COMMISSION
DE RÉGULATION
DE L'ÉNERGIE

Networks

Report for 2008 on electricity and natural-gas network operators: obedience to compliance programmes and independence

Report 2008

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Summary

This fourth annual report on the obedience to compliance programmes and the independence of network operators is adopted under Articles 6 and 15 of the French law 2004-803 of 9 August 2004, as amended. It serves a new context, in which network operators with over 100,000 customers now provide services that are legally separate.

Network operators have worked hard over the last four years to draw up and implement compliance programmes. The results to date have proved satisfactory: the programmes are now widely circulated and staff are well aware of them.

Transmission-system operators are effectively independent. CRE will nevertheless ensure that this independence is not jeopardized by the parent companies.

It is too early to assess definitively the actual independence of distribution system operators, and in particular of local distribution companies (*Entreprises Locales de Distribution - ELD*) whose legal separation is still recent. ERDF and GrDF have taken measures that increase their independence.

The general public is largely ignorant of distribution system operators and the work they do. This situation perpetuates an obscurity that damages the open market. It is therefore essential that these companies improve their public awareness.

There are few alternative suppliers present in the areas of ELD service provision, and virtually none in the electricity-distribution systems. This situation merits a more detailed review: how far is it caused by the attitude of the ELDs, and how far by the excess caution of new entrants?

BACKGROUND

Non-discriminatory access to the transmission and distribution systems for gas and electricity is at the centre of the move within the European Union to deregulate the markets over the last ten years.

Discrimination is a practical obstacle to market access for new entrants. Non-discrimination is also essential in gaining the trust of network users. For both these reasons, any discrimination hinders the development of a fair competition that benefits the consumer in energy production, sourcing and supply. This topic was central to the discussions concerning the Third Energy Package[1] on ownership unbundling for transmission system operators.

To this end, Community and national enactments stress two means to ensure non-discrimination: compliance programmes; and the independence of network operators.

Under these enactments, each operator of an electricity or natural-gas transmission or distribution system supplying more than 100,000 customers has sent the French Energy Regulatory Commission (*Commission de Régulation de l'Energie – CRE*) its annual report on applying the compliance programmes.

(1) Proposals for amendments to Directives 2003/54/EC and 2003/55/EC of 26 June 2003 on the internal gas and electricity markets, and to their enactments.

OBEDIENCE TO COMPLIANCE PROGRAMMES

Assessment compared with 2007

In 2008, each network operator subject to this requirement had a compliance programme and published it on its internet site. The programme set out the measures taken to guarantee to network users firstly that all discriminatory practices were banned, and secondly, that the application of the programme was being monitored appropriately. The operator carried out internal, and in some cases external audits, in order to ensure that the compliance programmes were properly applied. None of these audits identified practices that deliberately differentiated a particular supplier, or showed that commercially-sensitive information (*Informations Commercialement Sensibles - ICS*) had knowingly been disclosed. This was confirmed both by audits carried out by CRE and by the "mystery customer" survey that CRE initiated. Assessments made by network users during these surveys confirmed this conclusion.

In addition, a large part of the information required for equitable access to the network is available to users. The same is true of standard network-access contracts, key procedures, technical reference documentation, lists of additional related services, and descriptions of the networks, their capacities and their use. For the most part, this information satisfies Community and national requirements, although some network operators still need to supplement it.

The compliance programmes (imposed by the legislator as a non-discrimination measure) are therefore in place and applied. Their effectiveness in practice is also subject to assessment.

To this end, some distribution system operators and CRE[2] have carried out "mystery customer" surveys of the reception services of distribution system operators obliged to follow the compliance programme.

These surveys showed a sharp rise compared with 2007 in the frequency with which a customer-service representative indicated spontaneously to a customer that he/she could choose between several suppliers. There were, however, instances of customers being urged with undue haste towards their historical supplier or being dissuaded from choosing an alternative supplier. This was more marked for the ELDs than for ERDF and GrDF. CRE's survey showed that the local distribution companies surveyed[3] reached the standard of the distributors EDF and GDF in 2007. Specific measures must therefore be implemented or strengthened within local distribution companies.

Distribution system operators have difficulties with transparency: it is hard for them to supply the people they speak to with the information that enables them fully to appreciate all the factors involved in the negotiation. These difficulties are due partly to their low public visibility, which is related to their recent creation. Although they supply electricity to almost 35 million people and gas to 12 million, neither the distribution system operators nor the work they do are known to those who nevertheless are their day-to-day customers. Distribution system operators cannot be perceived as independent and non-discriminatory by people who do not know about them. This problem goes well beyond issues relating to non-discrimination and independence. It affects particularly the confidence network operators inspire in the markets, and more particularly, in the market for individual customers. This situation inhibits the open market, particularly because there are concerns over the quality of the supply and the time taken to intervene in the network. This will be an important topic in the years to come.

(2) The CRE had already carried out such a survey in 2007, but only for the distributors EDF and GDF, which became ERDF and GrDF when subsidiaries were created on 1 January 2008.

(3) For electricity, they were Electricité de Strasbourg, Gérédis, Sorégies Réseaux de Distribution and URM; for gas, they were Régaz and réseauGDS.

In spite of these shortcomings, progress to date is satisfactory.

Demands from CRE

The distribution system operators must continue to work on indicators for the compliance programme, and in particular, must make them more pertinent. Joint consideration of this topic is essential in the area of transmission. CRE will therefore set up a working group with the task of defining a common framework during 2009. Each transmission system operator will use this framework to define its indicator(s), which may, for instance, be based on the number of complaints, the time taken to process them, the extent to which the programme is circulated and adopted, and the implementation of and obedience to procedures relating to the protection of commercially-sensitive information.

The emphasis placed on training and informing staff, in particular representatives in contact with network users, must be increased. This is clear from the "mystery customer" surveys, and applies both to non-discrimination and also to transparency. Distribution system operators must also actively seek to make themselves and their work better known.

In addition, network operators must give more importance in their annual reports to the results of inspections and audits, both internal and external, and of the conclusions from satisfaction surveys of their network users.

To avoid any risk of privileged communication of information that could distort competition, and to guarantee and demonstrate separation of activities, network operators must not have their premises in the same building as an entity belonging to the same group and in the competing sector, except in the short term, and when the obvious impracticality of doing otherwise can be properly justified. If separation is acknowledged not to be possible, then physical means of protection, such as secured access, must be installed, until the entities are located in separate buildings. Similarly, the information systems of the network operator and the supplier must ultimately be entirely separate. If it proves impossible to achieve this within a short time, the systems must be adequately secured, meaning that particular attention must be paid to access rights.

THE INDEPENDENCE OF SYSTEM OPERATORS

Transmission system operators

In terms of their organization and decision-making, the operators of electricity and natural-gas transmission systems demonstrate a genuine independence that is well protected under current legislation. CRE will ensure that this independence is not jeopardized by the parent company in relation to communication or access to financial resources.

Developments in Community law are likely to impose new requirements and transmission system operators must be prepared for them.

Distribution system operators

The Directives of 26 June 2003 provide for the legal unbundling of distribution system operators by 1 July 2007 at the latest. This requirement was not transposed into French law until December 2006, which did not allow businesses to set up subsidiaries and define their detailed organization within the prescribed time. By 1 December 2008, 6 of the 7 distribution system operators supplying more than

100,000 customers were legally separate. Electricité de Strasbourg should achieve this separation on 1 January 2009.

Several arrangements for legal unbundling have been adopted, and they are described in the sections relating to each network operator. All cases require the implementation of safeguards necessary to protect the independence of the system operator and specific to the particular unbundling arrangement. In most instances, this has not been done. CRE is therefore asking the companies concerned to put adequate measures in place and to publicize them (on their internet sites, for instance). The unbundling arrangement that occasioned most reservations on the part of CRE is the one known as "light DSO (*distribution system operator*) ". In this arrangement, the subsidiary DSO does not have the technical and human resources to work on the networks, and sub-contracts this work to the parent company. As currently defined, the draft Third Energy Package rules out such an option.

Distribution system operators are largely unknown to their customers. In addition, in most cases, their names and logos are too similar to those of their parent companies. This situation, of which distribution system operators are aware, causes misunderstandings that are detrimental to market deregulation. It is therefore essential that operators improve their public awareness. More generally, CRE will observe carefully the contribution of parent companies to the necessary assertion of the independence of their network-management activities.

The extent to which the market has opened is particularly small in areas supplied by the ELDs, and CRE will review further the reasons for this during 2009.

Comments common to both transmission and distribution system operators

CRE will continue to ensure that the principles embodied in the Directives are respected. These are:

- to ensure that the subsidiary makes completely independent decisions, apart from the parent company's right of economic supervision;

- to guarantee the professional interests of the operator's managers, so that they can act entirely independently.

No member of a network operator's Board of Directors or Supervisory Board should be a member of a supplier's or producer's decision-making body. The companies concerned have to a large extent formalized this principle in their Articles of Association, and comply with it. As discussions stand at the moment, this requirement appears in the draft Third Energy Package for transmission system operators.

In practice, in a vertically-integrated company, the principle of independence cannot be totally respected without such a guarantee. This is because company law allows directors and Supervisory-Board members of such companies to access all the information they consider necessary. Long-standing suppliers could later use some of this information to gain a competitive advantage.

The independence of the network operator could also be jeopardized by using the services of an integrated group. This is especially the case for financial services, human resources and accountancy, even outside the "light DSO" model, where the network operator's core business is in practice performed by employees of a producer or supplier. In this regard, network operators work in a variety of different

ways. Recourse to the parent company must be limited to instances where it is impossible for the operator to provide the service itself, either directly or by using services from another third party, under acceptable economic conditions. In no case must this recourse threaten the subsidiary's independence as regards its organization and decision making. It must be the subsidiary's choice, made using transparent procedures, and not be a source of cross-subsidies. Lastly, recourse to the services of an integrated group must be formalized in contracts that may be audited.

The groups to which the network-operator companies belong must not communicate on topics that relate to the operators' work. They must refrain from any communication linking competitive activity and regulated activity, and from any interference in the subsidiary's communication policy.

Focus

Although there has been undeniable progress, both in monitoring non-discrimination and as regards independence, certain topics require special monitoring and remain central to CRE's concerns.

GUIDELINES FROM ERGEG

As it is acknowledged that the gas and electricity Directives give only general guidance on the independence of system operators and the content of the programmes of undertakings, ERGEG[4] felt it necessary to translate this guidance into guidelines defining the constraints imposed on network operators in order to ensure non-discrimination.

These guidelines were published in July 2008[5] and apply to distribution system operators. ERGEG states in the introduction that it will further consider the guidelines for transmission system operators in the light of the obligations included in the Third Package modifying the European Commission's gas and electricity Directives.

The guidelines deal in turn with:

- the actual independence of the network operator and the absence of its managers' professional interest in competing group activities;

- the independence of network-management staff in relation to group interests and to maintaining their professional interests;

- non-discrimination in decision-making:

- the protection of commercially-sensitive information and the separation of information systems;

- the implementation and management of the compliance programme.

For each of these areas, the guidelines set out the rules that the system operator must satisfy, and whose application is audited by the regulator.

CRE has participated actively in defining these rules, and will work with the different network operators to decide how they should be implemented. It will use the rules as a reference standard in future Annual Reports on obedience to compliance programmes and on independence.

MOVEMENTS OF PERSONNEL WITHIN INTEGRATED ENERGY GROUPS

Movements of staff, and particularly of executives, between different entities in a group, are a part of its human-resources management policy. In the electricity and gas industries, this type of staff circulation must be accompanied by the strongest possible guarantees to prevent the interests of competing group entities influencing the decisions of executives managing regulated subsidiaries. In particular, companies should avoid promoting, even informally, services provided to the group by an employee of the network operator, or imposing limitations on his/her neutrality as regards the group's competitive interests.

(4) The European Regulators Group for Electricity and Gas is a group of European electricity and gas regulators that was created by the European Commission in 2003. It is the official body via which regulators advise the European Commission on questions relating to the internal energy market.

(5) http://www.energy-regulators.eu/ Guidelines for Good Practice on Functional and Informational Unbundling for Distribution System Operators, ref C06-CUB-12-04b dated 15 July 2008.

The majority of system operators have already set up safeguards so that an employee with access to commercially-sensitive information may not move directly to another group sector where that information would offer a competitive advantage. For the public electricity-transmission system, a commission was set up under Article 13 of the French Law of 10 February 2000. This commission must be consulted when an agent who has come to know commercially-sensitive information in the course of his/her duties wishes to carry out activities in the electricity sector outside this service. At CRE's request, some other network operators have also created commissions with the same objective, without being legally bound to do so.

The Directives also provide that, "appropriate measures must be taken to ensure that the professional interests of the persons responsible for the management of the (...) system operator are taken into account in a manner that ensures that they are capable of acting independently". "Persons responsible for the management" must here be taken in the broad sense and not restricted to the subsidiary's Managing Director.

In its Guidelines of July 2008, ERGEG suggests the measures that should be implemented to ensure that the provisions in the Directive are applied in full, in whatever legal form (secondment, provision of personnel or sub-contracting) the transfer of staff takes place. In particular:

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.

It is also a requirement that a secondee and the entities that employ him/her are aware of these rules in advance. The rules must therefore be in written form, as described below:

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.

This rule must be adapted for employees in the gas and electricity industries (*Industries Electriques et Gazières - IEG*), since they do not sign formal contracts of employment. Thus, if an entity in the IEG moves to another entity in the IEG, no employment contract and no addendum can be signed. The rule G06 must therefore be embodied in a specific written document.

As regards dismissing members of Senior Management, Articles 6 (for transmission system operators) and 15 (for distribution system operators) of the French Law dated 9 August 2004 states that "persons responsible for the general management of system operators may not be dismissed without the French Energy Regulatory Commission giving advance notice of the grounds for dismissal". ERGEG simply adds to this that "persons responsible for the general management" should be construed as "members of the upper management". The French Decree 2005-1481 dated 25 November 2005 extends the procedure to all Board members of the operator of the public electricity-transmission system (*RTE - Réseau de Transport d'Electricité*).

During 2009, CRE will work with the different network operators to determine the best way to implement these rules.

ASSESSING THE FINANCIAL INDEPENDENCE OF NETWORK OPERATORS

Under the French Law dated 7 December 2006, the distribution activities of EDF and GDF Suez were transferred to subsidiaries on 1 January 2008.

This legal unbundling marks another step towards network operators that function entirely independently. However, as regards finance, it is not a sufficient condition for that independence. In practice, system operators maintain financial relationships with their parent companies and may depend on them to finance their activities and their investment programmes.

The invoicing of head-office charges is one of the financial flows that CRE reviews in detail. From the time it was reorganized into a subsidiary, RTE has controlled all the resources it needs to function, and has stopped paying such charges. This is not the case for the other network operators. If the parent company invoices head-office charges, it must identify the consideration in terms of the services it provides without jeopardizing the independence of network operators. Thus in the context of CRE's tariff proposals relating to gas transmission (ATRT 4) and gas distribution (ATRD 3), GRTgaz and GrDF have set out assumptions relating to the future course of these charges (from which CRE has excluded charges related to communication and the cost of head-office management personnel).

The independence of system operators' access to financial resources is generally decisive in guaranteeing that those resources are adequate for requirements. This is particularly so for investment requirements.

As regards access to financial resources, currently only RTE has its own cash-management system and no longer participates in EDF's cash pooling. RTE is also the only operator that uses the capital markets directly to raise loans.

The parent companies of all the system operators continue to exercise their shareholder prerogatives in terms of the dividends they receive and their control over the level of net indebtedness. Decisions of this type fall within the scope of those defined in standard company law. They may however compete with planned investment to improve the quality of the networks. Against this background, CRE continues watchful of changes to integrated operators' policies on dividends and indebtedness, and especially so in the current climate of financial stress.

CRE currently has the authority to approve investment programmes for transmission system operators. This is a provision designed to ensure that investment is adequate to requirements.

However, CRE has no authority to approve distributors' investment programmes, and its influence over tariffs cannot alone guarantee that the necessary investment in distribution will be made.

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