EU Unbundling and Regulation

by Nikos Katsis,
Director of the Strategy and Business Planning Division, DESFA S.A.

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UNBUNDLING & REGULATION IN THE EU
Overview of the EU internal gas market

- Since the mid-1990s the European Commission has been laying the pavement for European energy markets, especially gas and electric power, to be opened up, liberalized, and unified.

- The driving goal of these reforms in the gas sector: to reduce gas prices paid by consumers.

- One key problem identified in the 1990s was the dominance of incumbent monopolies that controlled import and onward sales of gas as well as transmission assets, and were shielded from competition.

- Progress toward the overriding economic objective of the EU—creating a “single market” for goods and services—was clearly impossible without breaking up or unwinding these monopolies. This goal was promoted by the First Energy Package.
Timeline of EU gas regulatory changes

**Second Directive (2003/55/EC):**
- rTPA for national transmission network and LNG terminals
- rTPA for storage
- Legal unbundling

**EU Third Package:**
Ownership unbundling or Independent System Operator
Creation of ACER

**Publication of the Network Codes:**
- CAM: 3\(^{rd}\) quarter of 2013 (effective as of Nov. 2015)
- BAL: 1\(^{st}\) quarter of 2014,
- INT: 1\(^{st}\) draft by ENTSOG to public consultation
- TAR: preparation of FG by ACER until Nov. 2013, NC afterwards.

**Framework Guidelines on Capacity Allocation and Gas Balancing:**

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**First Directive (1998/30/EC):**
- Principle of the single European gas market and timetable for market opening
- rTPA on the national transmission network

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**Year Events:**
- 1998: 
- 2003: 
- 2004: 
- 2007: 
- 2009: 
- 2011: 
- 2013: 
- 2014: DESFA’s application as an ITO and preliminary approval by RAE

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**DESFA**
Hellenic Gas Transmission System Operator S.A.

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**Ministry of Environment, Energy & Climate Change**

- Refers to Directive 2003/55/EC

- Required that all gas consumers would have a choice of supplier by 2004 (for industry and local distribution) or 2007 (for retail customers)

- Requirement for negotiated third-party access to transmission, storage, and LNG regasification facilities, with tariff methodologies subject to approval by national regulators

- Full legal unbundling between gas transmission and commercial functions
  - Although a transmission operator and gas wholesaler could still be owned by a single holding company

- Minimum requirements defined for national gas regulators; establishment of European Regulators Group for Electricity and Gas (ERGEG)
Market reality after Second Energy Package

- Main shortcomings monitored
  - Vertical integration, lack of independence of system operators
  - Different powers and competences of national regulators
  - Lack of transparency
  - Lack of integrated operation of the networks (TSO cooperation)
  - High degree of market concentration

- Refers to Directive 2009/73/EC
- Deeper requirements for transparent and fair third-party access to transmission, distribution, storage and LNG regasification facilities
- Stronger bias toward effective unbundling between transmission and commercial functions.
  - although the Independent System Operator (ISO), as well as the Independent Transmission Operator (ITO) options continue to provide an equivalent alternative to full ownership unbundling (effective unbundling models)
- Major emphasis on cross-border integration
- Formation of ACER the Agency for Cooperation of Energy Regulators
- Competition enforcement is now the center of the action
DESFA’s Compliance to EU regulatory framework

- DESFA complies with existing EU regulatory framework, including:
  - Directive 2009/73/EC, concerning common rules for the internal market in natural gas
    - DESFA has been awarded Certification ITO by RAE (preliminary decision)
  - Regulation 715/2009/EC, on conditions for access to the natural gas transmission networks
    - DESFA applies entry-exit tariff system, as of February 2013
  - Regulation 994/2010/EC, concerning measures to safeguard security of gas supply
    - The Preventive Action Plan has been finalized by RAE
    - the Emergency Plan has been prepared by DESFA and approved by RAE
    - The Risk Assessment Study has been published in December 2011
REASONS & MODELS OF UNBUNDLING
Reasons for unbundling

- Development of competitive gas markets working at their most efficient
  - From vertically integrated monopoly providing "bundled" services at single tariffs to competitive markets with separated monopoly and competitive activities, different tariffs for each service
  - Transition from monopoly market to a competitive market brings about rapid change of market environment and of market structure specifically

- Unbundling
  - Avoids potential conflict of interest for integrated utilities
  - Prevents utility to shift costs between regulated and unregulated businesses
  - Enables utilities to identify the cost structure of their business activities
  - Allows for separate costing of services and introduction of competition
Effective unbundling under Third Gas Directive: Ownership Unbundling (OU)

- Obligation to implement OU for any TSO set up after 3 September 2009
  - No choice between OU/ITO/ISO models in this case
- Owner of a transmission system shall act as a TSO
- Same person (*) cannot exercise control (**) over a production or supply company and at the same time exercise control or any right (***) over a transmission system, and vice versa.
- Same person cannot appoint board members of a TSO and exercise control or any right over a production or supply company
- Same person cannot be a member of the board of a TSO and of a production or supply company.

(*) Only shares/shareholdings within the EU relevant.
(**) Control definition established by the EC Merger Regulation: "Rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking." The key consideration in this regard is the concept of “decisive influence”.

(***) Rights particularly minority rights (25.1% but also case-by-case).
Ownership unbundling

SUPPLIER

- No control
- Only minority shareholding
- Dividends allowed
- No voting rights
- No appointment of administrators

TSO
Owns network
Manages network
Independent System Operator (ISO)

- ISO operates, maintains and develops the transmission system
- Transmission assets remain with vertically integrated company, but technical and commercial operation of transmission system is performed by ISO, acting as a TSO
- ISO must demonstrate that it has at its disposal the required financial, technical, physical and human resources to carry out its tasks
- ISO must be independent from supply or production interests and must comply with relevant rules on ownership unbundling. Also, ISO must have a strong say in investment planning
- Rights of ownership limited: Transmission owner obliged to finance investments decided by ISO
- Transmission system owner is legally and functionally unbundled
- Significant regulatory involvement
ISO Vertically Integrated Undertaking

SUPPLIER

NETWORK OWNER (Network leased to ISO)

+ stricter regulation and permanent monitoring (e.g. NRA approval of investment planning)

ISO Network operator (incl. investment decisions)
Independent Transmission Operator (ITO)

- TSO may remain part of the vertically integrated undertaking (VIU), but detailed rules ensure independent from the VIU.
- ITO has all necessary assets and resources
  - Owns the network
  - Sufficient staff to carry out TSO-tasks (day-to-day)
  - No outsourcing to VIU
  - Separate premises, branding, identity
  - Sufficient financial resources for investment (approved by Supervisory Body)
- Independence of the ITO
  - Effective decision-making rights for ITO (to operate, maintain and develop network)
  - Power to raise money on the capital market
  - Financial relations with VIU at arm’s length and at market conditions
Independent Transmission Operator (ITO)

- Independence of staff and management
  - Management appointed by Supervisory Body
  - Three Year cooling on period
  - Four year cooling off period
  - No shares/financial interests in VIU (also applies to staff)

- Supervisory Body
  - High level/big impact decisions
  - No day-to-day decisions
  - Independence requirements for half -1 of its members

- Regulatory Powers
  - Require ITO to invest under TYNDP and if not done,
  - Issue penalties in case of discriminatory behavior
  - Scrutinize commercial relations between ITO and VIU
ITO

Vertically Integrated Undertaking SUPPLIER

Supervisory Body Independent management Compliance Officer

TSO Network Owner and Operator

+ heavy regulation and permanent monitoring
TSO CONVERGENCE WITHIN EU AND STANDARDISATION OF TSO PROCEDURES
Legal background of Certification procedure

- Pursuant to Article 10 of the Third Gas Directive (2009/73/EC) in combination with the provisions of Article 3 of Regulation 715/2009 (Gas Regulation), a TSO can only be approved and designated as a TSO following a certification procedure.

- The certification procedure is applicable to all TSOs for their initial certification and subsequently at any time when a reassessment of a TSO's compliance with the unbundling rules is required.

- So far, 67 applications have been received by ACER:
  - 27 as ITO
  - 35 for OU
  - 5 other
Aim of certification procedure

- Verify whether the applicant TSO complies with the unbundling provisions of the Directive i.e. Article 9 of the Gas Directive

- Establish which person or persons exercise(s) control over the applicant TSO and whether the legal provisions on the assignment of tasks of a TSO depending on the chosen unbundling model have been respected
Procedure

Initiation
• Application (notification) by TSO

Within 4 months
• Preliminary certification decision by NRA
• Notification of Commission without delay

Within 2(+2) months
• Commission Opinion
• Commission can request opinion from ACER (+2 months)
• Non-issuance of an opinion results in tacit approval

Finalization
• Final decision by NRA
• Obligation to take outmost account of the Commission’s opinion
THE ROLE & FUNCTIONS OF THE REGULATOR
The Regulator under the Third Gas Directive

- Requirement on Member States to designate a single regulatory authority at the national level
- Safeguarding the independence of the regulator by requiring that the regulatory authority is a legal person, with budgetary autonomy and adequate human and financial resources to carry out its duties
- Regulatory authority must be functionally independent from any other private or public entity
- Clear mandate to cooperate at the European level and close the regulatory gap
- Enhancement of their statutory duties and powers
  - Right to take binding decisions
  - Investigations into market functioning
  - Right to impose fines
Regulatory Transparency and accountability

- More transparency
  - Budget spending
  - Decision making
    - Public consultation
- Yearly activity report to:
  - Government, Commission, ACER

- More legal accountability
  - Decision fully reasoned & justified
  - Decision subject to judicial review
  - Decisions to be made public
ACER

- Setting up a European Agency for the Cooperation of Energy Regulators

- Agency is not a substitute for the national regulators, nor is it a European regulator — it will complement at the European level the regulatory tasks performed at the national level

- Having a decision making power at the European level under certain conditions
  - Individual decisions based on EU guidelines
  - Art. 22 exemptions of cross-border infrastructure
ACER’s Role

- Ensure that national regulatory authorities have a framework within which they can cooperate, including possible review mechanism, on a case-by-case basis, on decisions taken by national regulators that have a direct impact on the internal market.
- Appropriate oversight of the cooperation between transmission system operators, including monitoring and review of the activities of the TSO cooperation.
- Ensure that individual decision making powers are established for specific cross-border issues, such as "Article 22" exemption requests for infrastructure projects involving more than one member state.
- Ensure that the current advisory role for regulators towards the Commission through ERGEG is preserved and even go beyond to the advisory role to the EC by providing recommendations to the EC.
CONCLUSIONS
Conclusion Remarks

- Choice between 3 unbundling models working in practice-Certification process time-consuming and delayed, but learning curve in interaction between Commission and NRAs

- Tension between unbundling rules and the need to attract (financial) investors for transmission assets important for the EU as a whole

- Expected Commission Guidance needs to provide ex-ante certainty for investors, in order to support EU energy infrastructure requirements

- EU member-states in turn need predictability for the long-term infrastructure investments, indispensable for making the internal gas market a success story
THANK YOU FOR YOUR ATTENTION!

Nikos Katsis  
Strategy & Business Planning Division Director, DESFA SA  
tel: +30 210 6510528 fax: +30 210 6541282  
e-mail: n.katsis@desfa.gr