



Guidelines for Good Practice on Functional and Informational Unbundling for Distribution System Operators

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1 Introduction

On 30th April 2007, ERGEG launched a public consultation on Draft Guidelines for Good Practice on Functional and Informational Unbundling - An ERGEG Public Consultation Paper¹. Following the ERGEG public consultation, the present Guidelines on “Functional and Informational Unbundling” reflect what regulators consider as an appropriate way to realise functional unbundling under the present legal framework for Distribution System Operators. The evaluation of comments received during the ERGEG public consultation on the draft GGP on Functional and Informational Unbundling is included in a separate document (C06-CUB-12-04a). ERGEG will further reflect on appropriate proposals to implement functional unbundling for Transmission System Operators under the present legal framework in light of the outcome of the 1st reading on the 3rd package. The Guidelines are referenced in a general way for both vertically integrated companies and network companies subject to functional and informational unbundling requirements. These guidelines only apply to “legally unbundled” network companies – DSOs - with two exceptions: where there is full **ownership unbundling** or where the NRA, acting fully independently (from the industry as well as politically), can show that an objective of a specific Guideline is already being met through demonstrable and verifiable means, such as **licence conditions**. Where this is the case, the NRA shall report regularly on the implementation of these means in relation to the achievement of the objectives of the Guidelines and, if necessary, consider action to address any discrepancy.

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.

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 our view effective unbundling implies:

¹ Draft Guidelines of Good Practice on Functional and Informational Unbundling - An ERGEG Public Consultation Paper Ref: C06-CUB-12-04 30-Apr-2007

- to effectively ensure non discriminatory access to networks, by excluding any possibility of discrimination of network users and to remove any (commercial) incentive for the network operators to give preferential treatment to related companies, including:
 - non-discriminatory access to the network for all potential users;
 - non-discriminatory access to information on network-related issues for all network users;
 - 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.

The following guidelines are subdivided into an A priority, which means that those guidelines must be implemented and are therefore mandatory, and a B priority, which means that implementation of those guidelines depends on national circumstances and should be decided by the relevant regulators. Where not otherwise stated, all the Guidelines are considered as an A priority.

2 Definitions/Clarifications

Management: The management of the network company includes the upper management as well as the middle management.

Sufficient resources: The meaning of sufficient resources entails full-functionality of the network company in the sense of concentration in merger control. Criteria to be met include a dedicated management to run the day-to-day business with access to sufficient financial/physical resources. Typically this will mean that the network company will own its assets, employ its own personnel and have access to sufficient financial resources adequate for an infrastructure company.

It is possible, however, that the personnel will not be directly employed by the network company. A third party may provide staff, or alternatively the parent company may provide personnel on secondment or via a subcontract. In this case the terms of secondment/subcontract must not deviate from usual terms with third companies, so that the network company deals with affiliated companies at arm's length and on the basis of normal commercial conditions, and as such is free to recruit its own employees².

Employment arrangements: Typically distribution companies do not directly employ all the labour force used directly but also profit from secondments and assignments.

- **Secondment:** In this set of Guidelines “secondment” means any arrangement between the network company and a third company (typically an affiliated company) whereby the employee (temporarily) moves to the network company. The practical effect of such a secondment arrangement is that the employee remains an employee of the home employer but the employee is directed by their home employer to take day-to-day direction from the staff of the host employer. Promotion, salary and other contractual terms are still governed by the employment contract between employee and home employer.
- **Assignment:** In this set of Guidelines “assignment” means any arrangement whereby an employee remains an employee of the third company but is located at the network company. The third company retains control over the employee’s day-to-day work.

3 Unbundling of Functions

The Electricity and Gas Directives provide that: *“those persons responsible for the management of the 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 and supply of electricity or natural gas”*.

² See “Sufficient resources to operate independently on a market” in the Commission’s Consolidated Jurisdictional Notice under Council Regulation (EC) 139/2004 on the control of concentrations between undertakings.

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 network company shall not be involved in any competitive business of the vertically integrated company. Equally, the competitive businesses must neither participate in the daily business of the network company, nor receive information concerning other issues relevant to their own clients or grid information that is not publicly available.

G01: (A priority) The network company shall be physically separated from the competitive business structures.

(B priority) The network company shall work in a geographically separated structure from the competitive business structures.

Physical separation means that access restrictions to the facilities of the network company are in place, whereas geographical separation implies different buildings for the network and competitive businesses.

G02: The network company must have sufficient financial and personnel resources to ensure real decision-making power and independence to carry out its work. This includes having enough resources to prepare decisions, to evaluate alternatives and to be assisted by external consultancy. The network company that employs personnel of the vertically integrated company must define the profile of the employees it needs and must not accept the personnel seconded by the vertically integrated company who do not match this profile. The network company could choose to benefit from general services performed by the parent company if it demonstrates that this choice results in lower costs and it does not imply any undue dependence. Such services shall be provided under precisely defined contracts, which are to be kept at the disposal of the regulator. Certain services, especially strategic ones such as the legal, regulatory and controlling services, have to be established in the network company.

Legal services and internal control functions are considered strategic in the sense that they handle all major decisions in a company. Therefore independent decisions are only possible if the network has independent advice in these areas. Independent decision-making also involves separation of information, as the integrated company would gain commercial advantage from information about major decisions within the network company (guidelines on separation of information follow later).

G03: The management of the network company shall be prohibited from holding any position in the management or supervisory board of a competitive business unit, wherever they might be located (Holding or affiliated company).

G04: The activities and rights of the vertically integrated company as regards the network operator are limited to securing its financial interest (supervisory function) via a supervisory report. Any interference in the network business by the vertically integrated company outside this supervisory function, and knowledge of the day-to-day network business is not allowed. The financial plan shall be proposed by the network company. Day-to-day decisions within the scope of the approved financial plans (or equivalent) must not be subject to further consultation or approval of the parent company. The supervisory board of the parent company may approve the global amount of investments, but thereafter the parent company must not be consulted on nor seek to influence any individual investment, whatever its cost, provided it stays within the limits of the financial plan for investment under Third Party Access (TPA) the return on capital is usually set by the regulatory authority.

4 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 ...distribution system operator (...) are taken into account in a manner that ensures that they are capable of acting independently*”.

This section concerns the additional measures that are necessary to ensure the independence of the management of the network company - Distribution. They are applicable whether or not legal separation is in place within the vertically integrated company.

The goal of the following measures is to allow the management of the network company to act independently and to guarantee its decision making power on grid-related issues. A way to achieve this to guarantee the professional interest of the management of the network company and other employees, and therefore to introduce specific stipulations in their contract of employment.

G05: The employment conditions of the management and employees, including those on basis of subcontracting of the network company, shall specify in particular:

G05a. The employee shall be subject only to the authority of the management of the regulated entity.

G05b. Wages and incentives are exclusively based on the results of the network company. The management of the network company must neither own shares of the competitive businesses nor shares of the vertically integrated company.

G05c. Promotions and sanctions can be decided only by the management of the network company.

G05d. The upper management of the network company shall not be dismissed without prior justification, in accordance with national labour laws. Justification for any dismissal shall be based on network issues and shall be notified to the regulator.

G05e. The conditions of the transfer of an employee of the network company to an affiliated company shall address the need for safeguards related to the disclosure of commercially sensitive and advantageous information acquired during his/her previous employment.

Ad 5b: The management of the network company should act independently, which is unlikely if they own shares of companies with commercial interest in its respective energy market. The primary concern of the GGP is for vertically integrated companies, but this provision may also be relevant for shares of competing companies.

G06: When a person employed in an affiliated company is seconded to a regulated subsidiary of the group, it is necessary, either for the employee to sign a new employment contract with this subsidiary, or for the employing company to sign a contract with the subsidiary to define the conditions of the secondment. 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 conditions of secondment with reference to the conditions laid down under G05.

Additional measures to reinforce functional unbundling concerning customer relations:

Customer relations between the network company and suppliers are a fundamental element of functional unbundling as they mirror the internal independence of the network business from the vertically integrated company. Customers must be convinced 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 of providing 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 therefore be reluctant to change suppliers. The affiliated supplier shall not benefit from the public credibility or reliability of the system operator. This must be assured through separate marketing activities.

G07: Network companies shall have their own identity; nothing shall imply a link between the network and the supply business. This involves clearly separate branding strategies, communication policies, and separate contact routes to the network and supply business such as separate telephone numbers and home pages (including transparent linking policies).

5 Unbundling of decisions

The Electricity and Gas Directives *provide that the distribution 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 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 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 distribution operators means that decisions must be made independently from competitive business units. The sphere of such decisions relates to the day-to-day operations and to the assets (physical as well as human) necessary for operating, maintaining or developing the network.

Effective decision making rights

Effective decision making rights entail the following requirements:

G08: All commercial and operational decisions related to the operation, maintenance and development of the network must be made within the network business in a non-discriminatory way, without involvement of the related supply business or holding company of the integrated company.

6 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 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, ERGEG³ 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). In terms of the unbundling rules, the confidentiality and disclosure of information must be specified in a well defined data management system in order to avoid any discrimination.

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)	Disclosure
Non-discriminatory implementation	Data access rules	Rules for data disclosure

³ See ERGEG Guidelines for Good Practice on Information Management and Transparency (ref. E05-EMK-06-10), 2 August 2006. http://www.ergreg.org/portal/page/portal/ERGEG_HOME/ERGEG_PC/GGP_Transparency

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 must be established so that contract partners can be given access to the data on equal terms, such as time, procedures, cost, and quality. Informational unbundling has to respect data protection laws, where the person in possession of confidential information is obliged to a specific behaviour.

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);

G09: The network company shall define for all network information at its disposal whether it is commercially sensitive (where it is owned by third parties) or commercially advantageous (where it is owned by the network company itself).

G10: For all network data, the network operator will define data collection, data processing and data access rules in a “data management system”. This system will ensure that for commercially sensitive information, confidentiality is respected and that equal, well specified and non-discriminatory access/disclosure) is guaranteed to contract partners. This involves equal treatment related to time, procedures, updating, costs and data quality. For commercially advantageous information the network company shall define whether data are to be disclosed, in a non-discriminatory way, or not (respecting the transparency needs of the market). Non-discriminatory access to such data again involves equal treatment related to time, procedures, cost and data quality.

G11: (B priority) The ultimate objective to comply with these requirements would be to ensure separate databases related to customers for the network and competitive businesses. This should allow each market participant to have equal access to information.

G12: The management and the employees of the network company shall not participate in any internal activities of the vertically integrated company in which commercially sensitive or advantageous information can be disclosed and which could give an advantage to the competitive business. Equally, the management and employees of the competitive businesses shall not take part in such activities of the network company.

7 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 network company shall create a framework (compliance programme) for the employees and management of the company dealing with network tasks. This must not be limited to employees of the network company, and shall be extended to affiliated or external service providers.

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 must 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.

Compliance officer

The network company shall appoint a person or a body as a compliance officer to monitor the implementation of the “compliance programme” in the network company. The compliance officer may also have the competence to *implement* the compliance programme in the company (drafting and publication of the compliance programme; defining measures to implement compliance; ...etc). The responsibility for an effective compliance programme remains however with the management of the network company.

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

G13: The contact details of the compliance officer, including name, address, e-mail, phone number, must be published in the compliance programme and communicated to all employees of the network 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 actual or suspected discrimination, disputes or queries, and breaches of the compliance programme.

G14: The compliance officer shall be guaranteed the necessary independence by the management of the network company through the compliance programme. He shall be trained properly in all aspects necessary of the job. He shall be equipped with the resources (including human resources) necessary to accomplish his mission and provided with all the necessary information.

G15: In order to monitor the compliance programme in an appropriate manner, the compliance officer shall have the following functions, which will be part of the compliance programme:

- Elaboration and improvement of the compliance programme
- 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 relevant 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 of instruction of new employees
- Right to propose disciplinary sanctions to the management in the event of the violation of the compliance programme in accordance with internal guidelines
- Direct access to the senior management of the network company

Compliance programme

In practice, the system operator should implement the compliance programme annually through the following stages:

G16: The network company should identify all activities to be examined within the compliance programme. This will be undertaken by, or at least in cooperation with, the compliance officer. All processes⁴ relating to these activities, including the data management system, must be defined in written form in the compliance programme. These processes will define the behaviour of employees in relation to customers, employees of other parts of the integrated company and third companies. The compliance programme should be integrated into the company quality system, where applicable.

⁴ In international quality standards this is often referred to as “procedures“

(a) Implementation

G17: The network company shall ensure compliance with the processes by its employees as well as seconded employees from affiliated companies and subcontractors, external or affiliated. They will train employees in the processes they are involved in and make these processes binding. Effective internal measures in case of non-compliance must be defined.

(b) Assessment

G18: The compliance officer shall monitor and assess the compliance programme, compare it to the requirements set out in the law and regulations and draw up reports on the results. To do so, he shall be provided with all the necessary information and adequate resources. The employees shall support the Compliance Officer in fulfilling his tasks.

(c) Development

G19: The compliance officer shall advise on the measures to be taken to correct any deviations detected in attaining the planned results and to continue to improve the processes.

(d) Reporting

G20: As a result of the assessment and development stage, the compliance officer shall draw up an annual report, submit it to the regulatory authority (details see G28) and publish it.

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 the daily processes in the company and provide information about the effort made by the network company to comply with the programme in its daily business.

G21: The annual report must provide information on the following issues:

- Promulgation of the compliance programme within the company
 - Information for employees about the compliance programme
 - Binding compliance programme
 - Signature of employees
- Training of the employees
 - Main issues
 - Organisation
- Report on all incidents
 - Number of sanctions imposed
 - Involvement of CO
- Cooperation from management
 - Support for CO
 - Consultation of the compliance officer
 - Number of consultations
 - Issues
- Presentation of the result of any process analysis, including any performed by external auditors

The report must be signed by the managing director of the network subsidiary, published and submitted to the regulator. The regulator will write an annual report on the monitoring of the compliance programme and the compliance report.