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**Status Review on the Implementation  
of Distribution System Operators'  
Unbundling Provisions of the 3<sup>rd</sup>  
Energy Package**

**CEER Status Review**

**Ref: C15-LTF-43-03  
1 April 2016**



## INFORMATION PAGE

### Abstract

This CEER document (C15-LTF-43-03) presents a Status Review on the Implementation of Distribution System Operators' Unbundling Provisions of the 3<sup>rd</sup> Energy Package.

The CEER Status Review provides an overview of the status of implementation of the unbundling provisions set out in the Directives of the 3<sup>rd</sup> Energy Package. Under this Package the energy networks are subject to unbundling requirements which oblige Member States to ensure the separation of vertically integrated energy companies, resulting in the separation of the various stages of energy supply (generation, distribution, transmission and supply).

This Status Review, together with the corresponding Status Review on the Implementation of Transmission System Operators' Unbundling Provisions of the 3<sup>rd</sup> Energy Package, aims to assess the status of DSO and TSO unbundling. Topics explored included related issues such as: Branding; Financial independence in terms of staff and resources; Compliance programme and officer; Investments, Joint-venture TSOs and Joint undertakings.

### Target Audience

European Commission, energy suppliers, traders, gas/electricity customers, gas/electricity industry, consumer representative groups, network operators, Member States, academics and other interested parties.

### Keywords

Unbundling; Cross-Sectoral; Networks; 3<sup>rd</sup> Package; Market Monitoring; National Regulatory Authorities (NRAs); Transmission System Operators (TSOs); Distribution System Operators (DSOs);

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## Related Documents

### CEER documents

- [CEER Memo on the transposition of unbundling requirements for Transmission, Distribution and Closed Distribution Systems Operators](#), Ref: C14-IBM-61-03, 30 July 2014
- [CEER Status Review on the Transposition of Unbundling Requirements for DSOs and Closed Distribution System Operators](#), Ref: C12-UR-47-03, 16 April 2013
- [The Future Role of DSOs - A CEER Conclusions Paper](#), Ref: C15-DSO-16-03, 13 July 2015
- [CEER Benchmarking report on removing barriers to entry for energy suppliers in EU retail energy markets](#), Ref: C15-RMF-70-03, 1 April 2016
- [CEER Status Review on the Implementation of Transmission System Operators' Unbundling Provisions of the 3rd Energy Package](#), Ref: C15-LTF-43-04, 1 April 2016

### External documents

- Commission Staff Working Paper; [Interpretative note on Directive 2009/72/EC Concerning common rules for the Internal Market in Electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas; The Unbundling Regime](#), 22 January 2010
- Commission Staff working document on Ownership Unbundling, ["The Commission practice assessing the presence of a conflict of interest including in case of financial investors"](#), SWD(2013)177final, 8 May 2013
- [Commission Staff Working Document Report on the ITO Model](#), SWD(2014) 312 final, 13 October 2014



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## Executive Summary

It is clear that Transmission System Operators (TSOs) and Distribution System Operators (DSOs) are important energy market actors, as they deliver electricity and natural gas to end-consumers, while guaranteeing the long-term ability of the system at the same time. As such, their independence, ensured through unbundling rules (among others), may strongly influence the level of retail competition available in the market.

The rules on legal and functional unbundling as provided for in Directive 2003/54/EC did not, however, lead to an effective unbundling of TSOs. Hence at its meeting on 8 and 9 March 2007, the European Council invited the European Commission to develop legislative proposals for the “effective separation of supply and generation activities from network operations”.

Without effective separation of networks from activities of generation and supply (i.e. effective unbundling), there is an inherent risk of discrimination not only in the operation of the networks but also in the incentives for Vertically Integrated Undertakings (VIUs) to invest adequately in their networks.

If compared with the unbundling rules for TSOs, which were thoroughly revised under the 3rd Package, resulting in new, more far reaching unbundling requirements, the unbundling requirements for DSOs have only been slightly reinforced in the 3<sup>rd</sup> Package. Another difference between DSO unbundling and TSO unbundling lies in the new requirement for TSOs, which now have to be certified by the competent National Regulatory Authorities (NRAs) as being compliant with the unbundling requirements and to be designated by the Member States. Such a certification and designation requirement does not exist for DSOs.

According to this CEER Status Review, it can be concluded that the DSO landscape in the EU remains heterogeneous; in some Member States there are hundreds of DSOs, in other countries there might be only one or two. When it comes to the different unbundling regimes implemented in the Member States, some DSOs have a separate ownership to suppliers/producers, whereas others are part of a VIU.

Apart from the Netherlands, where full ownership unbundling is required by law, all the other participating Member States require at least a legal and functional unbundling for both gas and electricity DSOs (as far as non-exempted). Most of the participating Member States reported that the legal form chosen for the DSO ensures a sufficient level of independence of the DSOs. Almost all of the participating Member States adopted detailed rules, particularly on the independence of the staff and management of DSOs<sup>1</sup> especially after the entry into force of the 3<sup>rd</sup> Package; such rules were already introduced in other countries from the beginning of the liberalisation of the energy markets.

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<sup>1</sup> Except Malta, Cyprus, Austria and the Netherlands (in the Netherlands no detailed rules were needed, due to the full ownership unbundling). Gas DSO(s) in Cyprus and Electricity DSO(s) in Malta are exempted from the unbundling provisions (according to Article 49 Gas Directive, respectively Article 44 Electricity Directive).



According to Article 26(4) if the Directives smaller DSOs serving less than 100 000 connected customers can be exempted from the requirements of both legal and functional unbundling. Almost half of the Member States<sup>2</sup> have adopted this exemption at national level.

One of the issues when it comes to the DSO unbundling is the branding and communication issue. The unbundling provisions of the 3<sup>rd</sup> Package constitute a minimum set of rules and the Member States may consider adopting further measures to ensure the effectiveness of unbundling. In most Member States, national provisions foresee that the DSO branding/communication (i.e. corporate identity) shall not create confusion with production and supply activities of the VIU. However, following the current NRAs' assessment, in some of the responding Member States, both gas and electricity DSOs have proven to create confusion in their branding and communication policy. Consequently the implementation of these provisions has required in many cases NRA interventions. NRAs have often obliged DSOs to rebrand and redefine their communications according to the unbundling requirements (e.g. by providing guidance on logos, etc.)

Finally, the majority of NRAs are satisfied with the compliance programmes set up by the DSOs and are of the view that compliance officers have enough information and resources to fulfil their tasks independently, particularly when it comes to the electricity sector.

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<sup>2</sup> Austria, France, Croatia, Denmark, Estonia, Germany, Hungary, Italy, Latvia, Poland, Romania, Slovenia, Slovak Republic, Spain (for electricity DSOs concerning functional unbundling, legal unbundling requirements must be met by 2016) and Sweden concerning functional unbundling.



## 1 Background

With the adoption of Directive 2009/72/EC<sup>3</sup> (“Electricity Directive”) and Directive 2009/73/EC<sup>4</sup> (“Gas Directive”), together referred to as “the Directives”, new rules have been introduced on unbundling for TSOs and to a lesser extent for DSOs.

This CEER Status Review provides an overview of the status of implementation of the unbundling provisions set out in the Directives of the 3<sup>rd</sup> Energy Package (3<sup>rd</sup> Package). Under this Package the energy networks are subject to unbundling requirements which oblige Member States to ensure the separation of vertically integrated energy companies, resulting in the separation of the various stages of energy supply (generation, distribution, transmission and supply).

For DSOs in particular (Article 26 of the Directives) the unbundling requirements focus on the legal, functional and operational (staff) separation of the DSO from other actors in the supply chain (known as legal and functional unbundling).

The information on the current status of unbundling was collected by way of a survey among the NRAs of CEER member and observer countries, based on the information available to them until February 2016.

26 CEER members (out of 33 CEER members and observers) participated in the survey for this Status Review - Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Great Britain, Greece, Hungary, Latvia, Italy, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden and the Netherlands. Input was provided until February 2016 to CEER and represents the status of the DSO unbundling in the respective country until then.

This report aims to assess the status of DSOs unbundling and topics explored included related issues such as: Branding and Communication; Financial independence in terms of staff and resources; Compliance programme; Investments.

## 2 Unbundling of Distribution System Operators

DSOs continue to be increasingly important and even more visible actors in the energy industry. Their duties do not only include the delivery of electricity and natural gas to customers through the operation and maintenance of distribution systems, but DSOs also play a major role in the efficient functioning of Europe’s energy markets; acting as “entry gates” to retail markets in most countries. DSOs also have an important influence on the competition level. Although the basic functional model of DSOs is broadly the same, there are various significant differences, in number, size, technical characteristics and activity profile of DSOs across Europe, which are reflected in the unbundling regimes.

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<sup>3</sup> 2009/72/EC Directive of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC

<sup>4</sup> 2009/73/EC Directive of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in gas and repealing Directive 2003/55/EC



## 2.1 Legal framework

Under the 3<sup>rd</sup> Package Directives 2009/72/EC and 2009/73/EC, European energy networks are subject to unbundling requirements which oblige Member States to ensure the separation of vertically integrated energy companies, resulting in separation of the various stages of energy supply (generation, production, distribution, transmission and supply). According to Article 26 of the Directives, where the DSO is part of a vertically integrated undertaking (VIU), the basic elements of this unbundling regime are the following:

- (a) **legal unbundling** of the DSO from other activities of the vertically integrated undertaking not related to distribution;
- (b) **functional unbundling** of the DSO in order to ensure its independence from other activities of the vertically integrated undertaking;
- (c) **accounting unbundling**: requirement to keep separate accounts for DSO activities;
- (d) **possibility of exemptions** from the requirement for legal and functional unbundling for certain DSOs.

A DSO must have, as a minimum criteria, “the necessary human, technical, financial and physical resources” to act independently from the vertically integrated undertaking (VIU) in terms of its organisation and decision-making power.

Unlike legal and functional unbundling, accounting unbundling is a basic principle laid down in Article 31(3) of the Directives according to which energy companies have to keep separate accounts for each of their transmission and distribution activities related to electricity and gas. Thus no derogation is possible from the rules on accounting unbundling in the case of smaller DSOs serving less than 100 000 connected customers<sup>5</sup>. Accounting unbundling is hence the minimum separation requirement to be respected by every network operator, without exception.

According to the European Commission’s Staff working paper from 22 January 2010<sup>6</sup> this means that the DSO cannot “unduly rely on the services of other parts of the vertically integrated undertaking, as the DSO itself must have the necessary resources at its disposal to operate, maintain and develop the network. Provision of services by other parts of the vertically integrated undertaking to the DSO will therefore be limited. Where such services are provided, conditions should be fulfilled to reduce competition concerns and to exclude conflicts of interest. In particular, any cross-subsidies to or from the DSO and other parts of the vertically integrated undertaking cannot be accepted. To ensure this, the service must be provided at market conditions and laid down in a contractual arrangement.”

Within the scope of the approved financial plan, the DSO must have complete independence. Furthermore, the financial plan, whilst it can be adopted by the VIU, must be compatible with the requirement to ensure that the DSO has sufficient financial resources to maintain and extend the existing infrastructure. The parent company can approve the annual financial plan or any equivalent instrument<sup>7</sup> of the DSO or the setting of global limits on the levels of

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<sup>5</sup> Article 26(4) of the Directives

<sup>6</sup> Commission Staff working paper “Interpretative Note on Directive 2009/72/EC and Directive 2009/73/EC, The Unbundling Regime, from 22 January 2010 (hereafter “COM Staff working paper”).  
[https://ec.europa.eu/energy/sites/ener/files/documents/2010\\_01\\_21\\_the\\_unbundling\\_regime.pdf](https://ec.europa.eu/energy/sites/ener/files/documents/2010_01_21_the_unbundling_regime.pdf)

<sup>7</sup> According to the COM Staff working paper this must be interpreted restrictively in the sense that only instruments that are functionally equivalent to a financial plan, but which according to the applicable national



indebtedness of its subsidiary. Moreover, it should not prevent the necessary and appropriate restructuring of management and personnel.

To ensure that there is no discriminatory conduct and the proper monitoring of this process, Article 26(2)(d) of the Directives also sets out requirements for the installation of a compliance programme. All employees of a DSO must meet the requirements set out in this programme and an annual report summarising the measures taken has to be submitted by a responsible person or body (compliance officer) to the NRA.

The compliance programme should be actively implemented and promoted through specific policies and procedures. Such policies may consist, inter alia, of the following elements:

- Active, regular and visible support of the management for the program;
- Written commitment of staff to the program by signing up to the compliance programme;
- Clear statements that disciplinary action will be taken against staff violating the compliance rules;
- Training on compliance on a regular basis and notably as part of the induction program for new staff.

In addition, DSOs are required to change their communication and branding in such a way that they can be clearly distinguished from the supply branch of the VIU.

In this regard, Member States may choose, when implementing the rules into national law, that these obligations would only apply for integrated electricity or natural gas undertakings serving more than 100 000 connected customers, or serving small isolated systems. Thus according to Article 26(4) of the Directives, small DSOs serving less than 100 000 connected customers<sup>8</sup> can be exempted from the requirements of both legal and functional unbundling. This possibility of an exemption shall not be limited in time.

According to Article 24 of the Directives, Member States shall designate or shall require undertakings that own, or are responsible for distribution systems to designate, for a period of time to be determined by Member States having regard to considerations of efficiency and economic balance, one or more DSOs. Member States shall ensure that DSOs act in accordance with Articles 25, 26 and 27 of the Directives regarding their tasks, unbundling and confidentiality obligations. This is not a designation process similar to the TSO certification where the implementation of the unbundling rules are assessed by NRAs, but mainly a company internal process linked to the implementation of the functional and legal unbundling when required.

According to Article 44(2) Electricity Directive Malta is explicitly derogated from the electricity DSO unbundling provisions of Article 26.

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terminology are not denominated a 'financial plan', may be subject to approval of the vertically integrated undertaking,

<sup>8</sup> For the Commission "Connected customers" could reasonably be interpreted as meaning: 'connections'. According to such an interpretation a household is considered to constitute one connection within the meaning of the Directives, irrespective of the number of people forming part of the household. In contrast, a building composed of, for example, eight apartments, is considered to have eight connections within the meaning of the Directives. (COM Staff working paper)



Article 49(2) Gas Directive provides for derogations from gas DSO unbundling provisions for Member States qualifying as an emergent market<sup>9</sup>, which, because of the implementation of the Gas Directive, would experience substantial problems. Such derogation shall automatically expire from the moment when the Member State no longer qualifies as an emergent market<sup>10</sup>.

The provisions of the 3<sup>rd</sup> Package also underline the legitimacy of the operation of a combined transmission and distribution system operator as long as that operator complies with the unbundling rules<sup>11</sup>.

## 2.2 General Issues

When it comes to the concrete implementation of DSO unbundling in the Member States we observe that different situations and regimes exist in various countries, particularly when it comes to the market structure. While in some Member States there are hundreds of DSOs, in other countries there might be one or two. The same applies to the different unbundling structures; some DSOs have a separate ownership to suppliers whereas some others are part of the same group.

The charts below show how the number of gas and electricity DSOs varies widely in the Member States as well as the number of DSOs serving less than 100 000 connected customers. There is a large number of DSOs in Europe. In some Member States, there are significantly more DSOs than in others. These differences can be explained through historical, political and geographical reasons.

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<sup>9</sup> “Emergent market” means a Member State in which the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier (Article 2(31) of the Gas Directive).

<sup>10</sup> According to Article 49(2) of the Gas Directive Cyprus is explicitly considered as an emergent market.

<sup>11</sup> Articles 28 of the Electricity Directive and Articles 9(1), or 13 and 14, or Chapter V or falls under Article 44(2).

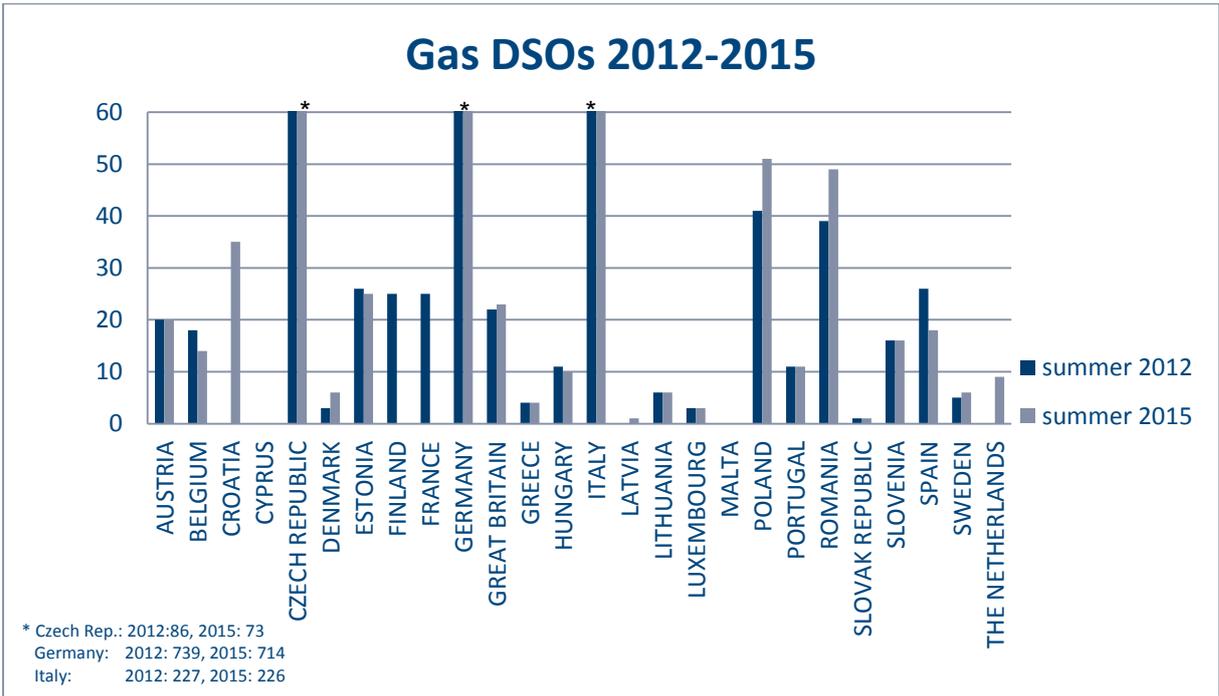


Figure 1: Gas DSOs 2012-2015

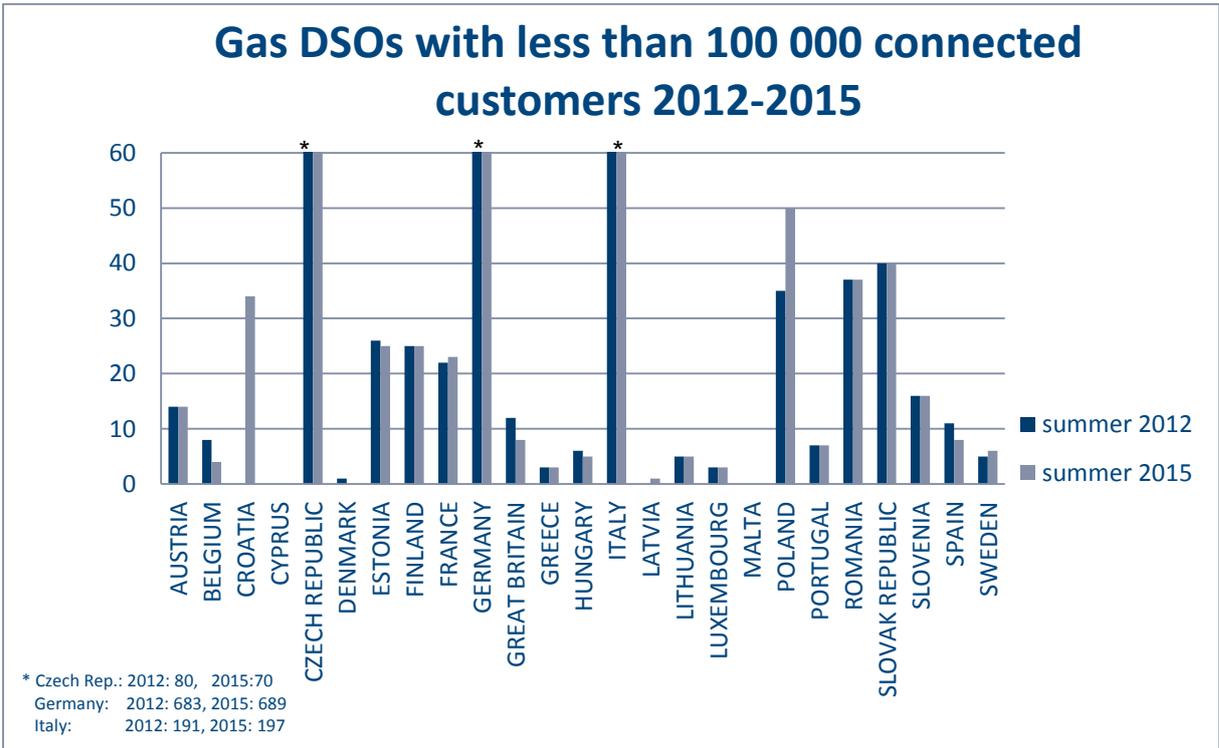


Figure 2: Gas DSOs with less than 100 000 connected customers 2012-2015

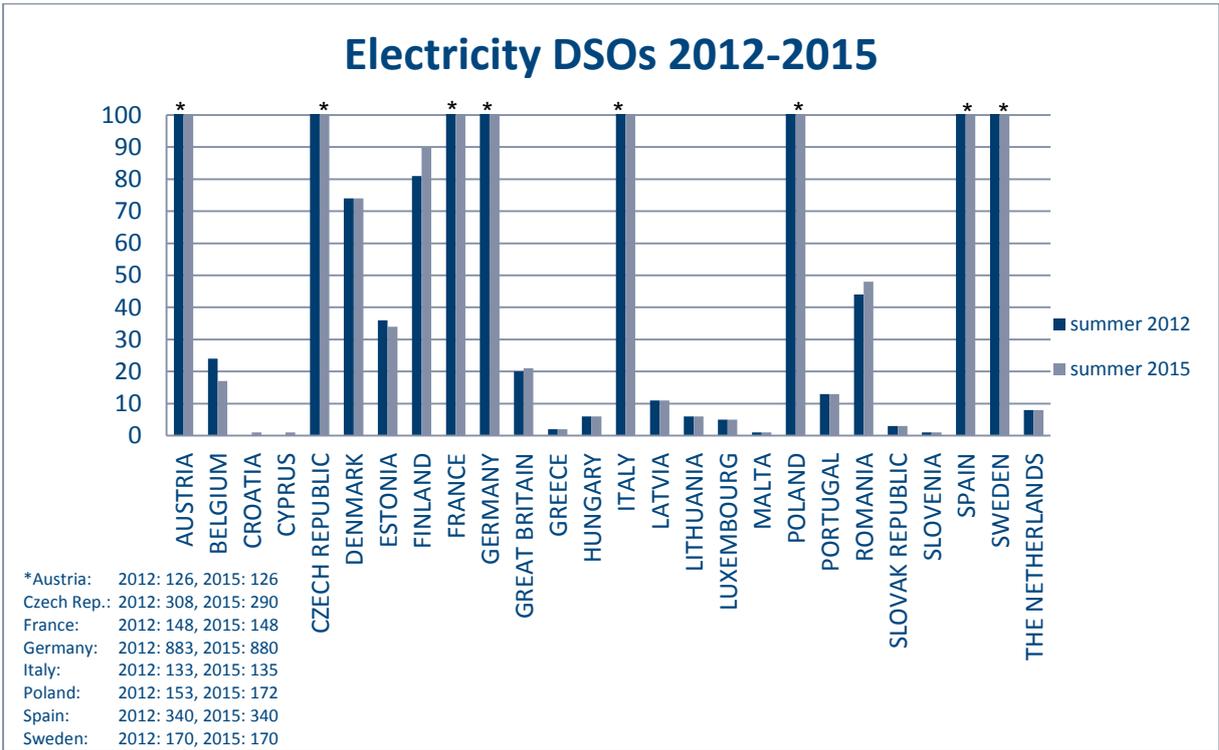


Figure 3: Electricity DSOs 2012-2015

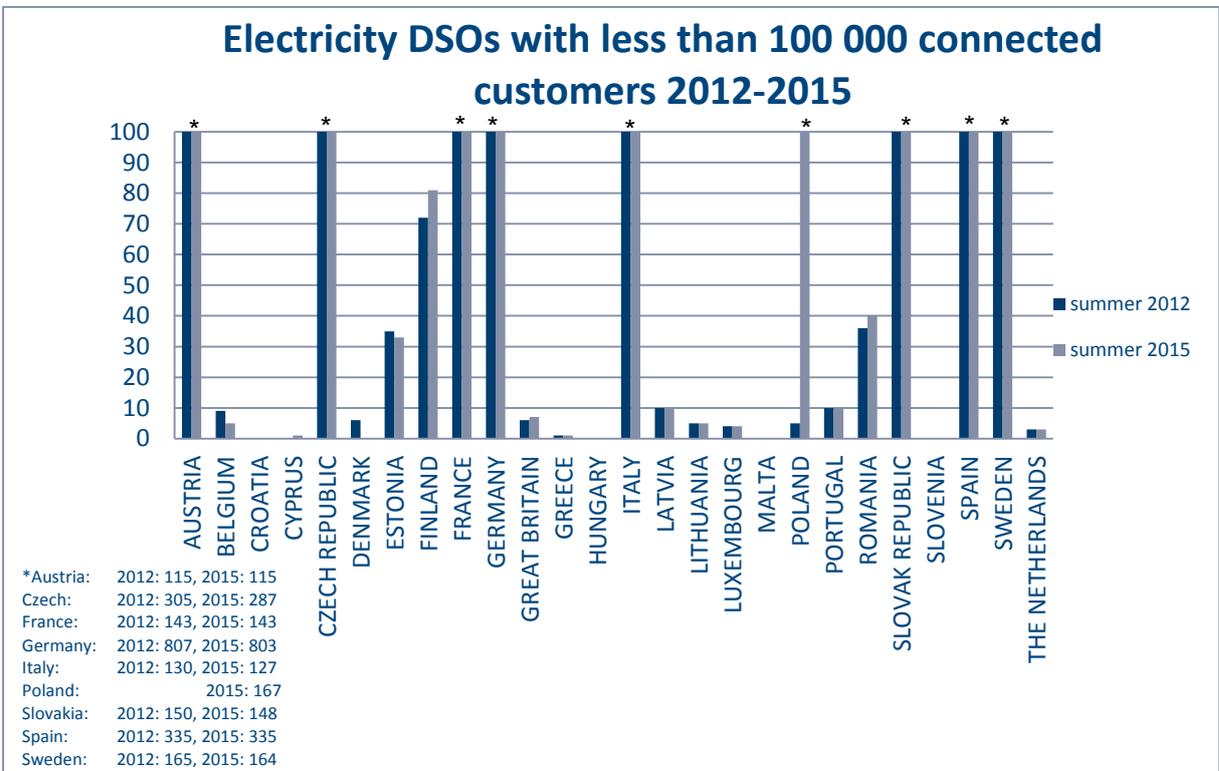


Figure 4: Electricity DSOs with less than 100 000 connected customers 2012-2015



After the implementation of the 3<sup>rd</sup> Package the number of DSOs did not change significantly and we cannot observe a major concentration as this might have been the case of the TSOs. The number of DSOs remains stable so that it can be concluded that the unbundling provisions of the 3<sup>rd</sup> Package did not trigger substantial structural changes.

When it comes to the unbundling regimes, apart from the **Netherlands, where full ownership unbundling** is required by law, in all other participating Member States national law requires at least a **legal and functional unbundling** for both the gas and electricity sectors. In Belgium, even though the relevant regional laws do not impose ownership unbundling for DSOs, in practice some DSOs have been fully unbundled in two regions anyway. In other countries different regimes are put in place for electricity and for gas DSOs. For instance, in Slovenia there are different requirements regarding gas and electricity: for electricity there is a legal unbundling requirement, whereas for gas only accounting and functional unbundling have been implemented. In two Member States – Malta<sup>12</sup> and Cyprus – there is a special situation regarding the unbundling requirements of electricity DSOs. In these countries DSOs form part of VIU and according to the national legislations only accounting unbundling is required<sup>13</sup>. In Italy the different provisions in terms of legal unbundling for electricity and gas DSOs set in the past have been confirmed with the implementation of the 3<sup>rd</sup> Package: in the gas sector since 2000 all DSOs must be legally unbundled, while in the electricity sector since 2007 such a provision applies only to DSOs serving more than 100 000 connected customers.

Although ownership unbundling can be considered as an efficient model to ensure the independence of the DSO, other models might also guarantee a transparent and independent decision making process within DSOs, as long as sufficient ring-fencing, regulatory monitoring and oversight are in place.

### **Situation for DSO with less than 100 000 customers**

Several participating Member States<sup>14</sup> apply the exemption at national level related to DSOs serving less than 100 000 connected customers. According to Article 26(4) of the Directives smaller DSOs serving less than 100 000 connected customers can be exempted from the requirements of both legal and functional unbundling. In two countries these provisions refer only to gas DSOs (Austria and Hungary). In Spain, electricity DSOs serving less than 100 000 connected customers are exempted from the provisions regarding functional unbundling, but must meet the requirements of legal unbundling by 2016. In Italy there are also different exemptions for electricity and gas sectors: electricity DSOs serving less than 100 000 connected customers are exempted from legal but not from functional unbundling, whereas respective gas DSOs are exempted from functional but not from legal unbundling.

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<sup>12</sup> Malta has a derogation from the requirements of Article 26 of Directive 2009/72/EC. DSO forms part of a vertically integrated utility. In the case of electricity the Electricity Market Regulations (S.L.423.22) require unbundling at internal accounting level.

<sup>13</sup> The Cyprus Energy Regulatory Authority (CERA) has recently issued a regulatory decision on the implementation of the functional and accounting unbundling activities of the vertically integrated company EAC in which the DSO is integrated.

<sup>14</sup> I.e. Austria, France, Croatia, Denmark, Estonia, Germany, Hungary, Italy, Latvia, Poland, Romania, Slovenia, Spain, Slovak Republic and Sweden.



In Belgium, there are no special provisions with regard to the unbundling of DSOs serving less than 100 000 connected customers, with the exception of specific provisions for closed distribution systems<sup>15</sup> in the Flemish region (exempting such Closed Distribution Systems (CDSs) from unbundling). In some countries the allowed threshold is set below the number provided by the directives of 100 000 connected customers:

Austria	50 000
Finland <sup>16</sup>	50 000 (for electricity)
Czech Republic <sup>17</sup>	90 000
Slovenia <sup>18</sup>	1 000 (for electricity)

In the view of the situation in the European Union as a whole, the threshold of 100 000 connected customers was chosen since it was considered an appropriate figure. However, it should be noted that when deciding on a possible derogation, Member States may consider national circumstances as well and, as a consequence, **lower the threshold** where this is appropriate.

Member States can choose not to systematically exempt DSOs with less than 100 000 connected customers from both legal and functional unbundling so that a more gradual approach is possible. It is thus possible to exempt the smaller sized DSOs from both legal and functional unbundling requirements, whereas the bigger ones can obtain an exemption from legal unbundling, while maintaining the requirement of functional unbundling, or at least certain elements of functional unbundling.

Unlike legal and functional unbundling, no derogation is possible from the rules on accounting unbundling in the case of smaller DSOs. Accounting unbundling is the minimum separation requirement to be respected by network operator.

### 2.3 Independence of DSOs

The 3<sup>rd</sup> Package requires that distribution is performed following the legal and functional unbundling requirements, which imply that the DSO shall be managed by a separated 'network' company. The obligation to create a separate company only concerns the network activities whereas other activities such as supply and production can be carried on within a single company.

The VIU is in principle free to choose the legal form of the DSO, provided that this legal form ensures a sufficient level of independence of the management of the DSO from other parts of the VIU in order to fulfil the requirements of functional unbundling.

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<sup>15</sup> In Article 28 of the Directives, Closed Distribution System operators are understood as systems which "distribute gas or electricity within a geographically confined industrial, commercial or shared services site and do not supply household customers". Such systems may be granted exemptions from obligations which would constitute an unnecessary administrative burden – for example the unbundling provisions.

<sup>16</sup> In Finland this threshold applies only for electricity DSOs as the total number of gas customers in whole country is about 37 000.

<sup>17</sup> "The 90 000 customers" rule, Section 59a, subsection 10 of the Czech Energy Act.

<sup>18</sup> Articles 84 and 85 of the Slovenian Energy Act.



Most of the participating Member States (except Malta and Cyprus) reported that the legal form chosen for the DSO ensures a sufficient level of independence of the DSOs.

An interesting situation can be observed in Flanders (Belgium) where there is no legal form imposed on the DSOs. All DSOs but three (Sibelgas, Ores Assets and Enexis) have chosen a form of inter-municipal cooperation as legal form (i.e. “*opdrachthoudende vereniging*”). In such companies, participation of third parties is limited to those persons or legal entities having the public task of operation of the grid, i.e. the municipalities. This is why a supplier, historically a typical participant of many of these DSOs, ended its participation at the end of 2014. However, as a DSO is a capital intensive company, the participation of other companies will be allowed (in the near future): legislation will be modified for this purpose. Such participation will only be possible under certain conditions: the participant cannot be a supplier or producer and its shareholder and voting rights in the DSO will be limited. In some cases the municipalities are the shareholders of the distribution systems and very often participate jointly, directly or indirectly in the producing and supplying activities.

Furthermore Article 26 of the Directives requires that the persons responsible for the management of the DSO do not participate in company’s structures of the responsible VIU, directly or indirectly, for the day-to-day operation of production, transmission or supply activities. Article 26 does not restrict the group of persons responsible for the management of the DSO to the top management, such as members of the executive management and/or members of a board having decision-making powers. Indeed, Article 26 addresses a wider group of persons, including the operational (middle) management of the DSO. Appropriate measures must be taken at national level to ensure that the professional interests of the persons responsible for the management of the DSO are taken into account in a manner that ensures that they are capable of acting independently.

The European Commission is of the view that when shaping the rules on independence of the staff and the management of the DSO, the detailed provisions on independence of the staff and the management of the Independent transmission system operator (ITO) as laid down in Article 19 of the Directives may serve, where appropriate, as a point of reference<sup>19</sup>.

Almost all of the participating Member States adopted **detailed rules on independence** of the staff and management of DSOs<sup>20</sup>.

When it comes to **management separation** the question of whether “**Common services**” between the VIU and the grid company are allowed becomes legitimate (i.e. services that are shared between transmission/distribution, supply and possibly other businesses within the VIU). The shared services are mainly related to personnel and finance, IT services, accommodation and also transport. Whether shared services are in line with functional unbundling, is case-by-case issue. According to Article 26(2)(c) of the Directives, the DSO must have at its disposal the necessary resources, including human, technical, physical and financial resources, in order to fulfil its tasks of operating, maintaining and developing the network. This implies that the DSO can rely on the services of its company and not on other parts of the VIU and that the DSO must have the necessary resources at its disposal to operate, maintain and develop the network.

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<sup>19</sup> COM Staff working paper, p.19

<sup>20</sup> Except Malta, Cyprus, Austria and the Netherlands (in the Netherlands no detailed rules were needed, due to the full ownership unbundling).



According to the European Commission, provision of services by other parts of the VIU to the DSO can therefore only be limited and accepted under the condition that competition is ensured and conflicts of interest excluded. In order to avoid potential cross-subsidies given by the DSO to other parts of the VIU, the shared service should be provided at “market conditions” and laid down in a “contractual arrangement”.

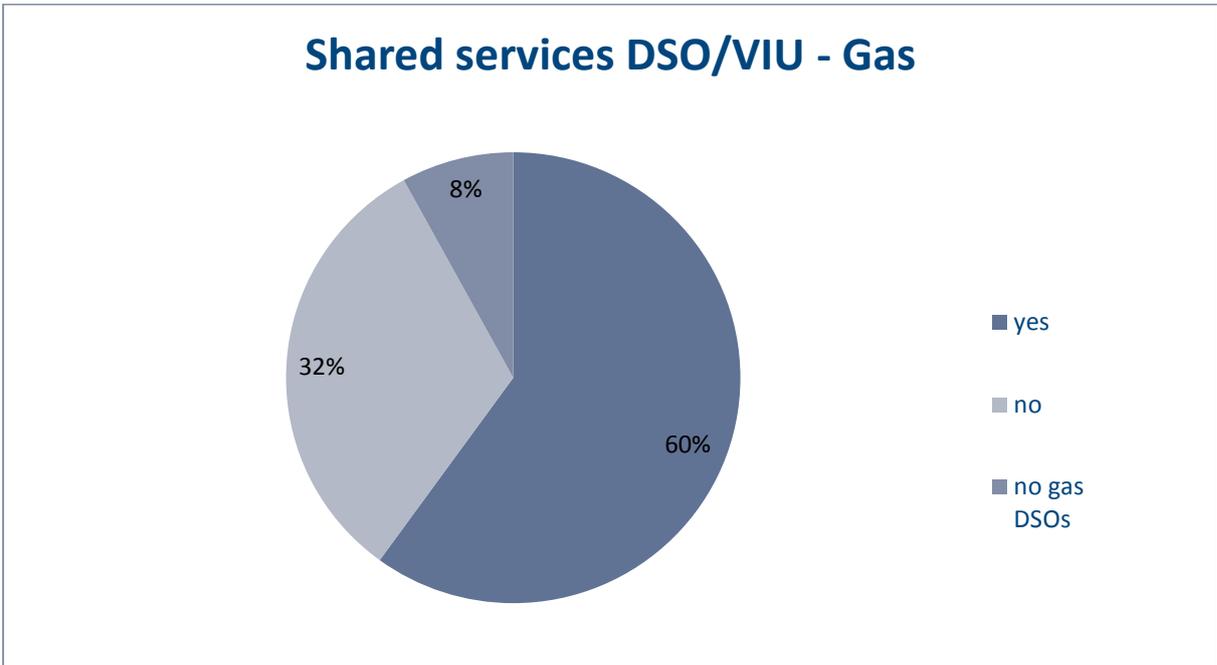


Figure 5: Shared services between DSO and the VIU – Gas

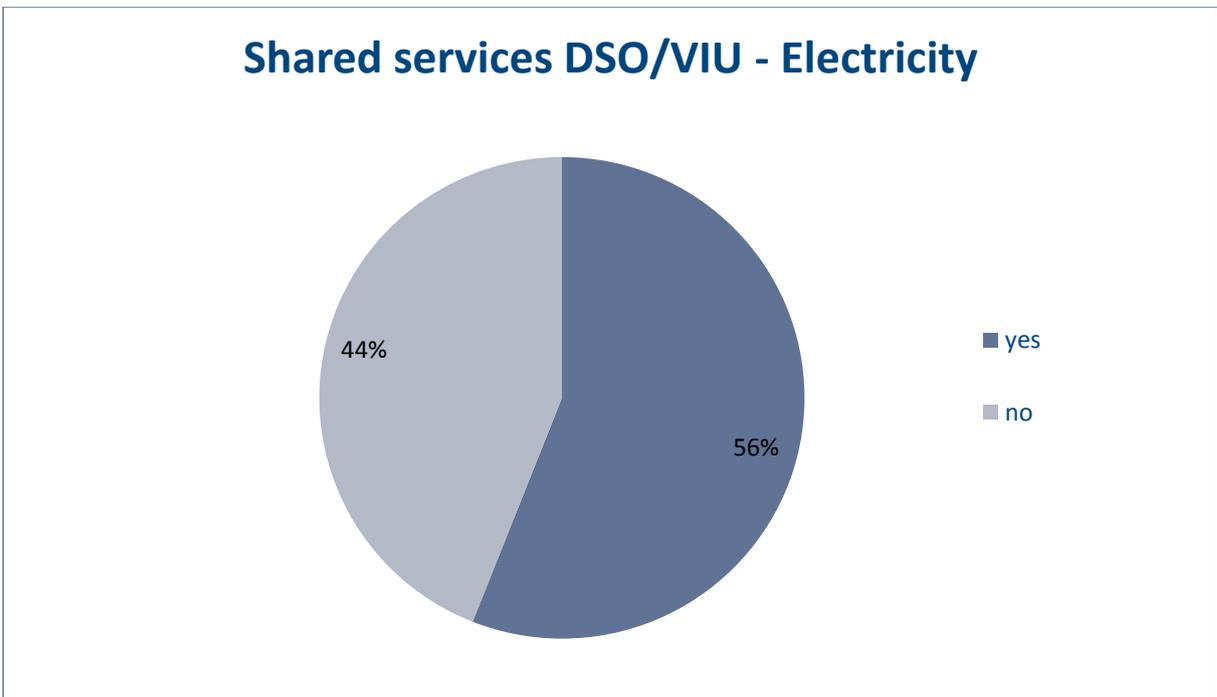


Figure 6: Shared services between DSO and the VIU – Electricity



The charts illustrate that in the responding Member States that have VIUs, almost half of the gas and electricity DSOs share services with their VIU. It should be taken into consideration that the European Commission recalled that the DSO cannot unduly rely on the services of other parts of the VIU, as the DSO itself must have the necessary resources at its disposal<sup>21</sup>.

When it comes to the **financial independence of the DSOs**, there must be a complete independence within the scope of the approved financial plan or any equivalent instrument<sup>22</sup>. The financial plan can be adopted by VIU, but must be compatible with the requirement to ensure that the DSO has sufficient financial resources to maintain and extend the existing infrastructure. Thus VIU is not allowed 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.

In the majority of Member States (with the exception of the Czech Republic, Denmark, France, Portugal, Slovenia and Greece<sup>23</sup>) the DSOs have got complete independence within the approved financial plan, or equivalent instrument. In Spain, the owner of an unbundled DSO is entitled to supervise and approve the economic and financial plans and determine the DSO debt level. In some countries (e.g. France), the executive board oversees the execution of the budget as well as the investment policy. In accordance with the shareholder supervisory role, DSOs have the power to manage their investment planning. In Denmark, the NRA (Danish Energy Regulatory Authority – DERA) sets efficiency requirements for the companies on the basis of a benchmarking. The revenue caps show the maximum permitted revenue DSOs can charge through the electricity bills. In Portugal, DSOs have their own financial structure, but in terms of financing conditions they are dependent on the group's financing conditions.

In certain Member States there are specific rules in force to ensure independence.

In Belgium, different rules in the different regions are coexisting. In the Walloon region, there are specific obligations regarding the financial status of a DSO, being:

- The performance of other activities is only allowed, if these activities do not have a negative impact on the independence of the DSO;
- Any disposal of infrastructure that is part of the distribution network is submitted to the regulator's assent;
- The annual accounts comprise a balance sheet together with profit and loss account for each category of activity, as well as the settlement rules of assets and liabilities and income and expenses applied to draw up separate accounts;
- The property income from the distribution network must be specified in the accounts;
- The Government is empowered to issue other rules governing transparency of the accounts.

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<sup>21</sup> COM Staff working paper, p. 26

<sup>22</sup>The term "any equivalent instrument" must be interpreted restrictively in the sense that only instruments that are functionally equivalent to a financial plan, but which according to the applicable national terminology are not denominated as a "financial plan", may be subject to approval of VIU.

<sup>23</sup> In case of Greece and Slovenia the lack of independence within the approved financial plan refers only to the gas sector.



In the Flemish region, there are no specific legal requirements concerning the financial status of a DSO but the NRA has to assess whether or not the DSO complies with the requirement of having adequate financial capacity. What sufficient financial resources mean, depends on the size of the DSO, and therefore should be reviewed by the NRA on a case by case basis. In the Brussels Capital Region, there are no specific legal obligations on the financial status of DSOs due to the fact that the sole DSO is ownership unbundled.

To ensure the independence of the DSO in the Czech Republic, there is a decision-making power when it comes to the property needed for the operation, maintenance and development, which must be exercised independently of the VIU. Furthermore the parent company is not allowed to provide any instructions to the DSO for the day-to-day operation and maintenance of the DSO or to interfere in the decision-making on the building or refurbishment of parts of it, unless such a decision exceeds the scope of the approved financial plan. This is without prejudice to the parent company's right to approve the annual financial plan or another similar instrument used by the DSO and to approve its maximum debt limits.

According to the implementation of Article 26 of the Directives, since 2011 the Italian DSOs belonging to a VIU in both sectors shall be independent in terms of their organisation and decision-making from the other activities not related to the distribution. However, the minimum criteria set out by Article 26(2) apply to all electricity DSOs and only to those gas DSOs serving more than 100 000 connected customers.

In other countries (e.g. Estonia) a DSO must have in its possession the resources required for the preservation and development of the network, including technical, physical, financial and human resources whereas in other countries (e.g. Finland) the DSO is responsible for all assets, liabilities, incomes and expenses of the network operations.

The independence of the DSO can also be ensured through the conditions defined in a Licence. In Great Britain (GB), for example, the key stipulations related to the ownership are contained in a Licence and are as follows:

- Restrictions on the disposal of network assets and receivables;
- Restrictions on non-DSO business activities;
- Certification requirements relating to adequacy of financial and operational resources;
- Requirements to obtain undertakings from ultimate controllers relating to information provision and licence respect;
- Requirement to hold an investment grade issuer credit rating;
- Restrictions on indebtedness, lending and transactions with affiliates.

Special financial capability rules can be set up if deemed necessary, for example in Lithuania, where the financial capability is calculated annually for each energy company, including DSOs, to determine whether it is appropriate for the respective activity.

In Sweden, the DSO must have its own resources to be able to perform the service. In the Netherlands, a minimal percentage of equity (financial status of the DSO) is submitted to the approval by the Minister of Economic Affairs.

The unbundling provisions, which ensure the independence of the DSO from the VIU, have been mostly implemented in all countries either through national or regional provisions (law, decrees, regulations, etc.) or through a licencing procedure (Great Britain).



## 2.4 Rebranding of DSOs

An additional measure to ensure the functional unbundling of the DSO is the branding and communication policy of the DSO. In its communication and branding, the DSO cannot create confusion in respect of the separate identity of the supply company of the VIU (Article 26(3) of the Directives). There is an obligation to avoid any confusion for consumers between the DSO and the supply company. In this respect, the European Commission makes a reference to the European Union trade mark law to identify whether or not there is a confusion in a particular case.<sup>24</sup> But the unbundling provisions of the 3<sup>rd</sup> Package are a minimum set of rules and the Member States may consider adopting further measures to ensure the effectiveness of unbundling.

Consequently in most of the Member States national provisions foresee that the DSO branding/communication (i.e. corporate identity) shall not create confusion with production and supply activities of the VIU.

In Greece and Finland clear provisions on rebranding refer only to electricity DSOs whereas in Belgium<sup>25</sup>, Poland, Romania, Slovenia and Malta such provisions are not foreseen.

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<sup>24</sup> See in particular Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trademarks, OJ L 11, 14.1.1994, p. 1, as amended, and Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008 to approximate the laws of the Member States relating to trademarks, OJ L 299, 8.11.2008, p. 25.

<sup>25</sup> For two Belgian regions DSO rebranding rules are not relevant anymore as: in Flanders there are no VIUs (anymore) and the sole DSO of the Brussels Capital Region is fully unbundled.

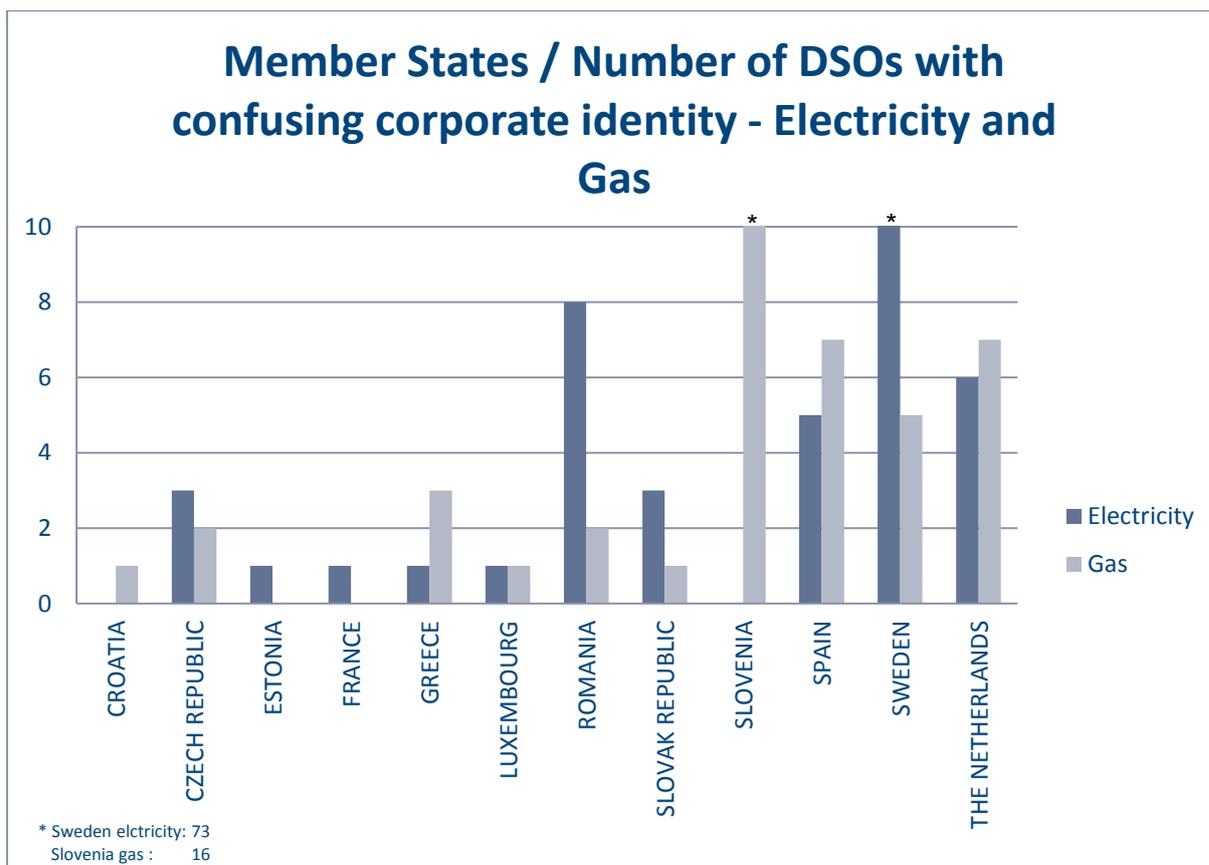


Figure 7: DSOs with confusing corporate identity - Electricity and Gas

The chart shows that following the NRA’s assessment, both gas and electricity DSOs have evidenced the creation of confusions in their branding and communication policy. In almost half of the participating Member States, the NRAs were directly involved in the rebranding/change of communication process. Their decisions usually concluded that the branding and the communication policy of the DSO/VIU create confusion for the end consumer between the VIU and DSO. The NRA often proposed concrete measures on how to avoid the confusion created through, for example, the modification of the company’s logos, the internet-based and written communication, the modification of the company strategy and external presentation (uniform, company cars, etc.). It included activities like direct coordination with DSOs<sup>26</sup> or specific requirement by NRA to change the corporate identity<sup>27</sup>; continuous overview and monitoring activities by NRAs<sup>28</sup>; approval of amendment in a new operational licence<sup>29</sup>; advisory activities for the competent Ministry<sup>30</sup> or proposal of specific amendments to legislation regulating the electricity market<sup>31</sup>.

<sup>26</sup> Austria, Slovak Republic.

<sup>27</sup> France.

<sup>28</sup> Denmark, Spain.

<sup>29</sup> Hungary.

<sup>30</sup> Netherlands.

<sup>31</sup> Cyprus.



In half of the participating Member States where rebranding of DSOs has been implemented, NRAs were satisfied with the process, whereas in the other half of the Member States required changes are still expected. The branding and communication issue remains one of the most contentious matters when it comes to assessing the implementation of unbundling at DSO level.

## 2.5 Resources of DSOs

According to Article 26(2)(c) of the Directives the DSO must have the necessary resources at its disposal, including human, technical, physical and financial resources, in order to fulfil its tasks of operating, maintaining and developing the network.

At this point it is important to highlight the accounting obligations. As already mentioned above, unlike legal and functional unbundling, no derogation is possible from the rules on accounting unbundling in the case of smaller DSOs. Accounting unbundling is thus the minimum separation requirement to be respected by every network operator, without exception. For accounting unbundling, an accurate application of accounting principles is of fundamental importance. It is vital that cost items are allocated in a transparent and accurate manner to the activities concerned. Notably, any overstatement of the costs of the network business must be excluded. Such inaccurate cost allocation is likely to lead to cross-subsidization favouring the supply business and thus distorting competition in the supply market.

Apart from the cases of ownership unbundled DSOs (for which the following issue is not relevant) all NRAs with the exception of the Czech Republic considered that DSOs have sufficient financial resources to ensure their decision-making power and independence.

In some Member States there are specific licence conditions relating to the availability and certification of both financial and operational resources<sup>32</sup>, whereas in certain other Member States DSO costs for network operation and maintenance are recovered through the network tariffs<sup>33</sup>.

In more than half of participating Member States there are no legal or regulatory guidance and/or methods to define the principle of sufficient financial resources whereas in other Member States a methodology for regulated tariffs is being used<sup>34</sup>.

In Great Britain and Greece, a definition for a minimum level of financial resources required by the DSO, e.g. for network development, is set out in the licence conditions.

“Monitoring policies” on financial resources have been put in place in 16 Member States, which are determined either by the methodology<sup>35</sup> or through monitoring obligations defined

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<sup>32</sup> e.g. Great Britain, Greece.

<sup>33</sup> e.g. Greece, Slovenia.

<sup>34</sup> e.g. Croatia, France, Latvia.

<sup>35</sup> e.g. Slovenia, Latvia, Croatia.



in the legal provisions. Some Member States monitor the financial resources on the basis of (efficiency) benchmarking<sup>36</sup> or according to the licence conditions<sup>37</sup>.

For instance, in Greece the licence conditions foresee the following requirements:

- The DSO has to report annually to the Regulator with respect to its estimations on availability of necessary financial resources for carrying out its duties for the following 12 months, as well as anytime when finance ability of the DSO operations is at risk;
- The Network Owner has to report to the DSO and the Regulator in case it cannot comply with its financial obligations towards the DSO as regards network development.

In Great Britain, there is scrutiny of the availability of the financial resources certification; the regulatory cost and revenue returns (especially cash flow and debt maturity schedules); the annual price control remodelling (Annual Iteration Process); the statutory and regulatory accounts and the credit rating analysis.

In most of the participating Member States, except Cyprus, Finland and France<sup>38</sup>, DSOs have sufficient personnel resources directly employed to ensure a decision-making power and independence. In Flanders (Belgium), a particular provision foresees that in case where not all directors are independent, a specific committee only composed of independent directors, has to supervise the decisions concerning strategic and confidential issues. In this respect it is noted that DSOs in general have their own Board of Directors, but apart from that, staff of the majority of the DSOs is employed by the operational entity and not directly by the DSO itself. Nevertheless, the same unbundling provisions apply also to this entity.

In Greece, the entire distribution business unit of one of the former VIU has been transferred to the DSO. This comprises executive staff, division and department managers and personnel, enabling the DSO to perform all aspects of network management (planning, development, operation & maintenance) independently from the VIU. The scope of shared services with the VIU is currently limited to part of the required services for IT, Accommodation, Health & Safety and Purchasing.

There is either legal or regulatory guidance and/or methodology to define the principle of sufficient personnel resources<sup>39</sup>. In Poland, according to the Polish Energy Law Act, the licence for electricity distribution as well as the licence for distribution of gaseous fuels can be granted only to an applicant who will guarantee to employ staff with the adequate professional qualifications referred to in the Energy Law Act.

NRAs have also contributed to precisely define or fine-tune the functional unbundling; e.g. Slovak NRA (Regulatory Office for Network Industries - RONI) provided the DSOs with clear instructions on how to optimize its functional unbundling. This issue is tackled in a different way in Lithuania where an “Energy Undertakings Technological, Financial and Management

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<sup>36</sup> e.g. Denmark

<sup>37</sup> e.g. Greece

<sup>38</sup> In France, it is not always the case. There are several DSO's that are structured on a “light DSO scheme” in which the operational personnel are employed by the supply branch of the VIU. In its 2013-2014 report on unbundling, the regulator asked these DSOs to send an action plan in order to solve this issue. These action plans were expected for the summer of 2015.

<sup>39</sup> Denmark, Germany, Great Britain, Hungary, Lithuania and Slovak Republic



Capacity Assessment Procedure” (approved by the Lithuanian regulator in March 2015) foresees additional provision to ensure a proper functional unbundling imposing some obligations on the human resources: qualitative and quantitative capacities to communicate with regulator, comply with its requests, provide necessary information and fulfil other legally defined obligations and in addition has the personnel for carrying out its regulated activity, preparing reports and implementing accounting requirements, has the personnel necessary to inform and consult the consumers, has the personnel necessary to deal with consumers complaints.

In Greece, where no specific rules have been adopted even if the number of employees is not explicitly defined, the restriction in outsourcing resources ensures that DSO has sufficient personnel for a proper decision-making and independence.

A defined monitoring policy related to the personnel resources has also been put in place in some Member States<sup>40</sup>. In Great Britain, there is no direct policy, because such monitoring is a matter for and the responsibility of business managers and there are significant contractor aspects that apply. However, personnel levels are reviewed under price control reporting arrangements. It can be also necessary for the undertaking to provide justification to the NRA on the changes related to the personnel when the licence has been issued or modified. In the Spanish Electricity Act, a monitoring mechanism is established by which a (fully independent) compliance officer shall have full access to the information needed to perform his duties and shall report annually to the NRA and the Ministry of Industry. A change in the DSO structure has been so far observed in some Member States<sup>41</sup> as a result of the implementation of the financial and personal resources requirements.

## 2.6 Compliance regime

Article 26(2)(d) of the Directives requires the DSO to establish a compliance programme which sets out measures taken to ensure that discriminatory conduct is excluded and to ensure that observance of this prohibition is adequately monitored.

The compliance programme should provide a formal framework for ensuring that the network activities, as well as individual employees and the management of the DSO, comply with the principle of non-discrimination. Therefore, the compliance programme shall contain rules of conduct to be respected by staff in order to exclude discrimination, e.g. obligation to preserve the confidentiality of commercially sensitive and advantageous information (Article 27 of the Directives). For the European Commission, the compliance programme must be actively implemented and promoted through additional specific policies and procedures (in Great Britain the support which must be given to compliance officers in performing their particular roles is also specified in licences) that may consist, inter alia, of the following elements:

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<sup>40</sup> In Cyprus, Hungary, Lithuania, Poland, Romania, Spain (only for the electricity sector) and Belgium (but only in Flanders where this monitoring policy is restricted to requirements with respect to independence of directors both for gas and electricity DSOs)

<sup>41</sup> Czech Republic (only in gas sector), Hungary, Sweden (only in gas sector), The Netherlands, Slovak Republic



- Active, regular and visible support of the management for the programme, for example through a personal message to the staff from the management stating its commitment to the programme;
- Written commitment of staff to the programme by signing up to the compliance programme;
- Clear statements that disciplinary action will be taken against staff violating the compliance rules;
- Training on compliance on a regular basis and notably as part of the induction programme for new staff.

It is up to the Member States to define what the compliance programmes should contain. A typical set of rules for the compliance programmes relates to the behaviour of staff vis-à-vis network customers (e.g. employees of a DSO must refrain from any reference to the related supply business in their contacts with customers of the DSO); but they may also refer to the sanctions imposed under national legislation in case of a breach of confidentiality rules.

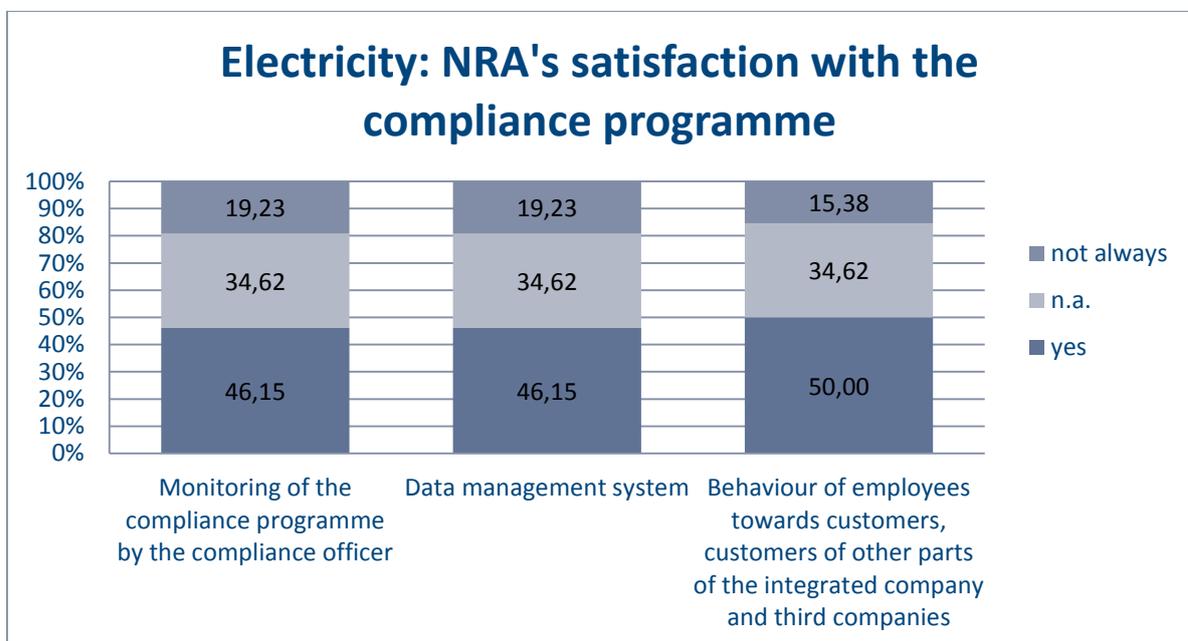


Figure 8: Electricity: satisfaction with the compliance programme of the DSOs

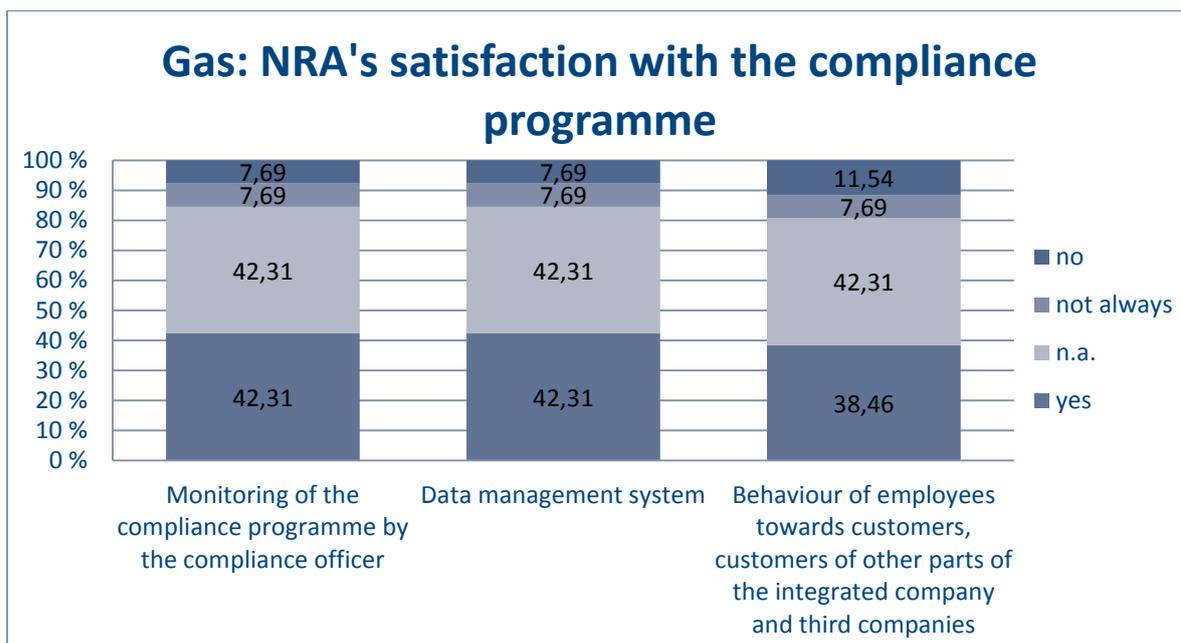


Figure 9: Gas: satisfaction with the compliance programme of the DSOs

These charts demonstrate that the majority of NRAs are satisfied with the compliance programmes set up by the DSOs. NRAs are of the view that compliance officers have enough information and resources to fulfil their tasks independently when it comes to the electricity sector. Regarding the gas sector, the relation might be different particularly when it comes to the behaviour of DSO's employees towards their customers or customers of other parts of the VIU. The data management put in place in the Member States as well as the monitoring of the compliance programme by a compliance officer are both satisfactory.

## 2.7 Conclusions

The DSO landscape in the EU remains heterogeneous while in some Member States there are hundreds of DSOs, in other countries there might be only one or two. This is to be explained through historical, geographical and/or political reasons. The same conclusion can be drawn when it comes to the different unbundling regimes implemented in the Member States; some DSOs have a separate ownership to suppliers/producers whereas most of the others are part of the VIU.

Apart from the **Netherlands, where full ownership unbundling** is required by law, all the other participating Member States require at least a **legal and functional unbundling** for both gas and electricity DSOs (as long as they are non-exempted). In Belgium, even though the regional laws do not impose ownership unbundling for DSOs, some DSOs have been fully unbundled in two of the three regions. In some Member States, different regimes can also be seen for electricity and gas TSOs, e.g. in Slovenia there are different requirements regarding gas and electricity – for electricity there is a legal unbundling requirement whereas for gas only accounting and functional unbundling have been implemented. In two Member



States – Malta<sup>42</sup> and Cyprus – there is a special situation regarding the unbundling requirements of electricity DSOs. In these countries, DSOs are part of a VIU and according to the national legislation only accounting unbundling is required.

Most of the participating Member States reported that the legal form chosen for the DSO ensures a sufficient level of independence of the DSOs. Almost all of the participating Member States adopted **detailed rules particularly on the independence of the staff and management** of DSOs<sup>43</sup> especially after the entry into force of the 3<sup>rd</sup> Package; such rules were already introduced in other countries from the beginning of the liberalisation of the energy markets.

Apart from the cases of ownership unbundled DSOs, all NRAs (with the exception of the Czech Republic) considered that DSOs have **sufficient financial resources to ensure their decision-making power and independence**. In some Member States, there are specific licence conditions relating to the availability and certification of both financial and operational resources. In a majority of the responding Member States, DSOs have complete independence within the approved financial plan or equivalent instrument, with the exception of eight countries (Cyprus, Malta, Czech Republic, Denmark, France, Portugal, Slovenia and Greece<sup>44</sup>).

Almost half of the **Member States<sup>45</sup> have adopted the exemption at national level related to DSOs serving less than 100 000 connected customers**. According to Article 26(4) of the Directives smaller DSOs serving less than 100 000 connected customers can be exempted from the requirements of both legal and functional unbundling. In two countries (Austria and Hungary), these provisions refer only to gas DSOs. It can be seen that this exemption has not been widely implemented so far.

In the view of the situation in the European Union as a whole, the threshold of 100 000 connected customers was chosen in the 2<sup>nd</sup> Package, as it was considered an appropriate figure. However, Member States may consider national circumstances and **lower the threshold** where it appears to be appropriate.

One of the controversial issues when it comes to the DSO unbundling is the **branding and communication issue**. In most of the Member States national provisions foresee that the DSO branding/communication (i.e. corporate identity) shall not create confusion with production and supply activities of the VIU. However following the current NRAs' assessment, in some of the responding Member States, both gas and electricity DSOs have proven to create confusion in their branding and communication policy. Consequently, the implementation of these provisions has required intervention by the NRA in many cases. NRAs have often obliged DSOs to rebrand and redefine their communications according to

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<sup>42</sup> As mentioned above Malta has derogation from the requirements of Article 26 of Directive 2009/72/EC. DSO forms part of a vertically integrated utility. In the case of electricity the Electricity Market Regulations (S.L.423.22) require unbundling at internal accounting level.

<sup>43</sup> Except Malta, Cyprus, Austria and the Netherlands (in the Netherlands no detailed rules were needed, due to the full ownership unbundling).

<sup>44</sup> In case of Greece and Slovenia the lack of independence within the approved financial plan refers only to the gas sector.

<sup>45</sup> Austria, France, Croatia, Denmark, Estonia, Germany, Hungary, Latvia, Poland, Romania, Slovenia, Slovak Republic, Spain (for electricity DSOs concerning functional unbundling, legal unbundling requirements must be met by 2016) and Sweden concerning functional unbundling.



the unbundling requirements (e.g. by providing guidance on logos and other brand messaging).

Furthermore, the majority of NRAs are satisfied with the **compliance programmes** set up by the DSOs and are of the view that **compliance officers** have enough information and resources to fulfil their tasks independently, particularly when it come to the electricity sector. The Member States are free to define what the compliance programmes should contain, even if typical set of rules for the compliance programmes relates to the behaviour of staff vis-à-vis network customers. Compliance programmes refer mostly to the sanctions imposed under national legislation in case of a breach of confidentiality rules.

In its July paper on “The future role of DSOs”, CEER<sup>46</sup> concluded that **the more DSOs are involved in non-core DSO activities, the greater the need for regulatory oversight and for reinforced unbundling**. If a new role for DSOs is to be considered in the future, it would be appropriate to also consider ways of avoiding discrimination between DSOs where ownership unbundling could be the right solution. Considering these new roles, CEER also concluded in its paper that the so called “de minimis rule”, concerning DSOs with less than 100 000 connected customers, might be revised in order to lower the threshold so that the majority of DSOs would be subject to proper unbundling requirements.

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<sup>46</sup> CEER paper “The future role of the DSOs” Ref: C15-DSO-16-03 from 13 July 2015, with reflections based on the results of a wide consultation on this topic with 108 consultation responses as well as input of a CEER DSO workshop held in March 2015.

[http://www.ceer.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_PAPERS/Cross-Sectoral/Tab1/C15-DSO-16-03\\_DSO%20Conclusions\\_13%20July%202015.pdf](http://www.ceer.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Cross-Sectoral/Tab1/C15-DSO-16-03_DSO%20Conclusions_13%20July%202015.pdf)



## Annex 1 – List of Abbreviations

Term	Definition
2 <sup>nd</sup> Package	Second Energy Package
3 <sup>rd</sup> Package	Third Energy Package
CDS	Closed Distribution System
CEER	Council of European Energy Regulators
CREG	Commission de Régulation de l'Électricité et du Gaz (Belgian NRA)
DERA	Danish Energy Regulatory Authority
DSO	Distribution System Operator
e.g.	Exempli gratia (for example)
EU	European Union
MS	Member State
NRA	National Regulatory Authority
Ofgem	Office of Gas and Electricity Markets (British NRA)
TSO	Transmission System Operator
RONI	Regulatory Office for Network Industries (Slovakian NRA)
VIU	Vertically Integrated Undertaking



## About CEER

The Council of European Energy Regulators (CEER) is the voice of Europe's national regulators of electricity and gas at EU and international level. CEER's members and observers (from 33 European countries) are the statutory bodies responsible for energy regulation at national level.

One of CEER's key objectives is to facilitate the creation of a single, competitive, efficient and sustainable EU internal energy market that works in the public interest. CEER actively promotes an investment-friendly and harmonised regulatory environment, and consistent application of existing EU legislation. Moreover, CEER champions consumer issues in our belief that a competitive and secure EU single energy market is not a goal in itself, but should deliver benefits for energy consumers.

CEER, based in Brussels, deals with a broad range of energy issues including retail markets and consumers; distribution networks; smart grids; flexibility; sustainability; and international cooperation. European energy regulators are committed to a holistic approach to energy regulation in Europe. Through CEER, NRAs cooperate and develop common position papers, advice and forward-thinking recommendations to improve the electricity and gas markets for the benefit of consumers and businesses.

The work of CEER is structured according to a number of working groups and task forces, composed of staff members of the national energy regulatory authorities, and supported by the CEER Secretariat. This report was prepared by the Legal Task Force of CEER's Implementation, Benchmarking and Monitoring Working Group.

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