



L'ENERGIA CHE TI ASCOLTA.

Enel response to the “Draft ERGEG Guidelines of Good Practice on Functional and Informational Unbundling”

Introduction

Following the publication of the ERGEG draft guidelines on functional and informational unbundling, Enel welcomes the opportunity to give its opinion on effective unbundling, particularly to contribute to the scope of the guidelines to establish an appropriate way to implement the existing EU legislation on unbundling.

Enel believes that an appropriate and harmonised implementation of the current legislation on functional and informational unbundling would guarantee a sufficiently level playing field, non-discriminatory behaviour and effective competition in Europe.

Hence, we would like to present our comments regarding the issues below:

- **General Issues**
- **Functional Unbundling**
- **Unbundling of Professional Interest**
- **Unbundling of Decisions**
- **Unbundling of Information**

General Issues:

The European legislation does not provide for any unbundling of ownership in network services; but rather their legal and functional unbundling that should be integrated with other policy regulations, linked with the ownership structure of the network company. In particular, the relevant Directives (2003/54/CE and 2003/55/CE) affirm that the adoption of administrative and accounting unbundling models should not, however, “*hinder the existence of proper coordination mechanisms, aimed at guaranteeing the protection of the controlling company’s rights for economic and managerial oversight.*”

Enel however agrees with some of the Commission’s remarks concerning the need for ownership unbundling of transportation/transmission operations (TSO). In fact, it seems quite likely that the company managing such infrastructure can affect, through its decisions, the development of a competitive market. It could be argued,

for instance, that creating bottlenecks in the transportation/transmission network (at national entry points, or between macro-areas) may be to the advantage of a dominant, vertically-integrated operator.

On the other hand, DSOs operate downstream and have no possibility of affecting the operators' competitive capabilities, which is determined by how open the upstream market is. As pointed out by ERGEG¹, unbundling must be proportionate to the risk of discrimination. Therefore we believe that DSO operations, that present a relatively limited risk to competitiveness within the system, call for a functional and legal approach to the unbundling issue.

Such an approach, integrated with auditing activities by the Regulatory Authority², allows for the elimination of the conflict that might arise between the non-discriminatory management of the distribution network, and the goal of profit maximization within the vertically-integrated group. The Authority can, in fact, keep track of DSO behaviour at all the times, through a series of quantitative parameters that are readily available.

Vertically-integrated network services do not entail discriminatory tariffs; actually, fairness in transportation and distribution tariffs in order to avoid cross-subsidization is guaranteed by the separation of accounting operations of the individual activities in the chain of production, as required by Directives 96/92/CE and 98/30/CE, which have been implemented in an almost completely uniform manner³, by all EU Member States.

Furthermore, in Italy, efficiency transfers towards consumers are guaranteed by the price-cap mechanism, whereas service quality improvements are supported by an appropriate system of bonuses and penalties.

According to Enel, the regulatory costs incurred by the system are offset by the advantages of integrated management of infrastructure in terms of cost reduction and service quality enhancements.

¹ ERGEG's Assessment of the development of the European Energy Market 2006, 06/12/2006

² The Regulator may check for example:

- a. Existence of obstacles to the switching process, by monitoring average times needed for the replacement of the supplying operator,
- b. Availability of information, e.g. readings, to network users can be checked by monitoring the existence of such information on accessible data platforms,
- c. Brand exploitation for commercial purposes may be monitored by market surveys

³ In 2005 audit of unbundled accounts in 19 Member States of 25 - Benchmarking Report 2005

From an economic point of view and with special regard to the distribution sector, network operators, even when functionally and legally separated, can obtain remarkable advantages from the vertical integration within a group.

Experience gained during recent years has shown that national electricity system might get outstanding benefits from integrated DSOs, in terms of:

- reduction of management costs through exploitation of economies of scale, due to increased size. At the beginning of each regulation period, such efficiency capability is passed to end-users through the profit-sharing mechanism;
- larger investment capacities allowing, e.g., for the mass introduction of electronic metering. There are countless advantages, which include reduction of costs for replacing traditional meter readings with remote readings; and increased energy efficiency through adoption of a Demand Side Management system;
- consolidated know-how, that allows for remarkable service quality enhancements. This has helped us to contribute to the reduction of, the cumulative amount of service interruptions for Italian low-voltage clients, due to distribution companies from 163 minutes in 1998 to 62 minutes in 2005.

Functional Unbundling

Enel subscribes to the principle of data confidentiality, but remains critical about how the ERGEG paper defines the controlling company's competences, as well as the ban of the controlling company, from interfering in the network operator's activities in any way other than financial oversight.

These circumstances entail, according to Enel, severe constraints on the controlling company's functions, since a controlling company should always be able to carry out activities of control and strategic decisions, not limited to the financial area, of the companies of the group.

Unbundling of Professional Interest

With regard to the G.07 guideline concerning the conditions for the return of an employee, previously detached from or transferred to the original company, and the possibility of disclosure of sensitive information acquired when said employee was working for the system operator, **Enel agrees with the need to define the limits, within which**

sensitive information should be preserved, while also guaranteeing protection of the professional interest of the employee involved. Actually, as soon as the detachment or transfer period is over, employees involved in network operations should be allowed to engage in commercial operations, in compliance with confidentiality principles to be defined via a compliance programme with the Regulator, on a case-by-case basis.

It is not possible to establish policies that are even more restrictive, with regard to the transfer of employees external to the group, or the transfer of regulated employees to the Regulator, and vice versa.

Unbundling of Decisions

Enel considers that the holding should be able to exercise control, not only of financial kind, over all companies of the group, including the network company.

The network company is required to define a financial plan consistent with payment levels adopted by the integrated company, no exceptions should be allowed. Return-on-the-capital rates considered as adequate for the integrated company, should also apply to network operations, including operations subject to Third Party Access (TPA).

Enel also proposes the adoption of a Corporate Governance model in Italy, capable of ensuring that the controlling company exercises its powers of strategic decisions, supervision and control, while also ensuring managerial and operational independence of the independent operator's activities. We suggest that the network operator's Board of Direction maintains jurisdiction over high-level matters; whereas an executive committee, independent from the holding, maintains jurisdiction over operational matters, including definition of the investment plan. Lastly, we also suggest an auditing body in charge of supervising compliance with the principles specified above.

Unbundling of Information

In the consultation paper, ERGEG asks for the codification of information considered to be commercially sensitive, whereas in its "NOTE OF DG ENERGY & TRANSPORT ON DIRECTIVES 2003/54/EC AND 2003/55/EC ON THE INTERNAL MARKET IN

ELECTRICITY AND NATURAL GAS” the Commission requires only the physical separation of data banks.

Enel believes, instead, that to preserve data confidentiality it is not necessary a physical separation of data banks, and that the same goal can be reached less costly through an efficient access system (e.g. password protection).

Compliance Programme and Compliance Programme Report

The structure of these documents should be defined in cooperation with the National Regulatory Authority, while taking into account the idiosyncrasies of different national systems.

Conclusion

Enel agrees with the ERGEG objective to put in place such guidelines to be implemented by each Member State. However, we have some reservations about certain points, for example, first of all the need to have different measures concerning DSO and TSO unbundling. Since DSOs operates downstream they have lower possibility of affecting the operators' competitive capabilities, secondly the holding obligation to accept the decision of the independent TSO has to be restricted to few fundamental decisions and finally holding power on the controlled TSO should not be limited just to financial control.

We eagerly await the result of the public consultation process and we look forward to more detailed discussion on unbundling with ERGEG and CEER members.

Brussels, 21 June 2007

Annex 1: Specific Comments on Individual Guidelines

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Specific Comments on Individual Guidelines

A careful examination of the guidelines brought out the following criticisms:

- **G.01.** The recommendation that independent system operators should be “physically” separated from other business structures is not very clear. Generally speaking, we agree that confidentiality of data and information needs to be protected.
- **G.02.** We also understand the requirement for network operators to have adequate financial and personnel resources, while complying with certain obligations of belonging to an integrated group.
- **G.03.** Enel concurs that independent operators should not be simultaneously engaged in competitive activities, but it maintains that there is no need to establish any rules incompatible with the controlling company’s activities.
- **G.04.** We find it reasonable for independent operators to be banned from participating in certain meetings of other companies of the group that operate in sectors subject to competition, if in these meetings an exchange of business-sensitive information takes place. Obviously, such a ban should not apply to meetings in which no exchange of information is expected to occur.
- **G.06.** The ERGEG Consultation Paper seems to limit the holding’s activities to sole financial control over independent operators. According to Enel, instead, and in compliance with company policy, the holding should be able to exercise powers of strategic decisions (even of the industrial kind), supervision and control over all companies of the group (please see “Unbundling of decisions”).
- **G.08. f.** Personnel that have come into possession of commercially-sensitive information during their stay in a company belonging to a vertically-integrated group must be trained with regard to any information they have acquired. It remains valid, for Enel, that such a solution must be shared with the regulator in the *compliance programme*.

- **G.09.** Enel cannot accept such a guideline, because measures of this sort seem to be disproportionate to the unbundling goals (e.g. brand separation might cause further confusion among consumers).
- **G.13.** Enel disagrees with the proposal that a holding should have, in any case, an obligation to follow up on actions decided by independent operators that entail obligations for other companies of the group, given that an independent operator's autonomy is only valid with regard to its actions. The Consultation Paper proposal is not clear enough about what resources the network company is supposed to rely on for indemnifying the group, in case of damages inflicted due to actions taken by independent operators. In fact, the hypothesis that an independent operator should use its funds ignores the fact that these funds already belong to the group, and if used it would just be a case of a simple transfer of resources from one company to another company of the group, without any real compensation taking place. Real compensation requires that such forms of reimbursement are covered by the tariff system.
- **G.14.** See **G.06**
- **G.15.** It is necessary that the controlling company exercises financial control over all companies of the group, including the network company that is required to define a financial plan consistent with payment levels adopted by the integrated company. Financial control by the controlling company affects all investments, including those regarding Third Party Access (TPA).
- **G.24** We believe that no physical separation of data banks is necessary, in order to guarantee confidentiality of information. Today's technology offers various efficient solutions less costly and with the same effect (**e.g. password protection**).