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Session 3:
Unbundling under the Electricity & Gas Directives

BUILDING PARTNERSHIPS FOR ENERGY SECURITY

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Unbundling under the Electricity and Gas Directives



WHAT DOES UNBUNDLING MEAN?

Unbundling refers to the separation of transmission activities from the production and supply activities.

WHAT IS THE GENERAL OBJECTIVE OF UNBUNDLING?

Unbundling aims to ensure equal access to transmission services for any company that intends to enter the internal electricity or gas market with production or supply activities. Energy transmission networks (high-voltage transmission lines for electricity and high-pressure pipelines for gas) should operate like highways, which allow any traveler (in case of the energy sector - any electricity or gas supplier) to have access to this highway in order to get to any point of destination.

WHY IS UNBUNDLING NECESSARY?

Third Party Access alone has failed to achieve undiscriminatory access to networks as vertically integrated undertakings often are not willing to grant access to their networks in a fair and undiscriminatory manner in order to protect their position. The third package – by separating transmission activities more strictly from supply and production aims to ensure access to transmission and distribution at competitive conditions.



Unbundling under the Electricity and Gas Directives

Unbundling options under the 3rd Energy Package



Under the electricity and Gas Directive there are three different models in which transmission activities can be carried out in the European Union. Each model has different unbundling requirements.

Model 1: transmission activities may be carried out by a separate undertaking that owns the network and carries out transmission activities and has activities or interests related to generation and supply. Transmission activities that are carried out in this way must follow the rules of ownership unbundling.

Model 2: Where on the 3rd of September 2009 the transmission system was owned by a vertically integrated undertaking transmission may be carried out by an independent system operator (ISO). Unbundling must follow the specific set of rules for Independent System Operators.

Model 3: Where on the 3rd of September 2009 the transmission system was owned by a vertically integrated undertaking transmission may be carried out by an Independent Transmission Operator (ITO) Unbundling must follow the specific rules for Independent Transmission Operators

Unbundling under the Electricity and Gas Directives

Unbundling options under the 3rd Energy Package



What is a vertically integrated undertaking?

A vertically integrated undertaking is an undertaking where the same person or persons are entitled to exercise control, and where the undertaking performs at least one of the functions of transmission or distribution, and at least one of the functions of generation or supply of electricity'.

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Unbundling under the Electricity and Gas Directives

The three unbundling models at a glance



Unbundling Model	Supply/Generation system ownership	Transmission System ownership	Transmission Operation
OU	Undertaking A	Undertaking B	Undertaking B
<ul style="list-style-type: none"> • strict separation of supply and generation from transmission • Complete confidence in independent exercising of functions • lowest regulatory burden: TSO needs to fullfill some requirements in order to guarantee independent exercising of it tasks 			
ISO	Undertaking A	Undertaking A	Undertaking B
<ul style="list-style-type: none"> • less obvious separation of generation/supply from transmissiom. Ownership of transmission system stays with vertically integrated undertaking A, while transmission system is operated by undertaking B • lower confidence in independent decision making • higher regulatory burden: Both undertakings need to fullfil a series of requirements in order to guarantee independent exercising of tasks by ISO 			
ITO	Undertaking A	Undertaking A	Undertaking A
<ul style="list-style-type: none"> • least obvious separation of generation/supply from transmission: generation, supply and transmission are carried out by the same undertaking. • low confidence in independent decision making • Highest regulatory burden: ITO needs to fullfill an exhaustive set of requirements in order to guarantee independent exercising of its tasks. 			

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Unbundling Option 1: Ownership unbundling at a glance

Undertaking A

Supplier/Generator

Undertaking B

TSO
Owns Network
Manages network

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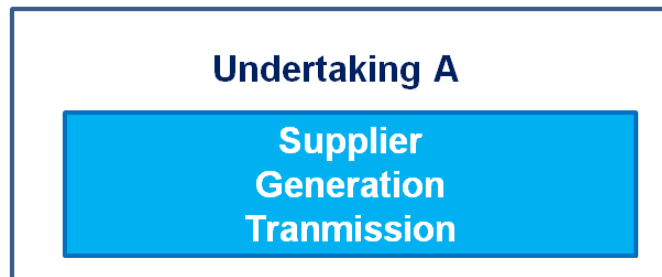
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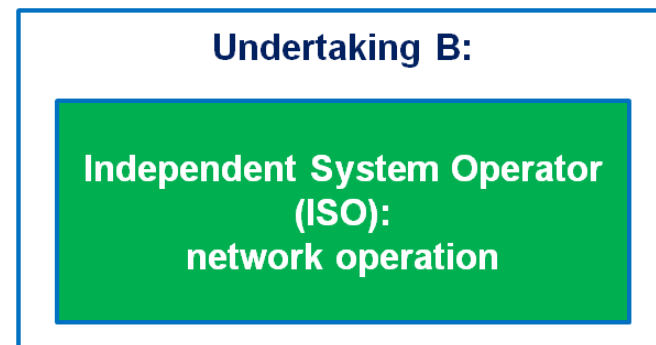
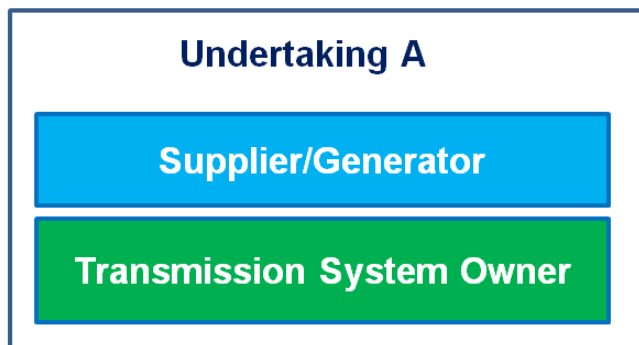
Unbundling Option 2: Independent System Operator (ISO) at a glance:

Only applicable where on the date of entry into force of the Electricity and Gas Directives, i.e. 3 September 2009, the transmission system belonged to a vertically integrated undertaking

Before:



After:



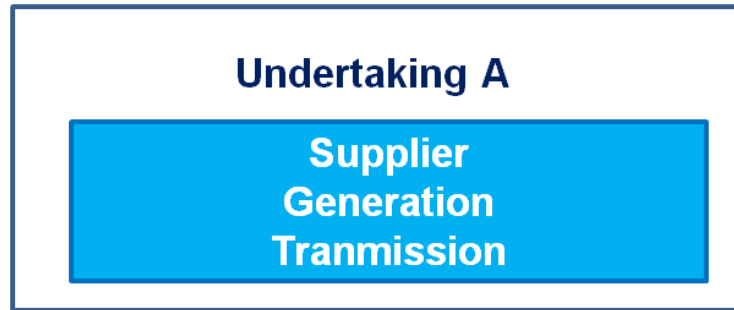
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Unbundling Option 3: Independent Transmission Operator (ITO) at a glance

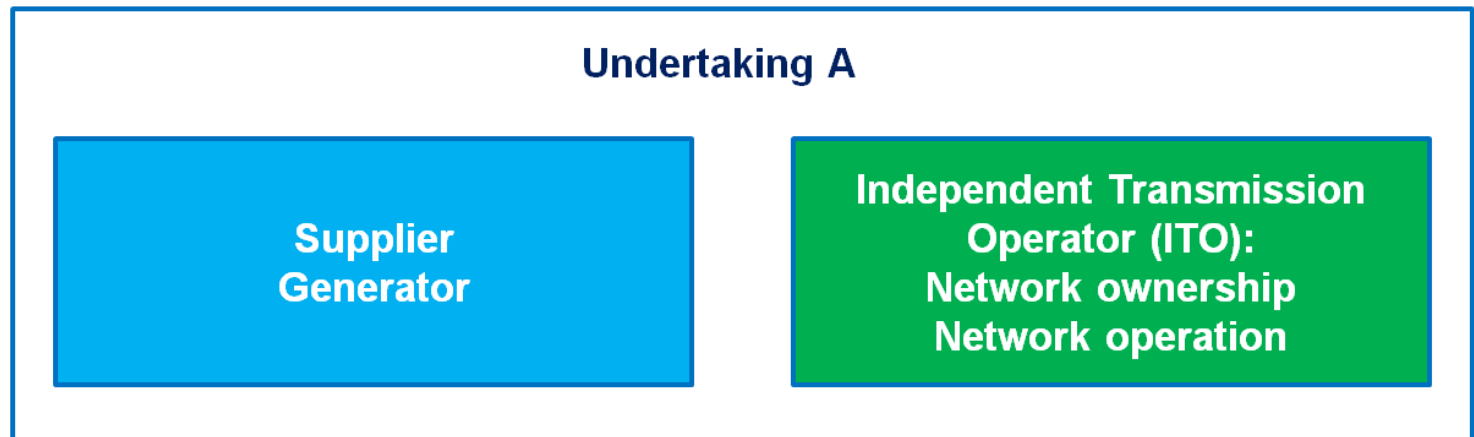


Only applicable where on the date of entry into force of the Electricity and Gas Directives, i.e. 3 September 2009, the transmission system belonged to a vertically integrated undertaking

Before:



After:



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10 ED
9 GD

Specific unbundling requirements: ownership unbundling



Unbundling Model	Supply/Generation system ownership	Transmission System ownership	Transmission Operator
OU	Undertaking A	Undertaking B	Undertaking B

- strict separation of supply and generation from transmission
- Complete confidence in independent exercising of functions
- lowest regulatory burden: TSO needs to fulfill some requirements in order to guarantee independent exercising of its tasks

Key rules that need to be fulfilled in order to keep TSO independent under ownership unbundling: undertakings that own and operate the transmission system and are not at the same time entitled to

- directly or indirectly exercise control over an undertaking performing any of the functions of generation or supply

or to be

- be a member of the supervisory board, the administrative board or bodies legally representing the undertaking of an undertaking performing any of the functions of generation or supply



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Specific unbundling requirements: Independent System Operator (ISO)

14 ED
15 GD



Unbundling Model	Supply/Generation system ownership	Transmission System ownership	Transmission Operator
ISO	Undertaking A	Undertaking A	Undertaking B

- less obvious separation of generation/supply from transmission. Ownership of transmission system stays with vertically integrated undertaking A, while transmission system is operated by undertaking B
- lower confidence in independent decision making
- higher regulatory burden: Both undertakings need to fulfil a series of requirements in order to guarantee independent exercising of tasks by ISO

Specific requirements that need to be fulfilled in order to guarantee ISO independence:

- ISO to be set up in form a separate legal undertaking, and needs to have required own financial, technical, physical and human resources to carry out its tasks
- Transmission System Owner needs to be legally and functionally unbundled (as separate legal entity, management shall not participate in generation/supply structures of vertically integrated undertaking, independent decision making capacity, compliance monitoring program etc.

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Division of Tasks between Independent System Operator and Transmission System Owner



Tasks of Independent System Operator

- responsible for granting and managing third-party access, including the collection of access charges, congestion charges etc.
- responsible for operating, maintaining and developing the transmission system, including planning investments and planning

Tasks of Transmission System Owner:

- provide all the relevant cooperation to the ISO for the fulfillment of its tasks, in particular provide all relevant information concerning the network
- provide for the coverage of liability relating to the network assets, e.g. for condition of the network but not for management (ISO)
- finance investments decided by the ISO and approved by the NRA
- provide financial guarantees to facilitate the financing of the network expansions

Unbundling under the Electricity and Gas Directives

Tasks of the Regulatory Authority under the ISO Unbundling Model (non exhaustive list)



- Regulatory authority must ensure compliance of the ISO with its unbundling obligations, in particular through constant monitoring of the activities of the ISO and of the transmission system owner.
- In the event of a violation, the regulatory authority is empowered to issue penalties for non-compliance in accordance with the general rules under Article 37(4)(d) Electricity Directive and Article 41(4)(d) Gas Directive. Penalties must be effective, proportionate and dissuasive and may go up to 10 % of the annual turnover either of the vertically integrated company or of the ISO
- Monitoring the relations and communications between the ISO and the transmission system owner (including the approval of any contracts between them)
- acting as a dispute settlement authority between the ISO and the transmission system owner
- approving the investment planning and the multi-annual network development plan to be presented annually by the ISO

Unbundling under the Electricity and Gas Directives

Specific requirements: Independent Transmission Operator (ITO) (1)



Unbundling Model	Supply/Generation system ownership	Transmission System ownership	Transmission Operator
ITO	Undertaking A	Undertaking A	Undertaking A

- least obvious separation of generation/supply from transmission: generation, supply and transmission are carried out by the same undertaking.
- low confidence in independent decision making
- Highest regulatory burden: ITO needs to fullfill an exhaustive set of requirements in order to guarantee independent exercising of its tasks.

ITO must be **fully equipped with all financial, technical, physical and human resources** necessary to fulfil its obligations and to carry out the activity of electricity or gas transmission:

- Own assets: all assets (not only network) necessary to perform its tasks must be owned by ITO
- own staff: staff necessary for performing the core activities of the ITO, including management and network operation, must be employed by the ITO
- Day to day corporate services corporate services, including legal services, accountancy and IT services, must be handled by own staff of the ITO
- Core activities (transmission) cannot be transferred to another entity
- leasing of personnel and sharing of other services from other parts of the vertically integrated undertaking , including of premises, ITO infrastructure etc. is strictly prohibited.

Unbundling under the Electricity and Gas Directives

Specific requirements: Independent Transmission Operator (ITO) (2)



Unbundling Model	Supply/Generation system ownership	Transmission System ownership	Transmission Operator
ITO	Undertaking A	Undertaking A	Undertaking A

ITO must be equipped with all financial, technical, physical and human resources necessary to fulfil its obligations and to carry out the activity of electricity or gas transmission: (continued)

-Own financial resources: ITO must have the power to raise money on the capital market

- all commercial and financial relations between the ITO and other parts of the vertically integrated undertaking, including loans from the ITO to other parts of the vertically integrated undertaking, must comply with market conditions

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Tasks of the Regulatory Authority under the ITO Unbundling Model (non-exhaustive)

Under ITO Unbundling model the National Regulatory Authority shall be entitled to

- to issue penalties for discriminatory behaviour favouring the vertically integrated undertaking of up to 10 % of the annual turnover either of the vertically integrated undertaking or of the ITO, as the case may be;
- to monitor communications between the ITO and other parts of the vertically integrated undertaking in order to ensure compliance of the ITO with its obligations;
- to act as dispute settlement authority between the ITO and other parts of the vertically integrated undertaking in respect of complaints;
- to monitor commercial and financial relations including loans between the ITO and other parts of the vertically integrated undertaking;
- to approve all commercial and financial agreements between the ITO and other parts of the vertically integrated undertaking provided that they comply with market conditions;
- to request justification from the vertically integrated undertaking as to any proposed decision on investment plans or individual investments, in particular as regards absence of discrimination to the advantage of the vertically integrated undertaking;
- to carry out inspections, including unannounced ones, on the premises of the ITO and other parts of the vertically integrated undertaking; and
- to assign all or specific tasks of the ITO to an independent system operator where the ITO persistently breaches its obligations under the Directives, in particular where it engages in repeated discriminatory behaviour to the benefit of the vertically integrated undertaking.

Unbundling under the Electricity and Gas Directives



WHAT IS THE RELATIONSHIP BETWEEN THE THREE OPTIONS?

Member States are in principle free to opt for one of the three models, which are on an equal footing in the Directives, under the following restrictions:

The ISO and ITO models can only be chosen for a specific TSO if on entry into force of the Directives, i.e. 3 September 2009, the transmission system belonged to a vertically integrated undertaking (Article 9(8) Electricity and Gas Directives)

In any case Member States intending to designate only ISOs or ITOs on their territory must in any event also transpose the provisions on ownership unbundling into their national law, in view of the fact that they cannot prevent a vertically integrated undertaking owning a transmission system from complying with the requirements of ownership unbundling

Example Germany: Germany has transposed all three options into national legislation. Undertakings are thus in principle free to choose any option.

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10 ED
10 GD



Certification of TSOs: unbundling certification

Mandatory certification of TSOs: Before an undertaking is approved and designated as TSO it shall be certified by the National Regulatory Authority that the undertaking complies with the unbundling requirements of the Directives

- all unbundling models are subject to certification
- Certification shall take place
 - (1) Upon request by a potential TSO or a reasoned request from the Commission
 - (2) Upon notification by a TSO of a planned transaction which may require a reassessment of their compliance with the requirements of Article 9
 - (3) Upon own initiative of the NRA where they have knowledge that a planned change in rights or influence over transmission system owners or transmission system operators may lead to an infringement of Article 9, or where they have reason to believe that such an infringement may have occurred

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Certification of TSOs: unbundling certification

10 ED
10 GD



Deadline for taking the decision: Deadline for taking a decision in response to a request from the Commission or from a TSO shall be 3 months from date of notification of request. If NRA does not take a decision within this time the certification shall be deemed granted.

Information obligation to the Commission: Regulatory Authority obliged to inform Commission on its explicit or tacit decision on the certification of the a TSO.

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26 ED
26 GD

Unbundling of Distribution System Operators (DSOs)

The unbundling regime of DSOs laid down in Article 26 Electricity and Gas Directives remains in substance unchanged as compared to the preceding regime:

Where the DSO is part of a vertically integrated undertaking, the basic elements of this unbundling regime are the following:

- (a) **legal unbundling** of the DSO from other activities of the vertically integrated undertaking not related to distribution;
- (b) **functional unbundling** of the DSO in order to ensure its independence from other activities of the vertically integrated undertaking (management separation, independent decision making capacity, compliance monitoring program)
- (c) **accounting unbundling**: requirement to keep separate accounts for DSO activities;
- (d) **Derogations** from legal and functional unbundling are admissible for DSOs that that serve less than 100.000 connected customers. Important: aggregated figure of connected customers has to be under 100000: if e.g. three DSOs that are controlled by the same company reach together more than 100.000 connected customers, all DSOs have to be unbundled.



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31 ED
31 GD



Unbundling of Accounts

- TSOs and DSOs have to keep separate accounts for each of their transmission and distribution activities in order to avoid cross-subsidies between transmission/distribution and supply/generation.
- The provisions on accounting unbundling in the Electricity and Gas Directives remain largely unchanged as compared to the preceding legislation.
- No derogations possible
- accounts have to be accurate and avoid overstatement of costs etc.
- regulatory authority has to monitor effective unbundling of accounts

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WHAT ARE THE IMPLICATIONS OF THE THIRD ENERGY PACKAGE FOR THE EUROPEAN ENERGY COMMUNITY IN TERMS OF UNBUNDLING?

Ministerial Council of the Energy Community has adopted the European Union rules on the internal market for electricity and gas known as the Third Energy Package (the TEP Decision). Investors and energy undertakings across South East Europe will be affected by the TEP Decision as transmission assets will now gradually need to comply with the EU's unbundling regime.

While generally the deadline for transposition of the Third Package for the Energy Community is 2015 for unbundling – with a view to the complexity of the issues involved – the deadline for transposition has been set for June 2016.