BGW, VDEW und VKU
Response to

ERGEG Draft Guidelines of Good Practice on Functional and Informational Unbundling - An ERGEG Public Consultation Paper

(Ref: C06-CUB-12-04
Version 12
30-Apr-2007)

Berlin and Cologne, June 26th, 2007

The associations BGW, VDEW and VKU appreciate the opportunity to comment on the ERGEG Guidelines of Good Practice. They support the regulators' efforts to implement the regulations for informational and functional unbundling. They agree that the neutrality of the networks - along with the standardisation of market processes - is an essential condition for effective competition on the energy market.

However, the associations hold that some centre points of the Draft Guidelines would need some reconsideration. A summary of these issues follows on this page and the following.

In the attached text (from page 5), BGW, VDEW and VKU present some concrete amendments to the ERGEG Draft Guidelines which would contribute to an appropriate implementation of the requirements for functional and informational unbundling while avoiding unnecessary administrative burdens for companies.

1. Framework of European and national legal bases exceeded

We would like to make a general preliminary remark regarding the data on which the Sector Inquiry is based. Network operators are currently in the process of adapting to the new legal framework. Likewise, the German regulatory authorities still continue to publish national regulations and guidelines which provide orientation for the undertakings (the last one on unbundling was issued only on June 13th, 2007). Thus, the "energy framework" in Germany has been changing considerably during the last one or two years. Hence, it seems questionable to draw conclusions and to make recommendations regarding the effectiveness of unbundling requirements without taking into account especially the recent (regulatory) changes in the energy sector. One should bear in mind that the almost two years old "snapshot" of the energy market, made by the Sector Inquiry, purveys an increasingly obsolescent pattern of the energy market.

The above-mentioned associations acknowledge that Guidelines of Good Practice contribute to the effective and equal implementation of the unbundling provisions in all Member States. Nevertheless, the guidelines must be in line with the provisions of the national and European legal framework. Although in the introductory part (section 1, page 8) of the current draft guidelines it is noted that regulatory authorities consider its provisions in line with the present legal framework, the guidelines exceed this framework to some extent. This is especially the case when regarding the main objective of the guidelines, namely the "mimicking of ownership unbundling". There is no legal base for this objective, as the unbundling requirements currently in force only provide the neutral management of the networks, regardless of their ownership structure. Individual articles in the points G 1 to 33 (for details see appendix) are exceeding the European and German legal base, too.

Moreover, to avoid misunderstandings the non-binding character of the Guidelines should be clearly noted (e.g. in introduction on page 4 of the attached paper).

In the introductory part of the Draft Guidelines potential advantages of ownership unbundling are extensively emphasised. But whether ownership unbundling will in practice lead to more competition is an open question. It still has not been empirically proven that ownership unbundling leads to the alleged advantages like higher in-

vestments in the network infrastructure, lower network access charges, improved security of supply or fewer complaints from trading competitors. Considering the concerns regarding constitutional law and the absence of sound economic estimations for the consequences of ownership unbundling, the national laws currently in force should have the chance to make their impact feel first.

An effective unbundling is an essential instrument to foster strict competitive neutrality of all grids. Furthermore a lot of the problems mentioned by the regulators can only be solved by a closer regional and interregional co-operation of the European network operators. In this context the Memorandum of Understanding on Market Coupling in the North-West European electricity market, signed by governments, regulators, TSOs, power exchanges and market participants on June 6th, 2007 is to be regarded as one important step for further market integration.

2. Approval of measures already taken

In different places the Draft Guidelines allege that vertically integrated companies inevitably discriminate against competitors and have not taken any measures to enforce the European unbundling provisions until now. This is not the case.

In the two years since the entry into force of the German Energy Industry Act (EnWG – Energiewirtschaftsgesetz), the unbundling regulations have initiated a change of culture in the companies. These efforts of the energy sector should be taken into account. Also, there is no reliable analysis from which the necessity of further measures can be deduced. For this reason a guideline for the implementation of unbundling regulations must not lead to a reversal of the burden of proof for the companies either.

Furthermore, with regard to the far reaching requirements in the Draft Guidelines, it has to be considered that at least in Germany regulatory authorities have sufficient competence of supervision and enforcement to correct potential flaws, as they have extensive competences of investigation and enforcement. For example, in Germany the separation of accounts is additionally supervised by certified accountants.

Besides, measures of supervision taken by the regulatory authorities in relation to informational and accounts unbundling are instantly enforceable by act of law. The regulatory authorities have to approve the network tariffs before their entry into force, so the proper allocation of costs is monitored twice. Discriminating behaviour of network operators can moreover prompt claims for damages by third parties, however, to site Mr. Kurth of the German federal regulatory agency, there are currently none in Germany. Therefore we are convinced that effective unbundling of the network and competition areas can be achieved by the implementation of the present legal requirements and consistent actions by the regulatory authorities.

3. Proposals do not take into account the existing (and effective) regulation of grid access

The measures proposed in the Draft Guidelines should not be applied to cases where other and more efficient measures are already applicable which prevent dis-

crimination, such as transparent and standardised procedures between market parties and verification procedures by regulatory authorities. This is particularly the case concerning discrimination potentials within vertically integrated companies (discrimination by discriminatory access to information, higher network tariffs, increasing costs for competitors and positive discrimination of affiliated companies). In Germany the potential for discrimination as far as the points mentioned above are concerned has already been erased by effective procedures for the approval of tariffs and by binding standards for customer switching processes, set by the regulatory authority.

As discrimination is already effectively addressed by these mechanisms, the introduction of additional unbundling requirements would be disproportionate. Therefore, we demur strongly to the establishing of dual regulative structures.

4. Recommended measures must be workable – avoiding bureaucracy

Some of the recommended measures will cause more bureaucracy and expenditure without measurable benefits. This is particularly the case for the extensive documentation requirements applying to all imaginable processes. „Mental“ unbundling and well-trained staff are much more important than the documentation of every single process where information is exchanged. For example, the decision of how and when further measures should be included in a certain quality management system must stay within the company. The same applies for the certification of these measures.

5. Exemptions for small distribution companies

Germany decided to apply exemptions for small distribution companies as provided in the directives 2003/54/EG and 2003/55/EG. Rules for legal and organisational unbundling do not apply for integrated electricity undertakings serving less than 100.000 connected customers. Due to the particular structure of German utility industry there is a variety of small and smallest companies, some of them highly efficient, who supply only a small share of customers. The situation of these companies is not considered in the ERGEG guidelines. Therefore the introductory part of the guidelines should clearly state that rules of operational unbundling may not apply to the above mentioned companies, if Member States decided to opt out of theses provisions when transposing the Directives into national law. Meeting additional organisational requirements for informational unbundling will impose a considerably administrative burden already for bigger companies. For smaller companies, the implementation of such organisational requirements will be impossible. For these companies, other ways of securing that information is properly ring-fenced must be provided.

Including Proposals for Amendments
by BGW, VDEW and VKU

Draft ERGEG Guidelines of Good Practice on Functional and Informational Unbundling - An ERGEG Public Consultation Paper

Ref: C06-CUB-12-04
Version 12
30-Apr-2007

Council of European Energy Regulators ASBL
28 rue le Titien, 1000 Bruxelles
Arrondissement judiciaire de Bruxelles
RPM 0861.035.445

Table of Contents

1 Introduction

The European Commission repeatedly points to the need for the second electricity and gas Directives to be implemented, not just in their letter but also in their spirit. In early 2006 the Commission signalled that if real progress did not develop and a true level planning field result, further measures such as full structural unbundling (i.e. separation of the supply and retail businesses from monopoly infrastructure) should be considered.

As stated in the findings of the European Commission's energy Sector Inquiry (10 January 2007), "it is essential to resolve the systemic conflict of interest inherent in the vertical integration of supply and network activities, which has resulted in a lack of investment and discrimination" and in their Strategic Energy Review (10 January 2007) the European Commission made a clear preference for ownership unbundling.

Unbundling, or the separation of network business (an essential facility) from the activities of production, supply and gas storage (which compete on the market) is a pre-requisite for effective competition and is therefore a key component of the liberalisation process. ERGEG regards the neutrality of network operators as one of the key issues for functioning wholesale and retail markets in gas and electricity.

The European Energy Regulators position on unbundling[1] and their reasoning is clear in the CEER comments on the European Commission's Energy Green Paper (C06-SEM-18-03), July 2006 and in the ERGEG response to the European Commission's Communication "An Energy Policy for Europe" (C06-BM-09-05), February 2007[2]. In principle, regulators consider ownership unbundling to be the preferred method. Of course, new legislation requires some time to come into force. The interim period is crucial until the comprehensive legal and regulatory framework with regard to unbundling arrangements is properly implemented. In the meantime the European energy regulators have prepared Guidelines for Good Practice in the context of the current legal framework which would assist the full implementation of the current legislation.

The present draft Guidelines on "Functional and Informational Unbundling" are what regulators consider is an appropriate way to realise functional unbundling under the **present** legal framework. As a subsequent step ERGEG advocates to integrate the unbundling requirements laid down in these Guidelines into quality standards and/or Corporate Governance Codices as proposed in Chapter 7. The Guidelines are drafted in a general way for both vertically integrated companies and network companies subject to functional and informational unbundling requirements.

The 2005 benchmarking report of the European Commission concluded that insufficient unbundling is one of the key factors responsible for limited retail competition in many markets. Likewise, the development of wholesale markets is impeded by relationships between TSOs

[1] www.ceer-eu.org/portal/page/portal/CEER_HOME/CEER_PUBLICATIONS/CEER_DOCUMENTS.

[2] http://www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG_DOCS/ERGEG_DOCUMENTS_NEW/Energy%20documents

and affiliated producers being too close or in the gas sector storage providers, producers or importers. The European Commission asked regulators to focus in particular on the issue of unbundling in their 2006 national reports. In ERGEG's assessment of the regulators' 2006 national reports, it found that insufficient unbundling as the most persistent impediment to competition in electricity and gas. ERGEG recommended a Regulation to define in detail minimum criteria for management and information unbundling, as well as monitoring and enforcement of unbundling including competencies for regulators to monitor cross border ownership links.

The CEER had already regarded unbundling as an area for priority action in their 2006 work programme. CEER work on the unbundling of accounts resulted in the development of ERGEG Guidelines for Good Practice on Regulatory Accounts unbundling (Ref: E05-CUB-11-02), following an ERGEG public consultation in 2006[3]. The current set of draft ERGEG Guidelines which are submitted for public consultation specifically deal with functional and informational unbundling, as required under the existing legislation.

The basis of the present Guidelines are the relevant provisions of the Electricity and Gas directives, which set out the minimum requirements of legal and functional unbundling of network operators, and the two interpretation notes of the European Commission on the unbundling regime[4] and on the role of regulators[5] respectively. The unbundling interpretation note highlights that the purpose of the unbundling provisions in the electricity and gas directives is to ensure non-discriminatory access to the network and to avoid conflicts of interest.

These Guidelines seek to establish Guidelines for Good Practice (GGP) on informational and functional unbundling by setting out a more detailed picture and giving precise guidance on how companies should comply with the unbundling requirements and how regulators shall monitor their compliance under the existing legal framework.

The importance of sufficient and effective unbundling

The risks and negative effects of insufficient unbundling of network and commercial activities, which are numerous and can seriously hamper competition and liberalisation, show that effective unbundling is a necessity and of crucial importance.

[3] Following a public consultation in 2006, ERGEG approved Guidelines of Good Practice on Regulatory Accounts Unbundling. View the ERGEG website for the Guidelines themselves and the Evaluation of the Comments received to the public consultation on accounts unbundling. http://www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG_PC/ARCHIVE1/GGP_ON_ACCOUNTS_UNBUNDLING

[4] Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, *The unbundling regime*, January 16, 2004.

[5] Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, *The role of the regulatory authorities*, January 14, 2004.

Vertical integration of different economic activities leads to (commercial) incentives for the network operators involved to give preferential treatment to their own upstream or downstream commercial branches in comparison to third parties. A vertically integrated company may have an economic interest in using its monopoly position as network operator to prevent or hinder competition in other areas of the value chain[6]. This can happen in many ways and distorts a level playing field. It also contributes to market foreclosure and gives rise to market entry barriers which hamper competition. Hence, incomplete unbundling lays the ground for discriminatory behaviour by vertically integrated network operators in favour of related companies and to the detriment of third parties. Consequently, insufficient unbundling can impede liberalisation and reduce its benefits.

Insufficient **compliance with the provisions of Directives 2003/54/EC and 2003/55/EC regarding** unbundling of network and commercial activities in vertically integrated companies, entails many risks, such as[7] :

Justification:

According to existing European and national law commercial incentives or preferential treatment of affiliated network customers is prohibited. By law the communication and information flow has to be strictly controlled, operational "Chinese walls" have to be set up etc... Further regulatory measures are not necessary, if national regulations are put into practice and enforced consistently.

- **Discrimination through unequal access to information**[8]. **If unbundling regulations are not strictly put into practice** ~~V~~**v**ertically integrated firms **can** have access to information which allows them to make strategic decision in ways in which their rivals cannot. ~~Thus~~ **In such cases** the danger of discrimination **can derive** due to:

    - a lack of transparency of information that should be publicly available in the market

    - privileged access of the commercial branch of the vertically integrated company (by reason of ~~shared physical locations~~, shared IT **systems without required access authorisation**, inefficiency of Chinese walls, etc.), including the risk of

[6] In several studies, vertical integration has been identified as a barrier to entry in itself and that the problem becomes even more onerous when a vertically integrated firm is also the incumbent and retains dominant positions in several energy markets.

[7] See among others:ERGEG's Assessment of the Development of the European Energy Market, 2006 (Ref: E06-MOR-02-03), 6 December 2006.
http://www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG_DOCS/NATIONAL_REPORTS/2006/E06-MOR-02-03_AssessmentReport_2006-12-06.pdf
The European Commission's report of the Sector Inquiry under Art. 17 Regulation 1/2003 on the gas and electricity markets, of 10 January, 2007.

[8] Especially in view of the problem of a lack of transparency due to which information is often not publicly available for the market.

access of the top management **of competitive undertakings** to strategic business information of the network operator (directly or through representation in boards);

- selective disclosure of information because of the commercial incentive for the network operator to provide certain information only to affiliated companies while withholding it from third parties;

Justification:

The wording of the guidelines suggests that no vertically integrated company has yet taken any measures to ensure the implementation of unbundling regulations. It alleges the same concerning government supervision. Informational unbundling provisions prohibit illegal exchange of information between the companies. But the overall strategy and financial supervision has to be the responsibility of the stakeholders and the respective top management as stipulated in the Directives. Shared physical location does not automatically mean violation of unbundling provisions. In many companies the day-to-day experience shows that the attitude of employees towards unbundling is much more important than locally separated working places. Accordingly, it is most important and effective to forcefully instruct and supervise staff as well as to establish management separation.

In case the legal requirement regarding the confidentiality or non-discriminatory disclosure of information is not yet fully implemented, it has to be improved and enforced by existing legal measures. If the Chinese walls are considered to be inefficient, they must be improved.

Moreover unbundling is not the only measure to ensure that discriminatory conduct is excluded. Notwithstanding the unbundling regulations German law imposes numerous obligations on energy undertakings (e. g. binding regulations for network access, for connection, calculation of tariffs). By all these means the undertakings are obliged to guarantee non-discriminatory third party access and connection to the system. Furthermore cross-subsidisation is excluded since costs are audited on the tariff setting and the procedure is supervised by the regulatory body. In Germany, there are also binding decisions of the regulatory authority concerning standard business processes (particularly customer switching processes). Furthermore they predefine contents, the data format as well as the point in time of electronic data exchange. These obligations make sure discriminatory conduct especially in customer switching processes will not take place.

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

- ~~**Increasing costs for rivals.** Vertically integrated companies may for instance increase the cost of bringing new generation capacity on line or make this *de facto* impossible by charging huge amounts for network extensions and reinforcements[9];~~

[9] Where rivals have no means to verify the validity of high costs for network reinforcement requested by the TSO or to verify validity of significant costs for connecting new power plants to the network.

Justification:

According to Art. 16 (Directives 2003/54/EC and 2003/55/EC) accounts have to be unbundled. In some countries additional external auditors make sure these rules are strictly obeyed to. Furthermore, tariffs have to be approved by regulatory authorities, before their entry into force. Therefore unbundling of accounts is cross checked on the occasion of approval of tariffs. Costs that arise from competitive undertakings will not be approved.

- **Discrimination by preferential treatment of related companies** in many respects, which cannot always be detected. For instance:
  - preferential treatment in nomination procedures, capacity allocations, access to available capacities on transit routes[10];
  - 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 (could also impact competitors' costs);
  - mainly with regard to DSOs:
    - 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 (e.g. metering information) or complicated administrative procedures in this respect (which can increase switching costs);
    - transfer of the image of the grid company to the supply business (branding);

Justification:

There are standard, transparent market rules set by the regulatory authorities or provided by national law for all issues mentioned above. Regulatory authorities verify compliance with these provisions and will fine any offences. First of all, there are standards drafted for capacity allocations and access to available capacities. German regulatory authorities enacted above-mentioned rules for electronic data exchange which ensure availability of accurate and timely information on actual and potential clients (e.g. metering information). It requires equal automatic procedures for the customer switching processes. Waiting times for rivals to get grid connections are already supervised, too.

[10] Where rivals often have no means to verify the validity of claims of congestion by the TSO (existence, location and degree of congestion is often not transparent).

Transparency of information is crucial for creating a level playing field. In order to make relevant information transparent especially for newcomers, in some countries like Germany new regulations for power plant connection are enacted. There are other rules that impose the obligation to publish certain information (e.g. in the internet), which can be and are enforced by national regulatory authorities. All these rules and obligations already exist and have to be taken into account while not becoming dispensable if ownership unbundling would be enacted.

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

  - that "shared services" are not provided at market based costs;
  - that decision making power on network related issues is delegated to a related commercial company (through Service Level Agreements);
  - 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~~ **shared services treat commercially sensitive and commercially advantageous** information ~~that~~ is strictly **in accordance with unbundling rules** ~~necessary is shared with these (sub)contractors~~ **and commits to** ~~under~~ strict confidentiality ~~clauses~~).

Justification:

The power of decision must remain with the network operator. This is true even or especially if the system operator outsources certain activities. Network operators have to be enabled to fulfil their tasks independently.

The effort of further unbundling measures would outweigh any improvements that can be achieved. It would lead to prohibition of shared services and therefore go far beyond the Directives.

It is prohibited that competitive entities receive preferential treatment concerning relevant information. The vertically integrated company or the system operator has to make sure that the compliance programme is extended especially to internal service providers. For external service providers it can be part of the contract or agreement.

General remark:

Regulatory authorities are responsible for fixing and approving terms and conditions for connection and access to national networks including tariffs. They ensure that tariffs are based on appropriate costs. Incentive based regulation will be introduced in Germany by 2009. Network operators will be benchmarked according to their efficiency. High costs will lead to worse results in the benchmarking process. Therefore, network operators will be under ongoing pressure to reduce their costs. On the contrary, this will result in the network operator putting pressure on shared services to increase their efficiency. Otherwise the network operator will change his service providers.

The concept of effective unbundling

The main role of the network company in relation to the competitive business is to serve as a market facilitator. It is therefore important to further define what effective unbundling means or what should be achieved by unbundling in order to be effective.

In ERGEG's view effective unbundling implies:

- to effectively ensure non discriminatory access to networks, by excluding any possibility of discrimination of network users and to take away any (commercial) incentive for the network operators to give preferential treatment to related companies. This includes:
    - non-discriminatory access to the network for all potential users;
    - non-discriminatory access for all network users to information on network-related issues;
    - correct incentives for managers and employees to act accordingly;
- to effectively ensure that network operators act in full independence of any commercial interests in the market to avoid any conflict of interest;
    - incentives for managers and employees to act independently;
    - full sovereignty of the network operators in decision making;
    - services from related companies to the network operators must at all times be provided at market based cost;
- to effectively monitor and enforce unbundling: precise written processes and procedures which effectively secure unbundling.

~~Different models are possible to implement unbundling in practice~~

- ~~Ownership unbundling: where the network company is in separate ownership and has no commercial interests in the potentially competitive parts of the market. This ensures that network companies operate their networks transparently in a truly independent way and do not have a commercial incentive to abuse their privileged position in the market place.~~
- ~~Structural separation of system operation: in the US, Britain, Italy and other countries structural separation of the system operation functions of TSOs has been applied. The Regional Transmission Operator (RTO) model in the US and the BETTA model in Britain require the separation of transmission asset ownership and management from system operation and those other areas of TSO activity which relate directly to network users.~~
- ~~Information ring fencing and oversight as well as management unbundling is one mechanism which can help to reduce the possibilities of discrimination against network users.~~

~~As for the risks and negative effects of insufficient unbundling set out above, it is to be noted that legal and functional unbundling measures (without ownership unbundling) render discriminatory practices in the exploitation of the network monopoly more difficult, but do not eliminate the incentives for vertically integrated companies to engage in such conduct. Even if the unbundling provisions of the Directives are fully implemented, there can still be incentives for preferential treatment within vertically integrated network operators.~~

~~In principle ownership unbundling, i.e. separation of network companies, both transmission and distribution, and their services form commercial activities, linked to energy supply, would solve unbundling problems which exist in many countries today. However, at present most companies are still vertically integrated.~~

~~Many problems in functional and informational unbundling would not be relevant in situations of ownership unbundling. The second best solution which is provided by the directives stipulates legally unbundled network operators. This would ideally entail network companies which own their assets, which do not share services with mother or sister companies and which tender all external services and products. However, in practice this does not seem to have been implemented in the majority of network companies in EU Member States. The proposed Guidelines therefore try to tackle problems of functional and informational unbundling, where these criteria are not met. The goal is to mimic as closely as possible the effects of ownership unbundling on TSO and DSO behaviour. Where ownership unbundling has been implemented the following Guidelines therefore do not apply.~~

Justification:

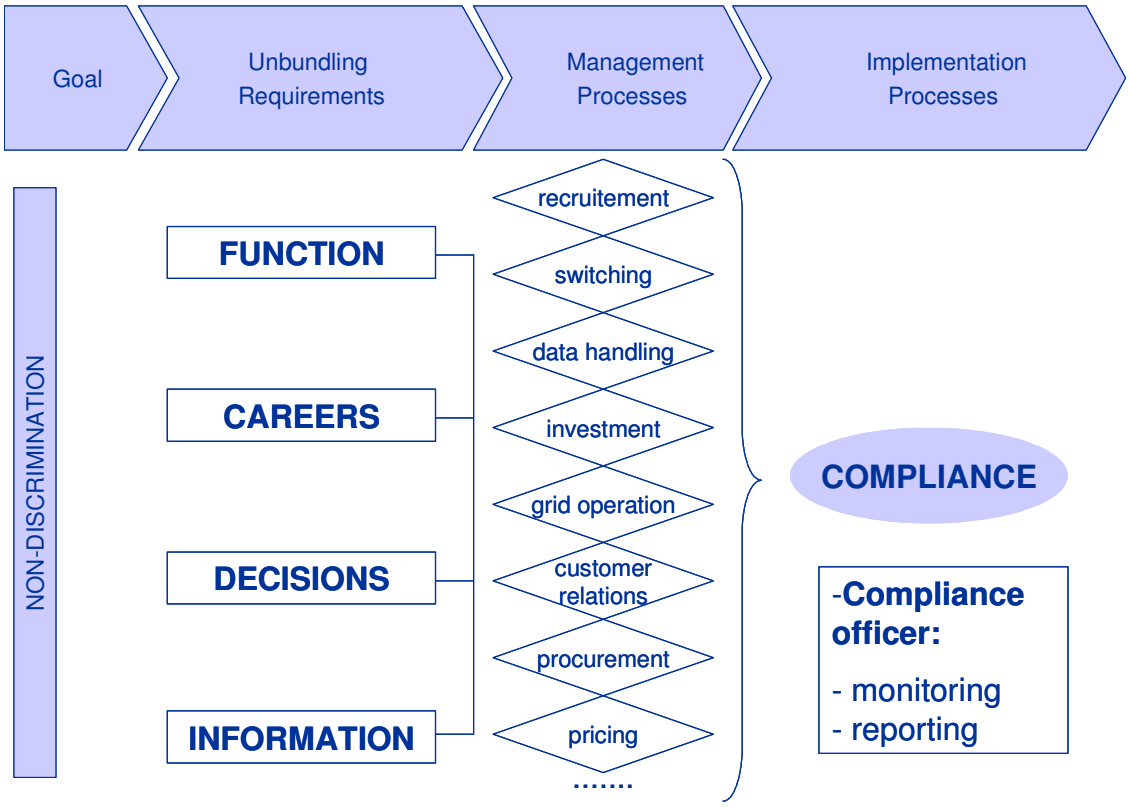
Undoubtedly, the implementation of the unbundling provisions requires still further efforts. There is, however, one general remark on many of the assumptions based on the results of the Sector Inquiry: The legal unbundling provisions for distribution system operators are to be transposed by July 1st, 2007. Just as well the German Energy Economy Act (EnWG) which transposes the directives 2003/54/EC and 2003/55/EC entered into force only on July 13th, 2005. But all data processed in the framework of the Sector Inquiry does not take into account these developments. Thus, conclusions and deriving recommendations from this historical data should take into account the changed legal framework and the adaptation of companies to this framework .

Although, in the introductory part (section 1, page 8) of the current Draft Guidelines it is noted that regulatory authorities consider its provisions in line with the present legal framework, the guidelines exceed this framework to some extent. This is especially the case when regarding the main objective of the guidelines, namely the “mimicking of ownership unbundling”. There is no legal base for this objective, as the unbundling requirements currently in force only provide the neutral management of the networks, regardless of their ownership structure.

In the introductory part of the Draft Guidelines the advantages of ownership unbundling are extensively emphasised. But whether ownership unbundling will in practice lead to more competition is an open question. It still has not been empirically proven that ownership unbundling leads to the alleged advantages like higher investments in the network infrastructure, lower network access charges, improved security of supply or higher switching rates. Considering the concerns regarding constitutional law and the absence of sound economic estimations for the consequences of ownership unbundling, the national laws currently in force should have the chance to make their impact feel first.

Systematic Concept of Functional and Informational Unbundling

The following graph sets out the concept of the Guidelines on functional and informational unbundling. The main principle is that processes have to be defined by setting out the rules on how to make decisions, who shall play which role in decision making, what shall be the management criteria etc. and finally how decisions shall be implemented by employees as well as how their implementation shall be monitored and enforced in the network company.



2 Unbundling of functions

The Electricity and Gas Directives provide that: *"those persons responsible for the management of the transmission [respectively distribution] system operator may not participate in company structures of the integrated electricity or gas undertaking responsible, directly or indirectly, for the day-to-day operation of the generation (for electricity) or production (for natural gas), distribution [respectively transmission] and supply of electricity or natural gas".*

Generation, production and supply of energy are hereafter the "competitive business" of a vertically integrated company. Unbundling of functions implies that the management of the system operator shall not be involved in any competitive business of the vertically integrated company. The competitive sectors must neither participate in the daily business of the system operator nor receive information concerning other issues on the management of their own clients or grid information that is publicly available.

G01: ~~The management of the system operator shall work in a geographically separated structure from the competitive business structures.~~ **The objective of the directives is to prevent access to network information by the employees of the competitive business, which would result in a competitive advantage for this business unit. Therefore clear rules for access and data security have to be established.**

Justification:

Geographical separation is not necessary. Other measures such as access rights have to be considered as equal to physical separation. Clear rules for access and data security (such as locking offices or filing cabinets) have to be established and are a much more efficient way to achieve the above-named objective. Moreover, well-trained staff and "mental" unbundling are the relevant preconditions rather than separate locations.

G02: The system operator must have enough financial and personnel resources to ensure real decision making power and his independence. He must also be free to choose his. The system operator that employs personnel of the vertically integrated company must before define the profile of the employees he needs and must not accept the personnel sent by the vertically integrated company that don't match with this profile.

G03: Personal identity of the management of the system operator with the management of a competitive business unit, wherever they might be located (Holding or affiliated company), shall be prohibited.

G04: The management and the employees of the system operator ~~shall not participate in any internal group activities of the vertically integrated company, in which~~ **must not supply the competitive business with or disclose** information **that** can give an advantage to the competitive business. **This is true especially for any internal group activities of the vertically integrated company.**

Justification:

ERGEG has pointed out the danger that network operators do not comply with the obligation to treat relevant information confidentially. But disobedience by the staff will be prevented by means of labour law already. Employees that do not comply with their duties will have to face sanctions. The basic assumption is that employees will normally follow the instructions. Random control should verify this assumption.

It is important that managers or employees of the network operators are properly trained and aware of the fact that disclosure of protected information can lead to legal consequences. Still it should be allowed for any competitive business (inside or outside the group) to ask for advice in network-related questions. German Company Law also demands a consistent corporate management and governance considering both sides – network and competitive business. Of course measures have to be taken as to ensure that no legally protected information is passed on the competitive business. This can be achieved by separating working groups whose information can be aggregated on corporate level.

G05: The **issue of shareholding by 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~~ **be addressed in such a way as to ensure** his independence**. This includes measures prohibiting a considerable part of the payment being dependent on the result of the vertically integrated company.**

Justification:

This measure is disproportionate and discredits the persons working in the electricity sector in an unacceptable manner. It interferes with general ownership rights. Furthermore, it is very difficult to see how it could be implemented in practice. Provided independence can be guaranteed by way of observing the rules of the compliance programme, employees and management of the system operator should be able to hold and buy shares of the holding company.

Moreover, this postulation goes far beyond the Directives and the Note of DG Energy & Transport on the unbundling regime of the Directives 2003/54/EC and 2003/55/EC on the internal Market in Electricity and natural Gas (16.1.2004) which states: “Equally, the issue of shareholding on a personal basis of the management of the network company needs to be addressed in a way that ensures the independence of management. The concern is that if, for instance, executive directors of the network company own many shares of the related supply/production company, conflicts of interests arise.”

Clearly, the commission has assumed that shareholding is possible but has to be monitored closely. Otherwise a general prohibition of shareholding for the management of system operators of any competitive business would have to be the compulsory consequence.

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.

Justification:

The supervisory function of the parent company is not restricted to securing its financial interest. A number of other activities are also associated with this function, e.g. the assignment of management, the fulfilment of statutory obligations such as health and safety and the adoption of strategic decisions such as how to fulfil the requirements of incentive regulations.

3 Unbundling of professional interest

The Electricity and Gas directives provide that "*appropriate measures must be taken to ensure that the professional interests of the persons responsible for the management of the transmission and distribution system operator (…) are taken into account in a manner that ensures that they are capable of acting independently"*.

This paragraph concerns the additional measures to legal unbundling to ensure the independence of the management of the system operator (Transmission/Distribution) and concerns both legally unbundled and not legally unbundled system operators.

The goal of the following measures is to allow the management of the system operator to act independently and guaranty its decision making power for grid related issues. A way to fulfil this aim is to guarantee the professional interest of the management of the system operator ~~and other employees~~ and introduce therefore specific stipulations in their contract of employment.

G07: When a person employed in an affiliated company is assigned **as a person responsible for the management of the transmission and distribution system operator** to a regulated subsidiary of the group, ~~it is necessary, either for the employee~~ **this person has** to sign a new employment contract with this subsidiary**.** ~~, or for the company he belongs to, to sign a contract with the subsidiary to define the conditions of the assignment. In this second situation, an amendment will be signed to the employment contract of the person. In both cases, the contract or the amendment will clearly define the assignment conditions to guaranty the professional interest of the employee. If the assignment is not to a subsidiary but to a regulated department of the vertically integrated company (not legally unbundled), an amendment to the employment contract must be written down defining the assignment conditions to guaranty the professional interest.~~

G08: The assignment conditions of the management ~~and employees~~ of the system operator shall in particular, specify the following items:

~~a. During the period of assignment, the employee shall be subject only to the authority of the management of the regulated entity.~~

b. Wages and incentives ~~are exclusively~~ **must not be considerably** based on the results of the ~~system operator~~ **vertically integrated company**.

c. Promotions and sanctions **concerning the management of the system operator** during the assignment can be only decided by the ~~management~~ **responsible company organ** of the system operator.

~~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.~~

e. The conditions of the return of ~~an employee~~ **persons responsible for the management** 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.

f. For the implementation of point 3e, the employment contract shall foresee that if the ~~employee~~ **persons responsible for the management of the system operator** 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. **It will also be satisfactory if he signs a non-disclosure agreement**.

~~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.~~

Justification:

Chapter 3 does not distinguish properly between persons responsible for the management of the system operator on one the one hand side and other employees on the other hand side as would be necessary. In case the proposals of the Guidelines are meant to be applicable not only to the management but also to other employees they go far beyond Art. 15 and 10 para. 2 lit. a of the Directives, if these employees have no power of decision These Articles are designed only for the management of the network operator and not for all employees occupied with network issues.

Activities related to the network operator with little or no impact on non-discriminatory access to the assets do not inevitably have to be carried out by the network operator itself but can be delegated to other internal or external service providers. Further regulations should for this reason apply to the management only. Moreover, these issues are subject to national employment law. Further regulations for employees are at least in Germany not necessary.

The provisions of present law require to address measures, which prohibit that a considerable part of the payment will be dependent on the result of the vertically integrated company. These rules do not demand a complete disconnection. Naturally vertically integrated companies must not elude the law by constantly transferring staff from the network system operator to the competitive entries.

To prevent any employee to work is not acceptable, however, because it would mean deep interference with private business without added value and create bureaucracy. It is sufficient if the relevant person signs a non-disclosure agreement. Otherwise, this rule has to be applied for persons coming from other grid companies too.

Additional measures to reinforce functional unbundling concerning customer relations:

Customer relations between the system operator and suppliers are a fundamental element of functional unbundling as they mirror internal independence of the network business from the vertically integrated company. Customers must be ~~convinced~~ **informed** of the separation of the system entity and energy suppliers. It must be clear for customers that the system operator is a neutral entity separated from any supply activities with the task to provide access to all energy suppliers in an equal manner. The customer must not believe that the integrated supplier is more reliable because of his closeness to the integrated grid and fear therefore to change his supplier. The affiliated supplier shall not benefit from the public credibility or reliability of the system operator. This must be assured through separate marketing activities. Credibility from the perspective of the customer is a key to functional unbundling.

G09: Network companies shall have their own identity~~; nothing shall imply a link from the system operator to the supply business~~. This involves **to as** clearly **as possible** 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).

Justification:

Of course customers have to be **informed** of the separation of the system entity and energy supplier. It must be clear for customers that the system operator is a neutral separated entity. Information of customers needs to be designed in a way that network operators appear as independent companies and that customers who wish to contact the system operator will not be referred to the energy supplier. However, it should not be the objective to convince customers that there is no connection between associated companies. Customers are mature enough to make their choice in full knowledge of all conditions.

Moreover, this postulation goes far beyond the Note of DG Energy & Transport on the unbundling regime of the Directives 2003/54/EC and 2003/55/EC on the internal Market in Electricity and natural Gas (16.1.2004). which states: ”It seems appropriate to look at this issue on a case by case basis. If common services are permitted it shall be required in any case that certain conditions are fulfilled, to reduce competition concerns and exclude conflicts of interest.”

Shared callcenter are not prohibited by current legislation, if certain requirements are fulfilled. Even the Interpreting note of DG TREN acknowledged that a requirement to systematically duplicate such common services would significantly increase costs without bringing corresponding additional benefits.

4 Unbundling of decisions

The Electricity and Gas Directives *provide that the distribution/transmission system operator shall have effective decision-making rights, independent from the integrated electricity undertaking, with respect to assets necessary to operate, maintain or develop the network. This should not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect to return on assets, regulated indirectly in accordance with Article 23(2), in a subsidiary are protected. In particular this shall enable the parent company to approve the annual financial plan, or any equivalent instrument, of the distribution/transmission system operator and to set global limits on the levels of indebtedness of its subsidiary. It shall not permit the parent company to give instructions regarding day-to-day operations, nor with respect to individual decisions concerning the construction or upgrading of distribution lines, that do not exceed the terms of the approved financial plan, or any equivalent instrument.*

Ensuring the ability to implement effective decision making processes in transmission and/or distribution companies, even if they are part of vertically integrated units, is one of the essential measures in support of unbundling processes.

Independent decisions

Ensuring effective decision making rights for transmission and distribution operators means that decisions must be made independently from vertically integrated units. The fields of decision relate to assets (physical assets as well as human capital) necessary for operating, maintaining or developing the network..

Effective decision making rights

Effective decision making rights entail the following requirements:

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, **beyond exercise of appropriate co-ordination mechanisms to ensure the economic and management supervision rights granted by Art. 10 and 15 of the Directives**.

Justification:

Operative decisions concerning day-to-day business have to be made by the management of the network company. However, according to Art. 10 and 15 of the Directives strategic decisions have significant impact on the financial supervision of the parent company have to be made by the management of the parent company.

G11: The network company shall **have enough human and physical resources** at its disposal to carry out its work and decide independently from other parts of the integrated company. This includes having enough resources to prepare decisions, to evaluate alternatives and to be assisted by external consultancy.

Network companies directly employing only management will have to rely on information provided by employees of affiliated companies with the potential consequence that they do not dispose of any credible disciplinary measures in order to enforce management decisions. It is hardly conceivable to act independently from the mother company when the majority of the workforce depends on essential decisions of the mother 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.~~

Justification:

Activities related to the network operator with little or no impact on non-discriminatory access to the assets do not inevitably have to be carried out by the network operator itself but can be delegated to other internal or external service providers. Moreover these issues are subject to national employment law. Further regulations for employees are at least in Germany not necessary. All this leads to the conclusion that there is no need to restrict leasing, under those terms, to pure maintenance.

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.

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 **which is not concerning profitability and the management supervision rights** within the scope of the approved financial plans (or equivalent) must not be subject to further consultation or approval of the parent company.

Justification:

The supervisory function of the parent company is not restricted to securing its financial interest. According to Art. 15 of the Directives vertically integrated companies are allowed to establish appropriate co-ordination mechanisms to ensure the economic and management supervisory rights of the company. The effective decision-making rights do not interfere with the management supervision rights of the vertically integrated companies.

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~~ **require an affirmation** on any individual investment, ~~whatever its cost~~ **beyond the approved financial plans (or equivalent).**

Justification:

If an individual investment is not in line with the financial plan due to its cost, it has to be approved separately by the supervisory board. Thus, the general clause “whatever its costs” must be deleted. Investment is accepted by the parent company whatever the amount provided this amount stays within the limits of the financial plan.

It should be possible to budget a certain amount in the financial plan. This amount must on the other hand not be kept down in a manner that it will lead to interference in day-to-day business.

5 Unbundling of Information

The Electricity and Gas Directives *provide that without prejudice to Article 18 or any other legal duty to disclose information, the distribution/transmission system operator must preserve the confidentiality of commercially sensitive information obtained in the course of carrying out its business, and shall prevent information about its own activities which may be commercially advantageous being disclosed in a discriminatory manner.*

Unbundling of information is concerned with the publication of data, respecting data protection rules and non-discriminatory access to data. With regard to transparency of information ERGEG[11] considers that information shall generally be made available to market participants unless there is a clear reason against it (e.g. in cases of legitimate commercial reservations or system security issues), or it is a proven fact that the cost of providing the information is significantly higher than the expected benefit. Concerning unbundling the confidentiality and disclosure of information have to be specified in a well defined data management system in order to avoid any discrimination.

5.1 General Guidelines

The following table lists the different kinds of information, their respective handling principles as well as general procedural solutions.

	Third party information	**Generic network information**
Definition	**Commercially sensitive Information**	**Commercially advantageous Information**
Treatment	**Confidentiality (Disclosure upon agreement)**	**Non-discriminatory Disclosure**
Non-discriminatory implementation	**Data access rules**	**Rules for data disclosure**

Third party information

Third party information (information which does not belong to the network company), obtained by the grid operators in the course of carrying out their business, is very often confidential and classified as commercially sensitive information. As a matter of principle confidentiality has to be respected except in the case where the data owner (third party) agrees to disclosure (general or specific addressees). Data access rules have to be established so that contract partners can get access to the data on equal terms such as time, procedures, cost, and quality. Informational unbundling has to respect data protection law, where the person in possession of confidential information is obliged to a specific behaviour.

[11] See ERGEG Guidelines for Good Practice on Information Management and Transparency (ref. E05-EMK-06-10), 2 August 2006.http://www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG_PC/GGP_Transparency

The following list of possibly confidential information is neither exhaustive (it depends on the role of the network company which information it receives) nor mandatory (information can be classified "non-confidential" in the case of the consent of the data owners):

- Financial and technical conditions of grid access (individual grid access contracts).
- Financial and other conditions of energy supply (individual energy supply contracts, such as interruptibility,…).
- Metering data, load profile and load forecast of the clients (enabling suppliers to set up tailor made products).
- Inactive and planned new connections to the grid (reducing acquisition cost).
- Name, address and bank account details of the client (reducing acquisition cost).
- Billing records (giving information on good/bad customer behaviour).
- Participation in capacity allocation procedures (revealing potential alternative suppliers).

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

G18: If required for the transparency and functioning of the system, the network operator has to seek agreement of data owners for general data disclosure.

G19: For such data **that is particularly important in order to operate the network in a non-discriminatory way** 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.

Justification:

Vertically integrated companies have to stipulate clear and precise rules for data processing as well as data access to make sure that confidentiality is respected and that equal, well specified and non-discriminatory access of contract partners (or non-discriminatory disclosure) is guaranteed. Companies have to choose their own way to implement a proper method, since there is not only one solution applicable in all situations. Important is that there is the possibility to implement an electronic system without there being an obligation to do so.

The current draft Guidelines covers all imaginable information and will cause more bureaucracy and expenditure without measurable benefits. This is particularly the case for the extensive documentation requirements applying to all processes without exception. Therefore the main issues should be „mental" unbundling and well-trained staff. These are much more important than the documentation of every single process where information is exchanged.

Generic network information

Some information resulting from operating the network may be commercially advantageous. Therefore, if disclosed, non-discriminatory access has to be guaranteed.

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

G21: For these data the network company shall define whether they are to be disclosed or not (respecting the transparency needs of the market).

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.

5.2 Guidelines on information management

Necessary data processes will vary between Member States as they depend (partly) on the market models in place.

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.~~ **Internal business processes which are vital in order to pass on information in a non-discriminatory way should be well defined and in written form. This is particularly true for ~~the following~~ processes such as the switching process that are relevant for non-discriminatory behaviour of the system operator:**

Justification:

Bureaucratic efforts have to be reduced as much as possible. It is nearly impossible and has numerous disadvantages to write down all possible commercially advantageous or sensitive information. Clarifying “crucial” processes and putting them under sufficient internal control is essential. This is the reason for the listing above. The German regulatory authority has enacted binding regulatory standards for electronic data exchange. It regulates all procedures connected with the switching process including timing and data type. The German regulatory authorities have mentioned the following processes as crucial:

- grid connection for energy input and output
- calculation of access tariff
- technical issues of access to the system
- planned and unplanned grid maintenance work
- calculation of grid capacity and power flow studies
- processes of access to the grid
- extension of the grid
- extension of capacity
- demand of compression for better workload

G24: The best practice to comply with these requirements would be to separate databases for the network and competitive **business, or to establish non-discriminatory access to such data**. This would allow each market participant to have equal access to information.

The processes have to guarantee confidentiality and equal access to information for all market participants. Equal treatment includes the content of information, the timelines of provision, updating, data formats used as well as prices for accessing the information.

Commercially advantageous ~~i~~information remains confidential (confidentiality has to be ensured by the network operator) until it has been disclosed.

The processes handle the management of information from their creation to data processing, updating, access rules and formats, prices, protocols, monitoring, reporting and training.

Justification:

To establish non-discriminatory access to relevant data is an equally effective but for some companies more efficient way and should therefore be mentioned.

6 Compliance programme

The Electricity and Gas directives *provide that the distribution system operator shall establish a compliance programme, which sets out measures to ensure that discriminatory conduct is excluded, and ensure that its observance is adequately monitored. The programme shall set out the specific obligations of employees to meet this objective.*

The vertically integrated company or the system operator shall create a framework (compliance programme) for the employees and management of the company dealing with network tasks. This must however not be limited to employees of the network system operator entity, and shall be extended to internal ~~or external~~ service providers. **For external service providers the obligation of confidentiality can be implemented in contracts or agreements.**

Justification:

According to the legislation , the compliance programme addresses employees of a vertically integrated company. Confidentiality of external service providers can be guarantied by signing adequate contracts or agreements.

This programme should be implemented and improved within the company under the supervision of a designated person or body (hereinafter "compliance officer").The compliance programme shall have the status of a management directive or an equivalent rule in the corporate culture. It has to be a legally binding part of the employees' obligations. The main target of the compliance programme is to secure the implementation of the established unbundled processes in the company.

In practice, the system operator **or the vertically integrated company** should implement the compliance programme ~~annually~~ through the following stages:

(a) Design
G25: The vertically integrated company as well as the system operator identify all **relevant** processes to be examined within **the implementation of** the compliance programme. This will be undertaken by, or at least in cooperation with, the compliance officer~~. All processes have to be defined in written form. The processes are part of the compliance programme.~~ The processes will define the behaviour of employees in relation to customers, employees of other parts of the integrated company and third companies. The data management system is one of these processes.

Justification:

Bureaucratic efforts have to be reduced as much as possible. To write down all thinkable processes is nearly impossible and has numerous disadvantages. Employees need detailed knowledge only of processes relevant to them. Particularly in bigger companies it will exceed the sensible scope of compliance programmes if all processes are listed in detail. Furthermore processes are often changed. This would lead to permanent new editions of the programme and thus to inefficient effort and extra expense. The compliance programme should only be modified if relevant amendments of structure or organisation in the company.

(b) Implementation

G26: The vertically integrated company as well as the system operator ensure compliance with the processes by its employees. They will train employees in the processes they are involved in and make these processes binding. Adequate internal measures in case of non-compliance have to be defined.

(c) Assessment

G27: The compliance officer monitors and assesses the processes, compares them to the requirements set in the law and regulations and draws up reports on the results. To do so he is provided with all the necessary information and adequate resources. Internal mandatory Guidelines of the network operator oblige employees to support the Compliance Officer in fulfilling his tasks.

(d) Development

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

Justification:

It is not the compliance officer taking the corrective measures regarding any areas of non compliance with the compliance programme that he might identify. The corrective measures themselves are a matter for the network business or the vertically integrated company.

(e) Reporting

G29: As a result of the assessment and development stage, the compliance officer shall draw up an annual public report, publish it and submit it to the regulatory authority (details see G33).

Compliance officer

The vertically integrated company or the system operator shall appoint a person or a body as a compliance officer to monitor the implementation of the "compliance programme" in the vertically integrated company. The compliance officer can also have the competence to *implement* the compliance programme in the company (Drafting and publication of the compliance programme; defining measures to implement compliance; enforcing the compliance programme …etc). The responsibility for an effective compliance programme remains however with the management.

The compliance officer should have direct access to the management. He must also have relevant experience to decide which areas have to be monitored in particular.

G30: The contact details of the compliance officer, such as name, address, e-mail, phone number, have to be published in the compliance programme and communicated to all employees of the vertically integrated company in the ways generally applied (such as Intranet etc.). As a matter of principle any employee in the company shall have easy access to the compliance officer in case of discrimination or non-compliance or related disputes.

In order to undertake his mission in a proper way the following Guideline shall be observed:

G31: The compliance officer shall be guaranteed the necessary independence by the management in his employment contract ~~and~~ **or** through the compliance programme. He shall be trained properly in all aspects necessary for the job. He shall be equipped with the resources necessary to accomplish his mission.

Competences of the compliance officer

G32: In order to monitor the compliance programme in an appropriate manner, the compliance officer shall receive the following competencies (renumeration **which** ~~to~~ **can** be integrated in his employment contract **or be part of the compliance programme**):

- Elaboration and improvement of the compliance programme (if possible enforcement).
- Control of compliance of the employees and management with the obligation of non-discrimination and equal treatment of customers through random sampling in the company.
- Unrestricted access to all data, documents and offices in the company.
- Right to request support in order to assess all processes **with regard to their relevance for potential discrimination.**
- Organisation of training on compliance issues in the company.
- **Organisation of** Instruction of new employees.
- Right to propose to the management disciplinary sanction in case of violation of the compliance programme in accordance with internal guidelines.
- Direct access to the management.

Justification:

Adapting the labour contract of the person who becomes compliance officer (when taking on this position and leaving this position) would produce unnecessary complexity. It is sufficient ensuring his independence by the binding compliance programme. Furthermore his field of activity should be limited to processes which have relevance for non-discriminatory network operation.

Report

As a conclusion of the monitoring and development stage, the compliance officer shall draw up an annual public report on the result of the monitoring of the compliance programme. The report must provide real insight into daily processes in the company and inform about the effort made by the vertically integrated company to comply with the programme in its daily business.

G33: The report must inform the regulator on the following issues:

- Promulgation of the compliance programme within the company (How were employees informed about the compliance programme? Did they receive a personal copy? Did they have to confirm the receipt of the programme with their signature making it a binding rule?)
- Training of the employees (How was training organised, by whom and on which issues?)

- Report on all incidents (Have sanctions been imposed? Has the compliance officer been involved in the procedure?)
- Cooperation with the management (Has the compliance officer been supported by the management? If yes how?)
- Consultation of the compliance officer (Has the compliance officer been consulted? If yes, on which issues?)
- Presentation of the result of potential process analysis

The report must be signed by the director of the company, published and submitted to the regulator. The regulator can write an annual report on the monitoring of the compliance programme and the compliance report.

7 Invitation to Interested Parties to Comment

ERGEG invites stakeholders to comment on issues raised in this paper and in particular on the recommendations and issues for consultation pointed out in the document.

Responses should be received by 26th June 2007 and sent by email to:
ergeg-unbundling@ergeg.org.

Any questions on this document should, in the first instance, be directed to:

Mrs. Fay Geitona
Secretary General
CEER
Rue le Titien 28
1000 Brussels
Belgium
Tel.: +32 2 788 73 32
Fax: +32 2 788 73 50
E-mail : fay.geitona@ceer-eu.org

Unless marked as confidential all responses will be published by placing them on the ERGEG website. If there is anything confidential please include it in a separate annex to your main response.

8 Recommendation and Issues for Consultation

The ERGEG invites stakeholders to comment on issues raised in the text. The main issues tackled in 33 Guidelines are:

- To guarantee non-discriminatory behaviour.
- To establish adequate "Chinese walls" within integrated companies.
- To clarify incentives of the management and employees to behave as an independent network company.

Specifically ERGEG would like responses to the following questions:

1. General: Do you think that these Guidelines are sufficient to guarantee a level playing field in view of vertically integrated companies?

While system operators generally support European efforts to harmonize energy markets, they do not consider the present Guidelines of Good Practice as necessary. In their opinion the requirements laid down in the existing Directives are sufficient. The present Guidelines tabled by ERGEG contain in many cases highly detailed and wide-ranging proposals. However, compared to the existing legal framework they are not of recognizable additional use for customers but may lead to an overregulation which will be detrimental to market participants in terms of costs and additional need for organisation/management (e.g.separate IT-systems, inappropriate limitations of shared services arrangements etc.).

Summing up, it is to be reiterated that the existing Directives and their implementation in German Law include sufficient requirements so as to serve as a basis to form a level playing field on the European energy market. A consistent implementation renders additional regulations dispensable.

2. Are unbundling requirements already today included in Corporate Governance Guidelines or your Quality Management Systems?

The European Directives on gas and electricity have been transposed into German law (German Energy Industry Act: EnWG - Energiewirtschaftsgesetz). The compliance programme in particular is understood by system operators as a type of corporate governance guideline.

Hence, rules and guidelines do exist and they need to be implemented. Additional interpretatory remarks from ERGEG may be useful. Results of the implementation process should be awaited and analysed before initiating further steps such as the compulsory introduction of a quality management system.

Do you think that these measures may harmonize implementation of unbundling in Europe?

The above-mentioned associations acknowledge that Guidelines of Good Practice contribute to the effective and equal implementation of the unbundling provisions in all Member States. Nevertheless, the Guidelines must be in line with the provisions of the national and European legal framework and must not lead to the establishing of dual regulation structures.

3. G06: Does unbundling in your view necessitate a restriction of information flows to the mother company further than those necessary for a pure financial investor?

In view of the already significant limitations to the exchange of information within vertically integrated energy companies there is no need for further tightening of legal requirements. Any additional limitation of the flow of information would be problematic as far as general commercial law is concerned. The mother company is legally required to ensure long term profitability of the company. It needs sufficient information to take strategic financial decisions so as to fulfil this legal requirement.

Do you experience conflicts of governance regulations in your country with unbundling requirements?

In Germany tensions exist between the unbundling requirements and a certain number of other laws. In particular, this regards general corporate law, data privacy laws and labour law.

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?

Such a requirement seems problematic given the legal duties of the members of a supervisory board. They are entitled to have access to certain information so as to fulfil their supervisory function. A limitation would give rise to concerns regarding liability aspects.

4. G08: Do you think that these rules can guarantee the independence of the management and employees?

There is no need for such a rule since the national law transposing the directives already contains requirements which ensure the independence of the management (§ 8 para. 3 of the German Energy Industry Act).

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?

Such a prohibition could be problematic considering the freedom to exercise a profession which is guaranteed by the German constitution. In addition, a transfer from the network company to the competitive business and vice versa is also possible between different groups of companies. It is also for this reason that the freedom to exercise a profession should not be limited. Rather, obligations to maintain confidentiality such as they follow from the compliance programme are to be considered as sufficient. Possible infringements are to be dealt with in the framework of labour law. In any case they would not justify a prohibition to exercise a profession for reasons of precaution.

9 Next step

This paper sets out ERGEG's draft Guidelines on Functional and Informational Unbundling. In ERGEG's view the proposed Guidelines are an intermediate step. Unbundling requirements are part of national and European law which influence corporate governance. Compliance should be ensured for example by integrating these unbundling requirements into European or/and national Corporate Governance Codes[12]. Operational unbundling and confidentiality of information define new obligations on the management level and will have consequences in case of non-observance.

A corporate governance Codes contains essential obligations for the management and supervision of listed companies as well as internationally and nationally recognised standards of good and responsible governance. They also aim at making the system transparent and understandable which is an essential goal for vertically integrated companies. The purpose of these codes to so promote the trust of customers, financial markets, employees and the public in the management and supervision of companies and vertically integrated companies in particular.

On the other hand, these Guidelines on Functional and Informational Unbundling should be integrated into regular Quality Management Processes within the companies where appropriate. The "ISO 9001 Norm" is the best known but not the only quality standard that certifies:

- the ability to consistently provide products that meet customer and applicable statutory requirements, and

- an effective application of a Quality Management system, including processes for continual improvement of the system and the assurance of conformity to customer and applicable regulatory requirements.

On the basis of this paper, ERGEG proposes to integrate the following measures (as quality management principles) into a Quality Standard in the near future to be applicable to all vertically integrated gas and electricity companies:

- non-discrimination between customers;
- measures relating to compliance programmes;
- process standards that guarantee confidentiality of information;
- process standards for transparent disclosure of information in a non-discriminatory way;
- training on unbundling requirements for employees and external service providers.

[12] Corporate governance is concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders.

On a European level DG Internal Market chairs a European corporate governance high level group (forum) which proposed to change in particular the 4th Directive 78/660 to harmonise the national corporate governance codes Measures mentioned in the draft Directives should improve compliance in the company through transparent disclosure of information, enhance communication with the shareholders, establish an appropriate remuneration of the managers, and improve the responsibility of the board of directors.

These next steps are in line with the Commission's statement in the 2004 note on Unbundling, that "additional measures" should be adopted to reinforce functional and informational unbundling. An adequate way to provide it is for national regulators to issue common positions on functional and informational unbundling to be integrated in a corporate governance codes and/or in ~~a~~ **existing** Quality Management ~~certification~~ **or equivalent systems**. These measures will not exempt companies from regulatory inspection on unbundling issues, but it will help minimize the necessity of regulators intervention, provide a clear reference for regulatory inspection and the broadest possible predictability of the outcome of these monitoring activities.

Justification:

Not all undertakings certify their Quality Management. To establish such certification systems will give rise to additional costs. Hence, the decision how to guarantee efficient application of the unbundling regulations has to lie with the company itself. The proposed regulations must not become compulsory for all companies.

References:

[1] DIRECTIVE 2003/54/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC.

[2] REGULATION (EC) NO 1228/2003 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2003 on conditions for access to the network fro cross-border exchanges in Electricity.

[3] DIRECTIVE 2003/55/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

[4] REGULATION (EC) No 1775/2005 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 28 September 2005 on conditions for access to the natural gas transmission networks.

[5] ERGEG Guidelines for Good Practice on Information Management and Transparency in Electricity Markets" (E05-EMK-06-10).

[6] Marco Becht, Patrick Bolton and Ailsa Röell (2005), Corporate Governance and Control, European Corporate Governance Institute.