



COMMISSION
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Networks

Obedience to compliance programs and independence for electricity and natural gas system operators

2009 report

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Introduction

This fifth annual report on the obedience to compliance programmes and system operator independence is adopted in application of articles 6 and 15 of French amended law No. 2004-803 dated 9 August 2004. Its observations are based on the enactments currently in force¹, and take into consideration forthcoming changes, in particular those relating to the “3rd energy package”.

System operators have pursued their efforts to implement compliance programs in their companies. In this respect, a certain level of maturity has been reached.

In view of current criteria, transmission system operators are operationally independent. In 2009, distribution system operators, who became subsidiaries more recently, consolidated their operating procedures and their position as energy market players in their own right was recognised. Over the next few years, the French Energy Regulatory Commission (CRE) will focus on the action that distribution system operators must take to increase their independence with regard to their parent companies.

Distribution system operators and their roles remain relatively unknown to the general public. This situation exacerbates an ambiguity that is not conducive to market opening to competition. Efforts to raise profiles must be pursued and put into widespread use. Similarly, parent companies should not seek publicity from the assignments entrusted to system operators.

1. European enactments:

Articles 10, 12, 15, and 16 of directive 2003/54/CE of 26 June 2003 concerning common rules for the internal market in electricity
Articles 9 and 13 of directive 2003/55/CE of 26 June 2003 concerning common rules for the internal market in natural gas

Non-bonding guidelines: ERGEG, Guidelines for Good Practice on Functional and Informational Unbundling for Distribution System Operators

French enactments:

Articles 16 and 20 of law n°2000-108 of 10 February 2000 concerning modernisation and development of electricity public service
Articles 2, 7, 9, 18 and 21 of law n°2003-8 of 3 January 2003 concerning gas and electricity markets and energy public service
Articles 5, 6, 7, 13 and 15 of law n°2004-803 of 9 august 2004 concerning electricity and gas public service and electricity and gas undertakings

Decree n°2001-630 of 16 July 2001 concerning commercially sensitive information known by transmission and distribution grid operators

Decree n°2004-183 of 18 February 2004 concerning commercially sensitive information known by gas infrastructures operators

Decree n°2005-1481 of 25 November 2005 concerning unbundling of professional interest of the persons responsible for the management of the transmission grid operator

Summary

1. BACKGROUND: SYSTEM OPERATOR INDEPENDENCE SERVING CONSUMERS

In France, system operators belong to groups that also conduct business in the energy sector, in fields governed by competition rules. They could therefore be tempted to use their privileged position to their group's benefit, which would disadvantage end consumers.

1.1. Non-discriminatory access to networks is essential for the development of competitive markets

Non-discriminatory access to electricity and gas transmission and distribution networks is at the core of the market opening to competition approach implemented by the European Union since the end of the 1990s.

All types of discrimination between market players on the part of system operators act as obstacles to newcomers accessing the market. By means of example, a system operator that grants preferential connection conditions (timeframe, price, *etc.*) to an electricity producer would create a distortion of competition that would disadvantage end consumers.

Non-discrimination is also essential to earn the consumers' trust. If a distribution system operator is known to practice discrimination to benefit the energy supply activities of the group it belongs to (for example, conducting repairs more quickly for customers of this supplier), end customers would no longer play the various competing suppliers off against each other, and would therefore lose the related advantages of competition.

Discrimination is an obstacle to the development of fair competition that benefits consumers for these two reasons.

1.2. System operator compliance programs and independence act as a guarantee of non-discrimination

EU and national enactments in force highlight two tools to ensure non-discrimination: compliance programmes and independence of system operators with regard to their parent companies. Firstly, compliance programs contain measures taken to ensure that discrimination is completely excluded and that their application is subject to appropriate monitoring. Secondly, system operator independence plays a part in preventing discrimination against competitors with other business activities (generation, supply, *etc.*) within the same group.

In application of these enactments, every electricity or natural gas transmission or distribution system operator serving more than 100,000 customers provided CRE with their annual reports on the application of their compliance programs.

1.3. The legal context in which these issues are addressed is set to change in the near future.

2. Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal electricity market and repealing Directive 2003/54/EC and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal natural gas market and repealing Directive 2003/55/EC, and related regulations (No. 713/2009, No. 714/2009 and No. 715/2009)

3. Further information on the “3rd energy package” provisions in terms of independence can be found in the focus section of this report.

Independence was a central issue during the discussions on the “3rd energy package”. The recently adopted European Directives² introduce new regulations that will enter into force in March 2011.

The main changes expected concern transmission system operators, who will have to be certified as compliant with one of the independence models that will be retained when the EU enactments are incorporated into national law. Regardless of the selected model, the changes for transmission system operators will be far-reaching. EU lawmakers considered that a transmission system operator belonging to a vertically-integrated undertaking can only be independent and act in a non-discriminatory manner if appropriate provisions in terms of separate resources, governance, relations within the group and the independence of management and personnel are implemented.

The requirements provided for by the “3rd energy package” concerning distribution system operators bring about fewer changes but will lead to certain situations being reassessed, in particular certain subsidiary transfer methods and the choice of names, logos and commercial brands of distribution system operators and/or related supply companies.

This report is therefore written in a period of transition. It draws lessons from the past year concerning the foundations of the enactments in force, but the observations made will in future be assessed against the forthcoming legal context³. As for every document written in a period of transition, this report presents what has been done up till now while identifying possible obstacles ahead.

2. A HIGH LEVEL OF OBEDIENCE TO COMPLIANCE PROGRAMS

2.1. The continued efforts of system operators prevent discrimination

System operators have pursued their efforts in 2009. They have upheld, and in certain cases have added to, their compliance programs. The audits conducted both internally and externally have shown that the principles of these programs (non-discrimination, objectivity, transparency and confidentiality) are known to and applied by the great majority of system operator staff members. Regular training sessions should keep this knowledge at a high standard.

As regards transparency, system operators have enriched the content and improved accessibility to their websites. They must now strive to update information regularly. Users of the networks often criticise the complex nature of the information they consult. Work to simplify and explain such points must be conducted so that users can rapidly access clear and precise information. It is therefore necessary to pursue and add to transparency measures to improve user information. Also, actions conducted to ensure confidentiality must not become an obstacle for transparency.

2.2. CRE has assessed distribution system operators by means of a mystery customer survey, providing satisfactory overall results

In 2009, CRE conducted another mystery customer survey in the field of distribution, this time stepping up efforts to assess local distribution companies (ELDs). The results for ERDF and GrDF show an improvement in the conduct of reception staff as regards the quality of information provided. It was also concluded that staff members do not clearly direct customers to the traditional supplier, or dissuade them from using an alternative supplier. The exercise conducted in assessment of ELDs shows that there has been significant improvement. In comparison to 2008, information quality remains stable, but hardly any cases of defamation of alternative suppliers or encouragement to use the traditional supplier were recorded. The same goes for the reflex of asking the name of the current supplier.

2.3. The level of quality reached must be upheld

Real progress was made in terms of both transparency and non-discrimination.

System operators have reached a certain maturity in their compliance programs. The main target for coming years is therefore to build on progress made in this area and make essential improvements.

2.4. The low public visibility of distribution system operators is detrimental to the proper operation of the market

As in 2008, and despite some noteworthy initiatives following CRE's requests, such as the ERDF advertising campaign, distribution system operators are suffering from a clear lack of public visibility. The general public is not particularly aware of the existence of system operators and is even more ignorant of the role they play. It remains difficult for people to clearly identify who they should contact, which does not help them to obtain appropriate information. The initiatives undertaken by some distribution system operators must therefore continue and be launched on a larger scale.

Moreover, due to the lack of knowledge on how the competitive energy markets operate, the possibility of a drop in the quality of the service provided by distribution system operators may be wrongly attributed to a lack of quality in supplier services, in particular for new suppliers (system operators are often involved in changes of supplier, while most users have only had dealings with them for meter reading up till now). Distribution system operators must therefore be aware that service quality is also part of non-discrimination⁴.

⁴ CRE report dated 17 November 2009 on the quality of service of gas network operators GrDF, GRTgaz and TIGF.

3. MIXED RESULTS FOR SYSTEM OPERATORS IN TERMS OF INDEPENDENCE

3.1. Common points requiring attention

Compliance with the principles provided for in the Directives is necessary, namely:

- the subsidiary must have total independence in terms of decision-making, particularly in terms of communication, subject to the parent company's right to economic supervision,
- to guarantee the professional interests of the system operator's personnel and managers, so that they can act entirely independently.

As regards the first requirement, CRE submitted requests to parent companies as part of its previous reports. In 2010, CRE plans to organise meetings with these companies in order to back up its assessment with more precise objective observations, mainly as concerns communication and crisis management. Although the situation of management boards in most cases meets the requirements of French and EU legislation, the profiles of the members of supervisory boards should be more diversified and parent companies must not create any structure that could undermine the independence of system operators.

CRE will also pay close attention to the communication initiatives conducted by system operators. According to ERGEG guidelines for good practice on functional and informational unbundling, independent communication not only provides market players with objective and reliable information that is essential when drawing up their strategies (forecast analysis, analysis of the winter period, etc.), but allows consumers to benefit from better understanding of how competitive energy markets operate. It therefore contributes to the development of fair competition to the advantage of informed consumers. As such, it is essential that system operators are independent in their communication and that the communication of parent companies is strictly limited to their scope of responsibility. Parent companies must not profit from direct publicity, putting themselves forward when certain operations are carried out by system operators; or from privileged operational information: in the event of a crisis, system operators must inform all suppliers in the same way.

3.2. The current independence of transmission system operators is a solid foundation for the implementation of the “3rd energy package”

CRE's 2008 report highlighted transmission system operators' independence in terms of organisation and decision-making. The same observation has been made in 2009. Transmission network users confirm this in the various surveys they answered.

In future, it will be necessary to reassess the independence of transmission system operators, in light of the more ambitious regulations provided for in the “3rd energy package”. This body of law lays out a large number of new requirements that transmission system operators will have to incorporate into their daily operations and organisation. In particular, compliance with these rules may prove to be a long-term task materially (for instance, the development of information systems or insourcing expertise that was up till now entrusted to the vertically-integrated company by means of a service contract) and therefore decisions that can only be based on an in-depth assessment of the situation of each transmission system operator may have to be made quickly. Their current organisation may provide a solid foundation for the implementation of changes on an EU-scale, yet the issue of compliance with the “3rd energy package” will be addressed as of 2010.

3.3. The independence of distribution system operators must be strengthened

After the phases of reorganisation related to legal unbundling, most distribution system operators set about ensuring stable operating methods. In 2009, they worked to better define their relations with their parent company (contract-based services, modification of the articles of association, etc.). However, in most cases, there is still a strong link between the two entities.

Distribution system operators must reinforce their independence, even if this involves altering certain situations brought forward from the period prior to the market opening to competition. Using the services of the parent company is conducive to weakening a subsidiary's independence. Consequently, the use of such services must be limited to cases in which it is impossible for the subsidiary to obtain this service from other providers or when the services proposed by other providers are financially less interesting than those provided by the parent company. Although some of these strong ties are understandable in view of the recent obligation of legal unbundling, CRE believes that this situation must change in the future and must invariably be subject to a justified decision made by the system operator.

CRE once more expresses scepticism about the so-called "light distribution system operator" model. In this case, system operators do not have the necessary technical and human resources to conduct work on the grids, and entrust most of these operations to the parent company. Although this situation is permitted under current national legislation, it will most likely be reassessed after the incorporation of the "3rd energy package".

Moreover, distribution system operators must ensure that it is not possible to confuse the distribution system operator with the vertically-integrated undertaking, particularly by adopting an appropriate brand strategy. This EU requirement is likely to lead to a change in logos, corporate names and/or brands for certain companies.

The uncertainty regarding changes to the visual identity of distribution system operators must not prevent these companies from raising their public profile. In 2009, ERDF launched an advertising campaign that is set to significantly increase visibility. Users' awareness of system operators and their role is a key aspect of the market opening to competition. The measures intended to promote their image must therefore be pursued and fostered.

In the short-term, distribution system operators' service quality contributes to the service quality of new suppliers and the proper operation of the competitive market, as perceived by the end user. In the long-term, distribution system operators must become the linchpins of efficient market operations, a role that requires real independence.

The extent of the market opening to competition in ELD sectors remains low. According to alternative suppliers, this situation is primarily due to the considerable costs required to adapt their information systems to the management of customers in these zones. The ELD must therefore work more closely with ERDF and GrDF with a view to furthering system interoperability initiatives.

Focus

1. INDEPENDENT SYSTEM OPERATOR COMMUNICATION SERVING CONSUMERS

1.1. Independent communication is necessary for the development of fair competition

In the past, CRE has often been asked to examine the communication practices of certain system operators or their parent companies.

2009 was a particularly illustrative year, due to the impact of the Klaus storm in south-west France on transmission and distribution grids. CRE also considered EDF's communication on the possible use of the income of its bond issue at the beginning of the summer to finance EDF Group regulated activities in France. The gas supply conflict between Russia and the Ukraine also showed how GRTgaz is able to communicate independently and separately from its parent company. More recently, ERDF was criticised by several market players for the presence of its logo, embossed on the front of advanced meters that will soon be used in the experimental phase, and during its recent television advertising campaign. The use of the logo in this campaign has been brought before the courts before an out-of-court settlement could be found.

According to ERGEG guidelines for good practice on functional and informational unbundling, which decline the Directives, independent system operator communication not only provides market players with objective and reliable information that is essential when drawing up their strategies (forecast analysis, analysis of the winter period, etc.), but also allows consumers to benefit from better understanding of how competitive energy markets operate. It therefore contributes to the development of fair competition in favour of informed consumers. CRE believes that system operator communication must be independent and that the communication of parent companies must be strictly limited to their scope of responsibility. It is therefore essential that parent companies do not take on the assignments of system operators or profit from direct publicity by putting themselves forward illegitimately.

1.2. Parent company and system operator communications: a relationship remaining to be clarified

Independence does not rule out the existence of two types of coordination mechanisms between the parent company and the system operator. Firstly, relations that convey the ties with shareholders, and secondly, the commercial relations developed between a system operator and one of the entities or companies of the group it belongs to, acting as an energy supplier, producer, shipper or infrastructure operator.

As shareholder, the relation that the parent company has with the system operator requires specific coordination in terms of communication, particularly financial communication. Aside from this type of relation, system operators must behave with the parent company as they would with any other market player (supplier, producer, etc.). For example, in the event of a crisis affecting supply continuity, all suppliers must receive the same information at the same time.

The regulations currently governing relations between system operators and market players in terms of communication are not laid out in a legally binding document. System operators must draw up transparent and non-discriminatory operating rules for the publication of information in the event of a crisis affecting continuity of supply.

System operators would benefit from an official clarification of their relations with their group in terms of communication. If such documents are drawn up, they must be published to meet transparency requirements.

2. SYSTEM OPERATOR INDEPENDENCE IN THE 3RD ENERGY PACKAGE

5. Directives
2009/72/EC
and 2009/73/EC

6. Regulations (EC)
Nos. 713/2009,
714/2009 and
715/2009

A body of law (2 Directives⁵ and 3 Regulations⁶), concerning the internal energy market was published in the Official Journal of the European Union on 14 August 2009. This body, commonly known as the “3rd energy package” brings far-reaching changes to EU legislation currently in force as regards the electricity and gas markets. It modifies the rules concerning system operator independence, for transmission system operators in particular, an issue which underwent much debate between the various European institutions during the elaboration of the package.

2.1. Changes in terms of transmission system operator independence

2.1.1. Member States choose from three models

The Directives define three possible independence models for transmission system operators: ownership unbundling, independent system operator (ISO), and independent transmission operator (ITO). The provisions of each of these models cannot be combined or mixed. Ownership unbundling is the systematic model, but when the transmission grid is operated by a vertically-integrated undertaking, as at 3 September 2009⁷, Member States may opt for one of the other models.

7. Article 9 of the
aforementioned
2009 Directives

In all cases, ownership unbundling, via a vertically-integrated undertaking’s transferring its transmission system operator activities, must be legally possible at all times. In addition, the Directive prohibits transmission system operators resulting from ownership unbundling to come under the control of a company performing any of the functions of energy supply or generation.

2.1.2. The regulator certifies and supervises transmission system operators

Before being designated by a Member State, a transmission system operator must be certified by the regulator in terms of compliance with the selected model. This certification involves the regulator checking that the operator complies with all the requirements of the selected model. The draft certification decision drawn up by the regulator is submitted to the European Commission for its opinion. The regulator is subsequently in charge of monitoring the transmission system operator’s compliance with the selected model.

Most of the various aspects of the independence models authorised by the 3rd package have already been addressed by CRE as part of preparatory work for reports on the implementation of compliance programs and independence for system operators. Certification, however, requires more in-depth checks leading to a CRE decision, which is a new procedure.

2.1.3. EU enactments define a timeframe for work

The EU enactments define the various phases of the certification procedure. The resulting timeframe is as follows, if a two-month period is considered sufficient to designate a certified system operator:



Given the date that the Directives enter into force and the timeframe presented above, CRE and transmission system operators must start preparatory work as of 2010.

2.1.4. Specific conditions for the ITO model

The ITO model is the result of modifications made to the initial drafts of the European Commission upon request of certain Member States, including France.

With regard to the provisions of Directives 2003/54/EC and 2003/55/EC, the level and the breakdown of independence requirements are strengthened in this new model. It is different in that the requirements applicable to transmission system operators are increased. These requirements concern the transmission system operator's own resources, corporate governance, relations with the vertically-integrated company, the guarantee of professional interests for TSO personnel and managers, investment control and the implementation of a compliance programme verified by an independent compliance officer.

These new requirements will bring about significant changes to TSO operating procedures.

2.2. Changes in terms of distribution system operator independence

As regards distribution system operator independence, the content of the published enactments is identical to the European Commission's initial proposals, dating back to September 2007, i.e. less than three months after the entry into force of the obligation of legal unbundling. Under these circumstances, the resulting changes are less significant than for transmission system operators. The provisions of Directives 2003/54/EC and 2003/55/EC on distribution system operator independence have been retained and three new points have been added:

- *“In order to fulfil [its] tasks, the distribution system operator shall have at its disposal the necessary resources including human, technical, physical and financial resources”*. This provision should lead certain system operators to change the scope of activities outsourced up till now;
- Compliance programmes, already laid out in previous enactments, must be monitored by a compliance officer, independent from the hierarchy and who must have access to all information concerning the distribution system operator and related companies required for the performance of his/her assignment;
- Distribution system operators belonging to a vertically-integrated undertaking shall not, in their communication and branding, create confusion in respect of the separate identity of the supply branch of the vertically integrated undertaking. This provision should lead some distribution system operators to change their corporate names, logos and/or commercial brands.