (amicable) shortening of the assignment for whatever reasons unjustly interferes with the rights of the employee. The employee would possibly be forced to terminate his or her assignment with unforeseeable social law consequences instead of seek-

ing an amicable solution with the network operator and/or the Group company. Upon request and only upon request by the party dismissed, the courts are responsible for checking the dismissal by the network operator or the Group company.

G09 – Separate branding of the network operator must generally be seen as a "cosmetic" measure. An effective compliance programme with the aim of non-discrimination is much more efficient than various brand names.
The prohibition to include a link to a possibly related energy supplier under group law on the network operator's website is contradictory by all means if this supplier is the legally prescribed basic or replacement supplier. Reference to the latter must be made by the network operator in any case. But we are also of the opinion that any other references by the network operator are not permissible. Conversely, it must be admissible nonetheless to include a link on the website of an energy supplier, a supplier who is entrusted with basic supply anyhow – whether related or not – to the site of the competent network operator. This must be so as the network operator as monopolist is obliged to provide each network user with connection and service.

Re 4 – Unbundling of decisions

G11 / G12 – The attitude expressed in these sections that a network operator must not use third parties to maintain its networks contradicts the express legal requirements in the directives. With regard to the short time which has passed since the coming into force of the corresponding regulations and the fact that the implementation deadline for the legal demerger of distribution system operators has not yet elapsed, such a restrictive assessment does not seem to be justified. It is not understandable, for instance, why the network operator should have its own training staff for its employees.

G14 - The guidelines cannot put the owner of the network company under the obligation to make additional payments, which are not provided for by company law, irrespective of whether the company is an energy utility or a financial group. If a company neglects its obligations for the proper maintenance of the network, it is up to the competent regulatory authorities to enforce these obligations. However, it is not possible to make any stipulations in advance if there are no indications of violation.
It is not acceptable that the guidelines shift decision-making rights and limit supervisory obligations under mandatory company law which is focussed on European law. The guidelines themselves must not call for violations of the law.

G15 / G16 - The call for full sovereignty of the network operator even with regard to the approval of the investment budget (limiting the decision-making rights of the Supervisory Board regarding the financial plan (refusal only if the predefined rate of return is not achieved)) is an unacceptable interference with the relationship between parent company and network operator. European law regulations and the unbundling provisions of the Energy Industry Act provide that measures of general corporate governance are maintained. These include, for instance, the approval of major individual investments as far as these do not fall under the approved financial plan and the order of magnitude of the approval reservations is

proportional to the size of the network operator. The complete prohibition of individual approvals "whatever it costs" explicitly violates the accounting law and risk management provisions of commercial and company law which have a European focus.

Re 6 – Compliance Programme

The role of the compliance officer:
The compliance officer is and remains an employee of the integrated energy utility. He is dependent on the cooperation of and support from the employees in operations in performing his legal tasks. This requires the building of a functioning relationship of trust. Practical experience has shown that the compliance issue has already become firmly entrenched in the minds of employees. The employees feel personally responsible. They do not only give hints to compliance deficiencies but often also provide possible approaches. They are thus the most important source for the compliance officer.
To require the compliance officer to merely assume a control and monitoring function, virtually as extended arm of the regulatory authority, would lead to an abrupt loss of trust and thus to the isolation of the compliance officer within the company.

Re the requirement for annual implementation of the compliance programme:
A change in the compliance programme requires a good cause which is also relevant to and verifiable for the employees as addressees, such as a substantial organisational change. Experience has shown that compliance-related changes have had a deep impact on corporate culture. Inflationary changes of the compliance programme involve the risk, which is not to be underestimated, of diminishing the already achieved acceptance on the part of employees and sustainably disturbing the positive development of the company's compliance culture. In this connection it must be taken into account that a change in the compliance programme would again require the involvement of the codetermination bodies, approval by the Executive Board and new disclosure throughout the company. However, to have a new decision-making process every year for an unchanged compliance programme together with the corresponding reporting would be a superfluous ritual.
The call for including all process descriptions existing within a (large) company into the compliance programme would render it impossible for the employees to read it and would mean to lose track of the reality of a large energy utility.

Re the compliance report:
As the report must be legally published, it goes without saying that personal data (data protection) and business secrets cannot be disclosed.
As required by law, the compliance report is an independent report of the compliance officer. The call for a mandatory signature by the company's management contradicts the prominent position of the compliance officer who is the person responsible for reporting to the regulatory authority.

Re 9 – Next Step

The wish expressed for integrating the guidelines into a quality management system pursuant to ISO 9001 is a far-reaching approach for which a great number of more viable options exist in corporate practice. The RWE Energy group, for instance, has been successfully using internal auditing for continuously certifying unbundling compliance.

We hope that our statements and suggestions will find their way into your guidelines.

Yours sincerely,

RWE Energy Aktiengesellschaft

ppa. Böwing

ppa. Dr. Nissen