

The “deep” independent system operator

A new sophisticated institutional design for system operators in the 3rd energy package of September 2007 in comparison to the Proposal of the 8 EC-Member States for a Directive of the EP and the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity and repealing Directive 96/92/EC

A German perspective on implementing an effective and efficient unbundling of Transmission System Operators¹

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Abstract

The ownership unbundling-model and the “deep” ISO-model are not compatible with the EC-Treaty, if they were realized against the interest of the shareholder’s assembly. The proposal of the eight EC member states for an effective and efficient unbundling avoids the constitutional problems and strengthens the independence of transmission system operators.

1. The independence of the system operator as the Archimedean point of an effective network regulation – the status quo

According to Artt.10, 15, and 17 of the Directive 2003/54/EC and Artt.9, 13 and 15 of the Directive 2003/55/EC transmission system operators and distribution system operators shall be independent at least in terms of their legal form, organisation and decision making from other activities not relating to gas transmission lines or distribution within an integrated energy supplying company. To ensure the independence of the system operator, the following four minimum criteria have to be met when implementing the directives:

1.1. Monopolising of commitment

The management of the system operator may not perform direct or indirect roles within the areas of electricity generation, production of natural gas or energy supply at the same time.

1.2. Self dependent decision-making authority

The management must have an autonomous, self dependent authority not bound to instructions concerning the operation, development and upgrading of the system reflected in the articles of association of the system operator and in its rules of procedure in order to facilitate the normative requirements for security of relations in exercising offices independently. However, controlling measures of the parent company to ensure the profitability of the system operator will remain unaffected.

1.3. Capability of acting independently

Appropriate measures must safeguard the professional interests of the management in a way that ensures that its capability of acting independently. This includes improved statutory protective provisions that ensure internal independence.

1.4. Compliance programme

The system operator is obliged to establish a compliance programme having the objective of monitoring and preventing any discriminatory conduct towards external system users and user applicants.

German legislature has correctly implemented these functional unbundling provisions into § 8 of the Energy Industry Act (EnWG).³ The Directives did not oblige the Member States to implement ownership unbundling (cp. Artt.10(1)(2), 15(1)(2), 17(1)(2) of the Directive 2003/54/EC, § 1(2) EnWG). The provisions that guarantee the management's capability of acting independently comply with the Basic Rights of the network operators' shareholders (Artt.9[1], 12 and 14 of the German Constitution [GG]). It is a matter of 'regulating', i.e. of concretising the social liability of the natural monopoly as company property in terms of Art.14(1)(2) GG, and also a matter of exercising associational and occupational freedom in a manner that is reconcilable with the common good. It is not a matter of 'taking', i.e. of compensable expropriation of property.⁴ Regulatory taking is explicitly excluded by the provisions that ensure profitability in Art.10(2)(a)(2) and (3), Art.15(2)(a)(2) and (3), Art.17(2)(a)(2) and (3) of the Directive 2003/54/EC, Art.9(2)(a)(2) and (3), Art.13(2)(a)(2) and (3), Art.15(2)(a)(2) and (3) of the Directive 2003/55/EC. Without these protective provisions, the rules concerning operational unbundling would be of dispossessing nature. They would indeed impinge on the basic right of

³ More detailed on that *Säcker*, RdE 2005, p. 65 ff.

⁴ Concerning the distinction between taking and regulation in US law cp. *Herrmann*, Das US-amerikanische Energierecht am Beispiel Kaliforniens, 2005, p. 154 ff. Instruction by Community Law of a regulation with dispossessing effect without concrete evidence of abuse in terms of Art.82 EC, Art.7 of the Regulation (EC) No 1/2003 also would infringe European primary law: cp. Art. 295 EC (formerly Art. 222 EC-treaty): "Article 222 of the EC Treaty provides that the Treaty 'shall in no way prejudice the rules in Member States governing the system of property ownership. According to the applicant, the Commission has affected the value of property owned by the French State and thus infringed that article. Without its being necessary to consider whether affecting the value of publicly-owned property prejudices the rules governing the system of property ownership, it is sufficient to state that in any event the Commission, in the contested decision, does not in any way affect that property. In that regard, in recital 98 to the contested decision, the Commission expressly states 'that it is not required ... to decide on the levels of fees charged to the service suppliers in question. Likewise, in the operative part of the contested decision, it merely orders ADP to put an end to the levying of discriminatory commercial fees, but does not prohibit the levying of fees or even fix a maximum fee. Accordingly, in the contested decision the Commission did not place a value on publicly-owned property, but merely required ADP to observe the mandatory provisions of Article 86 of the Treaty, with which the bodies responsible for the management of publicly-owned property, like private owners, are required to comply. It follows that the plea alleging infringement of Article 222 of the Treaty is unfounded. That finding is not affected by the argument that the contested decision adversely affects the contracts concluded by ADP. The public policy nature of competition law is specifically designed to render its provisions mandatory and to prohibit traders from circumventing them in their agreements." Cp. ECJ Rec. 2000, p. II-3929, para. 234-241.

freedom of association, and excessively affect the shareholders' legitimate powers to control the network operator's management board, specifically regarding issues of profitability.⁵ The Community-law regulation is thoroughly thought out and takes into account the non-codified European fundamental rights as these are laid down in the Charter of Fundamental Rights.⁶ The same applies to the national provision of § 8(4)(2) EnWG, which is in line with the Basic Rights of the Constitution (property and occupational freedoms).

However, from a competition policy point of view the question arises in respect of corporate practice, whether the rules of functional unbundling are effective enough to actually ensure the independence of the system operators from their affiliated companies (as regards system operation, development and upgrade). The implementation of operational unbundling by numerous undertakings raised significant doubts in that regard. In its sectors inquiry, the Commission detected that system operators remain captured by group interests.⁷ This led to the conclusion that it is either necessary to introduce ownership unbundling, or – as second best solution – to strengthen the independence of the affiliated system operator.

2. Disadvantages of ownership unbundling

To the extent that ownership unbundling can be considered as a legislative instruction of compulsory sale, significant doubts arose in terms of compatibility with the Constitution. First, one may question whether a sufficient common good interest would justify such expropriation. Namely, the objectives pursued are as follows:

2.1. Improved enforcement of a non-discriminating

⁵ As regards the interplay between Community regulation and fundamental rights, one should stress that the former, in principle, considers the non-codified European fundamental rights substantiated and manifested in the Charter of Fundamental Rights (available at http://www.europarl.europa.eu/charter/pdf/text_en.pdf). On this issue, see cp. *Baur/Pritzsche/Klauer, Ownership Unbundling*, 2006, pp. 46 et seqq.; *Schmidt-Preuß, Substanzerhaltung und Eigentum*, 2003.

⁶ Available at <http://europa.eu.int/constitution/de>; concerning this cp. *Baur/Pritzsche/Klauer, Ownership Unbundling*, 2006, p. 46 ff.; *Schmidt-Preuß, Substanzerhaltung und Eigentum*, 2003; *Callies, Energiewirtschaftliche Tagesfragen*, 2007, vol. 11, p. 92 ff.

⁷ DG Competition Report on Energy Sector Inquiry (SEC/2006/1724, 10 January 2007), see Annex II.

establishment of tariffs

As far as this objective is concerned, it can be argued that – considering the aspect of the transparency of payments for the use of the network - there is no genuine risk of discrimination.⁸ An open discrimination of applicants is not realistic in an effective execution of the unbundling provisions by a legal safeguard of the independent system management. Illegal behaviour is even more unlikely⁹ as all prices require the approval of the systems operators. In fact, the operator has no possibility to charge discriminatory prices in a transparent procedure for all competitors.

2.2. Prevention of cross-subsidisation within the group of affiliated companies

There appears to be no risk of cross-subsidisation. Arguably, the company has no interest in cross-subsidising the electricity generation by burdening the network operator with contribution payments for other affiliated companies in the form of excessive service fees or an excessive group charge. Rather, there subsists the danger that the network operator is burdened with excessive charges (e.g. unjustified overhead cost contributions), in order to enhance payments for the use of the network to the account of power plant operators and energy dealers without network. Energy companies being able to increase profits by operation their networks, can afford to charge lower distribution fees in order to deter competitors. However, this risk of cross-subsidisation is minimized by the proceedings of ex ante approval of access charges (§ 23a EnWG) and moreover by § 30 EnWG that aimed at abusive behaviour.¹⁰ Neither the Federal Network Agency (FNA) nor the Commission have proven a definite case of cross-subsidisation so far.

2.3. Prevention of abusively excessive system charges

Ownership unbundling does not contribute to the reduction of network access charges. Rather, there is a risk that ‘pure’ system owners, e.g. a group of private investors, increase the profitability of the company to the

⁸ More detailed on that *Säcker*, ZNER 2005, p. 270, 278.

⁹ Concerning that cp. ECJ, WUV/E EuR 875.

¹⁰ More detailed on that *Säcker*, ZNER 2005, p. 270, 279.

disadvantage of network security and irrespective of the statutory obligations of §§ 2 and 11 ff. EnWG. In contrast, an integrated energy supply undertaking is not only interested in the system but also in the secure distribution of electricity and gas. Each breakdown of the system decreases the electricity and gas sales and, consequently, the profit earned. Similarly, electricity and gas suppliers also have an own economic interest in the operability of networks. Provided that regulatory authorities perform their duties according to the standards of Art.23 of the Directive 2003/54/EC, Art. 25 of the Directive 2003/55/EC, the own interest of energy suppliers would suggest that they make necessary investments in the networks in such a manner that their viability is secured (Artt.23(2)(a) and 25(2)(a)). Yet, the ownership separation of system and generation activities eliminated this systematic relation.

2.4. Prevention of anti-competitive investment decisions due to insufficient system developing only oriented by group interests and of discrimination of new power plant operators by maintaining system bottlenecks and non-transparent control of bottlenecks

Ownership unbundling facilitates a need-based system developing apart from the group's interest and ensures network neutrality in competition.¹¹ Without Standards of Conduct that are effectively monitored by regulatory authorities and that prevent acting to the disadvantage of competitors outside the group, the suspicion of a hidden favouring of the group of affiliated companies cannot be ruled out.¹² Thus, – this is to be conceded to the Commission – there is a need for improved rules for ensuring the independence of network operators and a decision-making power on investments necessary for system upgrading, restructuring and expanding apart from the system owner. If the management of the system operator independently decides, based on expert analyses, to develop the network so that generous network access can be provided to all applicants, then the network shareholders are obliged to back this decision. In fact, they do not have the authority to prevent this decision. Community law guidelines set out the principle according to which the autonomous conduct of business resides with the board of directors (§ 76 of the German Stock Corporation

¹¹ DG Competition Report on Energy Sector Inquiry, (SEC/2006/1724, 10 January 2007), Annex II.

¹² Regarding that cp. the US Code of Conduct, FERC Ordner 889 (61 FR 21764 May 10, 1996), reprinted in *Säcker, Der Independent System Operator 2007*, p. 201 ff.

Act (AktG)) and that the shareholders are not entitled to an independent right to participate as a corporate body (§119 AktG). The commitment of shareholders to system related developing decisions of the network operator's management is safeguarded by the provisions on ensuring profitability. The power to prepare and agree to the financial plan does not include the right to undermine a need-based and reasonable system developing with an insufficient budget or to threaten the system management with sanctions in situations when it autonomously takes on a loan for system developing costs. Such sanctions would constitute a serious infringement of the provisions of the Directives 2003/54/EC and 2003/55/EC according to which system investment decisions are taken by the management of the network operator exclusively without commitment to guidelines by the integrated power supply group. The shareholders' profitability interest is just as little jeopardised as in case of a stock company where stockholders are entitled to decide on the investment budget; because the legal representative body is entitled to act on behalf of the undertaking and thereby must consider the stockholders' pecuniary interests and has to do everything to manage the undertaking efficiently so that the interest paid on the capital invested by shareholders in the network is adequate to the risk and complies with the market's standards.¹³

Since the statutory obligations to develop and modernise the network in a need-based and coordinated way and to secure the interoperability of the interconnected system¹⁴ bind not only the management of the system operator but also its shareholders, it is appropriate to assign the execution of this duty solely to the management. Indeed, due to the explicit separation of functions between system, generation and distribution, the management

¹³ Cp. *Säcker*, ZNER 2003, p. 214, 215 proposing to include the following provisions in the articles of the network operator: The board of directors has to provide connection with and access to their supply system, storage facilities and upstream pipeline network under transparent and competition-oriented conditions. These must not be more unfavourable than those charged in fact or calculative for services in comparable cases within the company or to affiliated or associated undertakings. Conditions are considered to be competition-oriented if they orient to the principle of the investor acting market based; they have to ensure that investments in the network business are profitable and there subsist sufficiently high incentives for an effective service provision and preservation of need-based networks. Statutory provisions emerging from the application of the law on incentive-based regulation have to be complied with.

¹⁴ This is in particular a matter of expansion and refurbishing investments which according to § 24 of the Directive on incentive-based regulation of 5 November 2007 (BGBl. I, 2529) are required for:

1. need-based developing of the energy supply system according to § 11 EnWG
2. integration of installations coming under the Renewable Energies Act
3. developing of interconnection according to Art.6(6)(b) of the Regulation (EC) No 1228/2003
4. the system for network connection of offshore-installations according to § 17(2a) EnWG and
5. underground cables according to § 43(3) EnWG

– as distinguished from the shareholders – is not exposed to a conflict of interests when exercising this task. Therefore, it is justifiable, considering the profitability of the subsidiary, not to apply the “coordination mechanisms” provided in the Directives 2003/54/EC and 2003/55/EC (Art.10(2)(c) and Art.9(2)(c)) to investment decisions and to regulate this explicitly *de lege ferenda*. These rules have to be statutorily laid down by a competition-promoting directive on power plants regarding the connection to and use of the network and subsequently implemented by complementing arrangements by regulatory authorities. Thus, the scope for hidden discrimination in relation to using the system and the control of bottlenecks is widely narrowed. Therefore, a reason for a dispossession of networks based on fundamental rights is not existent any longer. Seen from this angle, the instruction of a compulsory sale would appear as a disproportional encroachment on the property and occupational freedoms.¹⁵

For this reason, the EU should leave it to the decision of the Member States whether they intend to implement what the Commission wrongly discredited as “second best” solution and increase the statutory requirements for the independence of network operator from the interests of the group of affiliated undertakings by means of improved functional unbundling provisions. In doing so, the delimitation to compensable regulatory taking has to be considered.

However, independence of the management cannot mean that the administrative bodies of the network operator do not have any obligation at all towards the owners of the undertaking. Neither is it possible to replace the shareholders’ rights of self-determination with a determination from outside through the company’s bodies. Functional unbundling must not become a vehicle for permanent expropriation.¹⁶ In a free order – characterised by the freedom of association, occupational freedom and freedom of property –, the administrative bodies of legal persons are agents, not principals. Therefore, they cannot be independent in the meaning of an autonomous freedom to incur legal arrangements, but rather in the meaning of a duty-related functional independence.¹⁷ As managers,

¹⁵ In case of disproportional encroachments, both Art.12 and Art. 14(1) of the German Constitution (GG) would be infringed, cp. *Baur/Pritzsche/Klauer*, Ownership Unbundling, 2006, p. 46 ff.; *Baur/Pritzsche/Simon*, Unbundling in der Energiewirtschaft, 2006, p. 23 ff., pp. 47 ff.

¹⁶ Likewise the discussion in the US; cp. *Herrmann*, Das US-amerikanische Energierecht am Beispiel Kaliforniens, 2005, p. 154 ff.

¹⁷ Cp. e.g. Federal Court of Justice, ZIP 2006, p. 72; referring to that *Säcker/Boesche*, BB 2006, p. 897.

they have to act obligatorily in the meaning of holding assets in trust accompanied by the “monopolisation of commitment”¹⁸ to the transferred function.

In the following section the constitutional framework is specified, which has to be considered when increasing the standards of independent conduct. Subsequently, definite proposals are submitted on how to design an improved and specified operational unbundling in light of the previous experiences.

3. The Independence of the network operator between regulating and taking

The issue of defining substance and limits of independence in compliance with the free movement of capital from primary Community law is not a new aspect. Occupational freedom and freedom of property of shareholders is safeguarded by the freedom of capital circulation at the European level. Art.56(1) of the EC Treaty guarantees the free movement of capital among Member States.¹⁹ The exercise of ownership powers must not be impaired in its substance; state-induced splitting-off of fundamental rights from the ownership position in favour of autonomy of the management constitutes a restriction of the free movement of capital according to Community law. The exercise of rights of membership must not be subject to restrictions impairing the functional effectiveness of the fundamental freedoms. Therefore, independence of system operators owned by energy supply undertakings cannot have the meaning that the influence of the owning company on the system operator is reduced to zero in order to secure its profitability.²⁰ The decision of the European Court of Justice,²¹ dated 13 May 2003, says accurately: “Rules which limit the acquisition of shareholdings ... or which restrict in some other way the scope for participating effectively in the management of a company or in its control ... constitute a restriction on the free movement of capital.” According to the judicature of the European Court of Justice²² the free movement of capital as a fundamental principle of the Treaty may be restricted only by rules

¹⁸ Cp. *Krüger*, Allgemeine Staatslehre, 1964, p. 474; *Säcker*, RdA 1965, p. 372 ff.

¹⁹ Regarding that cp. ECJ, EWIR 2001, p. 373, comments by Rohde.

²⁰ More detailed see *Pielow/Finger*, Jura 2007, pp.189.

²¹ ECJ, EuZW 2003, p. 536, 539.

²² ECJ, EuZW 2003, p. 536 ff.

which “are justified by reasons referred to in Article 58(1) EC or by overriding requirements of the general interest. Furthermore, in order to be so justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality.” Thus, independence of the system operator may not go as far as that the control ability of this undertaking in terms of profitability is reduced to an extent that would be equal to an expropriation. Moreover, secondary Community law is also bound to the fundamental rights of the EC Treaty; therefore, inner harmony and balance between the interests for undistorted competition and the exercise of freedoms connected to ownership had to be found. The Directives 2003/54/EC and 2003/55/EC take this into account by, on the one hand, dictating the independence of system-related decisions of the management and protecting it from discrimination by shareholders but, on the other hand, also allowing the economic control of the company in terms of interests in profitability.

This balancing of interests was successful from a legal methodology perspective; for claiming the fundamental rights of freedom of association and freedom of property may not disregard competition rules of primary Community law. Freedom of property, freedom of association and occupational freedom are elements of a modern competitive economy; without it these fundamental rights could only conduct a shadowy existence in practice. Therefore, these fundamental freedoms may not turn against the principles of functioning of the competitive economy safeguarded by Artt.81, 82 of the EC Treaty.²³

4. A legal (“third”) way to an effective and efficient unbundling of transmission system operators

All experiences of industrial economics have demonstrated that, in the area

²³ Cp ECJ, Rec. 1979, p. 3727 and Rec. 1989, p. 2237; ECJ, Rec. 1991, I-5119; ECJ, Rec. 1994, II-555; cp. also *Baur/Pritzsche/Klauer*, op. cit, p. 67 ff. Also the EC Treaty (Art.II-72) contains as unwritten fundamental rights in compliance with the Charter of Fundamental Rights the freedom of association. This European fundamental right is directed against sovereign decisions of Community institutions only, not against national legislation which implements independence in its own decision-making power and within legal frameworks.

of natural monopolies, opening markets by statute alone is not sufficient for creating effective competition processes. The railway sector, which provides a good example, will be looked at here in order to draw parallels with the energy sector. Due to the inability to duplicate comprehensively, transportation networks of vertically integrated infrastructure system companies inevitably contain potential for discriminatory behaviour that restricts competition on the downstream level of distribution. This can not be disputed. The essential facilities doctrine²⁴ crafted for giving access to natural monopolies constitutes the economic and legal response to this finding. Paramount to the regulation of network industries is a legally secured, non-discriminatory access to railway lines for competitors. In compensation, the network owner is entitled to collect charges corresponding to competition for the use of railway lines. as well as a distinct separation of the area of infrastructure from the area of service provision of the vertically integrated undertaking in order to prevent just this discrimination. Accordingly, bringing competition on the railways and efficient trans-European network infrastructures depends on effective unbundling.

In the 3rd energy package of September 2007, the Commission demanded a increase of the normative requirements for operational independence of system operators if an ownership-related unbundling is dispensed.²⁵ On the occasion of this inquiry limited to the energy sector in January 2007 the Commission shaped the general model of the ISO. This claims for an “institutional design” by which the system operator shall act independently from the interest of the group of affiliated undertakings.²⁶ According to the Commission’s opinion the objective of market opening has not been achieved by means of unbundling so far. Hurdles for effective competition remains as it is not able to develop due to market concentration, vertical market foreclosure, non-transparency of access to the network and of prices. Thus, further reaching structural measures are needed.²⁷

This cannot be achieved without the unbundling in respect of accounting. With significant emphasis placed on accounting-related unbundling,²⁸ the question arises whether effective unbundling is possible at all at this level without ownership-related separation as mentioned above. This shall be

²⁴ Concerning that cp. *Mestmäcker/Schweitzer*, Europäisches Wettbewerbsrecht, 2nd edition, 2004, Art.18 recital 42; *Möschel* in Immenga/Mestmäcker, EGWbR, 1st edition, 2001, Art.86 recitals 258 ff.

²⁵ DG Competition Report on Energy Sector Inquiry, SEC/2006/1724.

²⁶ Cp. also *Ensthaler/Bock/Strübbe*, ELR 2006, p. 353, 355.

²⁷ DG Competition Report on Energy Sector Inquiry, SEC/2006/1724, p. 12 ff.

²⁸ Cp. §§ 9, 9a AEG.

achieved in the first place by ownership-related separation and only in the second place by establishing an ISO.²⁹ Insufficient unbundling would create regulation “loopholes”, in particular with respect to cross-border situations. Not least the in-transparency shall be reduced.³⁰ Drawing a clear separation of branches within the same legal person or within a group of affiliated companies is hardly possible and only controllable with great effort, no matter how detailed the provisions are.³¹ Only by strict separation “discrimination, cross-subsidisation and competitive distortion”³² can be prevented. Whether this danger seriously is present, when operational unbundling is executed consistently, remains to be explained in the following.

First, it needs to be considered, that the legislator has followed a coherent objective, both in terms of regulation policy and economic terms.³³ There upon the operation of infrastructure shall be undertaken independently and in a non-discriminatory way in order to enable third parties to act unhindered and non-discriminated on the market. Competition is not only to be promoted by regulating interconnection, access and charges but also by provisions referring to the corporate separation of network and service. Thereby anti-competitive effects of vertical integration shall be abolished. Provided that the result is a comparability of network sectors in economic and legal respect, a consistent general model for the independent system operator may be developed.

The unbundling provisions in the 3rd energy package refer to vertically integrated energy supply companies and legally independent but affiliated operators of transmission systems. The vertically integrated undertaking is obliged to treat the network operator as an independent legal entity. Since the legal organisation alone is not sufficient to provide for financial independence, it is furthermore proper to undertake functional unbundling as well. The system operator must have the sole decision-making power in terms of the network business and must be organisationally independent from the other parts of the undertaking.

²⁹ DG Competition Report on Energy Sector Inquiry, SC (2006) 1724, p. 14.

³⁰ DG Competition Report on Energy Sector Inquiry, SC (2006) 1724, p. 325.

³¹ *Olfert*, *Kostenrechnung*, 4th edition 2005, p. 52; it is to be proceeded from the assumption, that the Commission refers to this, when it mentions increased regulatory effort, *cp. op.cit.* (fn. 16).

³² See Directives 2003/54/EC, 26 June 2003 (OJ EC 176/37) and 2003/55/EG, 26 June 2003 (OJ EC 176/57), for the railway sector see points 5 ff. of Directive 2001/14/EC (OJ L 75/29), points 9 ff. of Directive 2001/12/EC (OJ L 75/1).

³³ *Masing*, *Verhandlungen des 66. DJT*, vol. 1, 2006, p. D18; *Staebe*, *IR* 2006, p. 204.

Three instruments can be considered for improving the independence of the management of the system company for decision-making on investments:

1. The system-related independence of the representative body statutorily entitled to act on behalf of the undertaking, has to be incorporated in the articles of the company respectively the contract of association in order to secure the neutrality of the system company. The authority of the shareholders of the limited liability company to issue directives has to be restricted accordingly and constructed corresponding to the stock company rules. Insofar as directives are permitted, these have to be submitted to the supervisory board for approval. Contracts of domination are illegitimate.³⁴ The articles of the company compliant to unbundling should be reviewed by the regulatory authority.
2. A supervisory board responsible for appointing and dismissing members of the representative body statutorily entitled to act on behalf of the undertaking and for concluding the employment contracts, is to be established in every system company regardless of the legal form of organisation. The internal independence of the supervisory board in staff and substantial decisions has to be improved in order to achieve stringent infrastructure-related neutrality by means of participation of neutral members in the decision-making process to ensure neutrality.
3. According to Community guidelines, the staff of the system company entrusted with management functions including the level below the top management, must not perform management functions directly or indirectly in other affiliated undertakings. Shared services regarding management functions within the group of affiliated undertakings are precluded.

From the above mentioned considerations, a new sophisticated market design of the independent system operator arises which enhances the institutional guarantees of the independence of network operators not only normatively but also practically compared to the status so far.

In the following section the individual provisions concerning the proposal for an effective and efficient unbundling of the transmissions system operator (see appendix) will be analysed in detail.

³⁴ More detailed on that see *Säcker*, ET 2007, p. 87 ff.

The operation of electricity and gas supply systems is a natural monopoly, since building a new network in parallel to an already existing one is economically unreasonable. Any competition within the network thus depends decisively on the possibility for all applicants to use the system on objective, transparent and non-discriminatory conditions. Pursuant to European prerequisites, non-discrimination is the central element of the access right, completed by a negotiated access corresponding with the legally private nature of the right of third party network access.³⁵

The future demand for gas and electricity is more or less predictable. The demand of gas and electricity cannot be increased considerably by low access charges and cannot be decreased considerably by high prices. Due to the lack of substitutability the consumption of gas and electricity is stable and independent of pricing issues. This factor reinforces the natural monopoly.

Therefore central element of the European provisions in all regulated industries is a fair and non-discriminatory access to network infrastructure, which shall be achieved through “the separation of certain essential functions and/or the creation of a rail regulator fulfilling the control and implementation functions”³⁶.

According to the Guidelines, the independence of the network operators regarding their form of organisation has to be established. The most adequate legal form is the joint-stock company (see § 76 AktG). Formal requirements on the procedure of legal unbundling are not sufficient for ensuring a non-discriminatory and transparent network operation. The law on stock companies, which contains the obligation to preserve the company’s interest, does not alone guarantee for orientation towards non-discriminatory competition. As long as the network operator is a part of the integrated group of affiliated companies and without additional provisions, there remains an incentive to favour the distribution and traffic undertakings of the group over competitors; e.g. through cross-subsidization, differentiated price systems or through shortages respectively planning of capacities. In order to prevent such discriminatory practice, the new provisions in the 3rd energy package regarding unbundling require further operational unbundling.

³⁵ At present the DB Netz AG as subsidiary of DB Holding is performing these services in Germany.

³⁶ Cp. para. (2) of the preamble of the Directive 2001/12/EC, OJ L 075, 15/03/2001, p. 1-25, p. 2.

The shareholder's possibilities to influence the operation of the network are limited by law by the so-called functional unbundling. Network operators must be independent in terms of organisation and decision-making, as far as decisions about railway lines and charges are involved. The network operator has to shield its power of decision from interference by the parent company. Instructions referring to network schedules and charge are forbidden.

This normative independence is partly undermined since the parent company appoints and dismisses the board of directors of the network operator. If the members of the board do not plan to jeopardise their promotion prospects, their increase of salary or their belonging to the group, they are under mental pressure to act loyally to the group. Additionally, the cost pressure is increasing due to the payment regulation;³⁷ difficulties in achieving group internal targets of return are in practice quite able to lead to loyal behaviour in other areas.³⁸

At the parent company's level, there is also an undergoing conflict between the integrated direction of the group, on the one hand, and the limitation of influence by the functional unbundling, on the other hand. In practice, this situation of conflict has rather been resolved in favour of the group affiliation³⁹, as the EU Commission has stated in its analysis⁴⁰ of 10 January 2007. Characteristic here is the execution of a so-called "narrow" unbundling. The network operator is equipped with own personnel and material means only to a small extent and therefore is relying on services provided by the holding undertakings or group affiliated companies ("shared services companies") in order to fulfil its tasks. This applies to legal service, accounting, data handling, human resources, development, maintenance, repair, and partly also the management of the network and the calculation of charges.⁴¹ The use of such shared services companies for

³⁷ Contrary to Ruge's perception it is not a toothless paper tiger who eats all cost thrown at him. *Ruge*, AöR 131 (2006), p. 1 ff.

³⁸ For detailed description see *Schönborn* in: Säcker/Busse von Colbe, *Wettbewerbsfördernde Regulierung*, 2007.

³⁹ Cp. the criticism in the decision of the Federal Railway Authority (Eisenbahn-Bundesamt), press release dated 27 November 2006, available at http://www.eisenbahn-bundesamt.de/aktuelles/presse/pm_unabhaengigkeit.htm.

⁴⁰ DG Competition Report on Energy Sector Inquiry (SEC (2006) 1724) 10 January 2007.

⁴¹ A typical example of the problems raised by the outplacement of group affiliated service companies is the statement by the chairman of the board of a network operator, in an interview in June 2006 (translated into English): "Every division has its own managerial responsibility, but always in due consideration to the vital interests of the group. (...) As far as group interests are at the fore, it is regarded as imperative to follow these group interests." (OWTTE).

managerial functions of the network operator is illegitimate, because it exerts a direct influence on the operator's decisions. The principle according to which the office holder's commitment towards the company is monopolised ("*Prinzip der Monopolisierung der Gebundenheit des Amtswalters*") is violated by bipolar management in the group; the danger of a conflict of interest cannot be denied.

In practice, the parent company in the group rather than the board of the network operator does control the economic contest about higher network access charges. The parent company or respectively the undertaking concerned with energy distribution decides about negotiation tactics and the acceptance or the appeal of governmental decrees. An independent, robust Corporate Governance codex with a concentration on the tasks of the network operators, which secures the factual independence by implementing an adequate management philosophy and provides protection from compliance to group interests, does not exist, yet.⁴² At present, this is the instable state of network operators.

5. Consequences

Since ownership unbundling is not a satisfying solution, the question arises as how to achieve independence concerning the operation of networks in order to secure non-discriminatory conditions. The EU Commission suggests – as already mentioned – the formation of an independent system operator (ISO) as a second best solution.⁴³ However, this model is incompatible with the EC-Treaty (see above under 3.)

5.1. Contracts of domination and factual independence of the system operator's executive boards.

Contracts of domination are illegitimate under the objectives of regulation law as they provide permanent influence on the system operator by the parent company. They contradict the objective of unbundling. Factually limited contracts of domination ("*Teilherrschungsverträge*") are also lethal for

⁴² In order to guarantee the efficiency of the unbundling provisions, sooner or later it will be inevitable to develop such a codex. This would meet the EU Commission's approach.

⁴³ Cp. DG Competition Energy Sector Inquiry (SEC (206) 1724), 10 January 2007, p. 14; *Ernstlicher/Bock/Strübbe*, ELR 2005, p. 353 ff. had made the suggestion earlier as well.

the proper functioning of functional unbundling. Merely formal constructions, which do not affect the actual situation, are pointless for the development of an independent Corporate Governance of network operators. Contracts of domination are illegitimate even if restricted to single areas of decision, which themselves are unrelated to the use of networks or charges (despite the fact that such contracts may preserve an area defined as free from instructions). The psychological implication of a contract of domination is to “enslave” the recipient to the parent company, bind the management and eliminate the factual independence.

Incompatible with the postulate of independence is not only the double staff of the supervisory board but also any overlap in personnel matters between the system operator and service providers, which allows the latter to unilaterally decide on issues relating to the management posts of the system operator. The body responsible for the election must be staffed with independent representatives of the network operator, who are committed to the principle of an independent system operator and a respective Governance codex.

5.2. Companies providing services (“konzerninterne Dienstleistungsgesellschaften”): joint services)

The outsourcing of group activities into affiliated companies that provide services is also to be precluded within the railway sector, as far as management functions are concerned. Public procurement law is not sufficient to protect autonomous decisions regarding procurement. It even contains a derogation clause for the procurement of service commissions to affiliated undertakings, as long as the commissioned undertaking achieves at least 80% of its turnover within the group (§ 10 Vergabeordnung).

Labour and employment legislation prohibits managers in charge of the operation of the network from being attributed to other companies of the group. Lawyers of the service provider, provided with power of attorney issued by the network operator may not contract with other lawyers of the service providers, issued with power of attorney of the parent company, without putting the neutrality of the network operator at risk. Therefore, any management related services for the network operator must actually be located within its premises. Vertically integrated undertakings are obliged to create internal provisions to ensure that the network operator and its personnel are empowered with effective decision-making power concerning

facilities of operation, maintenance and expansion of the railway network and are able to exercise these powers without interference by the leadership of the vertically integrated group. Consequently, the network operator must have adequate human and financial resources, in order to fulfil its tasks fully independently from other parts of the integrated group.

5.3. Trustee and ultimate control of the shareholder

The goal is clear: in order to achieve an effective unbundling and a truly operational independence a real separation of the functions and interests of the Transmission System Operator (TSO) from the interests of the vertically integrated electricity and gas undertaking is necessary.

Therefore it is necessary that the system operator has the power to independently adopt its annual investment plan and to raise money on the capital market, in particular through financial loans. However, the border (“rubicon”) to a regulatory taking is exceeded, if the shareholders’ assembly only has the right to appoint a trustee, which, instead of the owner, has the exclusive responsibility for the election of all members of the supervisory board (without a single member of the shareholders’ side). In turn, the supervisory board is authorized to appoint the members of the board of management. Taking into account that the valid appointment of the trustee is dependent upon the official consent of the regulatory agency (Bundesnetzagentur), the shareholders have no secure influence over the trustee on the supervisory and management board taking who follows financial instructions and represents the interests of the shareholders’ side. The transmission company will be a free floating balloon, if the owner loses the ultimate personal control. The veto right of the single capital side member of the supervisory board against certain financial resolutions of the board passed in accordance with the decision of the management is, in controversial situations, not sufficient to keep a balance between the financial interests of the shareholders and the interest of the other shareholders, represented in the supervisory board.

Therefore, it is necessary to limit the Bundesnetzagentur’s right of a general veto without argument as proposed by the EC Commission in the same way as for example in the German banking or insurance law. The BAFIN has the right of protest only if an appointed manager (trustee) is recognizably not qualified in the subject; otherwise the veto is void. Only with this important restriction taking can be avoided. It will be a difficult procedure

to implement all the amendments in the German Law of the stock corporation.

The proposal made by the commission to commit TSO's shareholders to increase the capital of the company for financing essential capital investment for the transmission network is incompatible with the idea of free capital movement. This decision must remain in the power of the owner of the company so that he can decide dependent on the answer of the question, whether a rate of return can be achieved that is commercially usual and risk adequate. In the case of negating that question the basic right of property – of EC law as well as of national law – protects owner against a capital investment under pressure that is inconsistent with the freedom of acts of disposal, which is an essential part of legal ownership.

5.4. Personnel self-determination

Personnel self-determination in terms of labour/employment law in relation to personnel management functions is also part of the network operator's independence. Otherwise its factual independence is challenged.⁴⁴ It is responsible for entering into employment contracts and it controls the conditions of these contracts.

Furthermore, the leadership of the group has no competence to enter into collective labour agreements for the group, insofar as the network operator is impaired in the self-determined and cost-effective fulfilling of its tasks, as legally imposed. The provisions on operational unbundling exclude any authorization of the group's leadership with respect to group-wide collective labour agreements. Since a contract of domination is generally illegitimate, competence cannot be derived from any such framework. Consequently, a corresponding personnel responsibility follows from the factual responsibility. Thus, the network operator has to decide on the number of staff necessary to provide for a safe network and related service facilities, which periods of cancellation exist, and if agreements are provided with preclusions of due terminations for operational reasons (*“Verbot ordentlicher betriebsbedingter Kündigungen”*). Regulation law requires the board of the network operators to take independent decisions in these domains. Decisions concerning the network may only be taken by the personnel of

⁴⁴ Cp. the Federal Railway Authority (Eisenbahn-Bundesamt), press release dated 27 November 2006, available at http://www.eisenbahn-bundesamt.de/aktuelles/presse/pm_unabhaengigkeit.htm.

the system operator and, thus, independently from the parent company. This implies complete independence from the parent company with respect to personnel decisions. The options for “narrow” unbundling are therefore limited, because the infrastructure company, as such, must be able to act independently from other group companies. The technical management of the networks, the decisions about the network schedule and the railway lines and the calculation of access charges must be conducted by the network operator independently.

5.5. Exercise of regulation management powers

The exercise of regulation management powers is a task for the network operator only (performed in fulfilment of its legal assignment). The parent company indeed may use corporate tools to control the maximum levels for the accumulation of debt and may define the annual financial plan in order to secure the profitability interests of the group. But, this control must not impair the fulfilment of the legal obligations concerning investments regarding modernisation, expansion or re-structuring of the railway lines (these issues must be decided upon by the board of the network operator).

The provisions regarding unbundling explicitly prohibit any instructions on the running of system’s operations, the allocation of lines, the schedule or the charges/fares. Such instructions violate the independence of the management. The EU Directive only names the approval to the annual budget and the setting of maximum levels for accumulation of debt as examples for the exercise of influence and control. Thus, only similar measures can be considered as equivalent tools in the Directive’s meaning, which in function and effect correlate to an annual, abstract general finance plan. Within this legally defined frame, the network operator has to take decisions on the “if” and “how” of concrete investment activities and doing so independently from the group interest.

5.6. Performance-based remuneration

A limitation of the parent company’s influence by law is going to be unsuccessful as long as the network operator’s management is voluntarily oriented by internal targets of the group, because it has internalised the group interest as the sole benchmark due to the group’s corporate governance. Considering this, the group’s leadership has to respect the

factual independence to act of the network operator's management. It has to refrain from any sort of incentive payment, which could influence the leadership of the operator to favour activities of the group over those of its competitors. Moreover, it must also be ensured that the leadership of the operator is not penalised in case they – in accordance with to their corporate obligation – pursue the operator's interests consistently. For this reason any performance-based remuneration and payment are to be solely oriented by the success of the network operator (as opposed to the group's overall results). Otherwise, there would be incentives for a network manager to favour the group's distribution interests and, thereby, indirectly increasing its own remuneration.

5.7. Duration of management contracts

Since the performance of the network operator may be damped due to regulated pricing targets, there is a danger of lowering the remuneration of the system operator's management in comparison to that of other executive bodies in the group. In order to guarantee the professional independence, direct and indirect work-related disadvantages resulting from beneficial activities for the operator must be prevented. Therefore, the duration of management contracts must not deviate "downwards" compared to the duration of similar contracts in other units of the group. However, this alone is not sufficient. Contrary to other companies of the group, the leadership of the network operator must be additionally protected, because – if necessary – its task is to take decisions against the group's interest. Securing the factual capability to act independently requires special measures. This particular institutional design can be met by a minimum duration of management contracts. A minimum term of three years seems necessary to provide independent decision making by the executives. This example shows that the conflict between independence due to unbundling and dependence due to group affiliation is difficult to resolve through normative measures. This is a significant barrier for achieving an effective unbundling.

5.8. The intra-enterprise conspiracy doctrine

Considering the operational independence of network operators in the future there will not be a justification for agreements restricting competition between parent company and its subsidiary pursuant to the intra-enterprise

conspiracy doctrine⁴⁵; considering the purpose of unbundling it may not exist.

5.9. Remaining capability of discrimination?

Effective competition cannot be reached without a non-discriminatory, transparent network access at competitively analogous prices. The amount of network access charges is determined according to the principle of cost-based calculation (“*Prinzip der Kostenbasiertheit*”), completed by the principle of non-discrimination and efficient provision of service; the charges must be priced in a cost-efficient way.⁴⁶ The principle of competitively analogue prices (“*Prinzip der wettbewerbsanalogen Preise*”) is to be applied to all network related sectors, which in case of a lack of adequate benchmark from comparable markets is defined by the concept of efficient service provision (“*Konzept effizienter Leistungserbringung – KEL-Konzept*”). The non-discriminatory charges is, as it is stated in the respective EU Directives, the prevention of cross-subsidisation and other impediment of competition. Access to networks for competitive purposes is not only mandated by specific regulation law but also protected by Art. 82 EC. Discriminatory conduct in relation to network access infringes both of these provisions. Moreover, inadequate, competitively non-analogue, cost-ineffective prices is incompatible with Art. 82(2)lit.a EC; and Art. 82 (2) lit.c EC applies to discriminatory conduct in relation to non-affiliated companies.

Both, open discrimination of applicants and concealed discrimination, for instance, by way of cross-subsidisation are prohibited. The same applies for ensuring that subsidies from the public budgets are not used for (concealed) impediment of competition.⁴⁷ In theory, a vertically integrated undertaking could be tempted to charge higher system fees from all customers, since this strategy results in cost advantages in the competition for customers; the crowding out of competitors without a network with low system fees leads to the situation, that the losses within the group can be balanced by redistribution and have no effect on the system fees (“*deep pocket theory*”).

⁴⁵ If one would allow these internal agreements, one would foil the postulate of independence as set down in the unbundling provisions; just as *Lecheler/Herrmann*, WuW 2005, p. 482, 488 ff.

⁴⁶ Cp. *Säcker/Böcker*, “Die Entgeltkontrolle als Bestandteil einer sektorübergreifenden Regulierungsdogmatik für Netzwirtschaften”, in: 10 Jahre wettbewerbsorientierte Regulierung in Deutschland, 2008; contrary *Ruge*, AöR 131 (2006), p. 1 ff.

⁴⁷ *Gerstner*, in: *Hermes/Sellner* (eds.), *Beck’scher AEG-Kommentar* (Commentary), § 9 recital 28.

The competitors were exposed to a price-cost-divergence due to abusive behaviour, since the integrated undertaking could keep its prices despite the increase of system fees. Such a price-cost-divergence is a sort of predatory competition (predatory pricing), which is only realisable by vertically integrated undertakings; because in the end the final result of the group is unchanged. In an effective execution of the unbundling provision, a legal safeguard of independent network management from such behaviour is unlikely to happen, the more so as the increased price need to be approved by the federal network agency. In this procedure, the network operator would not have any realistic chance to gain any higher interests than the interest on own capital as prescribed by the authority. It would also be unable to charge transfers/allocations upstream higher than the cost of efficient provision of service to the parent company. An internal cross-subsidisation could only be achieved indirectly by entering into overpriced contracts about network-related services (particularly shared services) with service companies affiliated to the group. Apart from the objections already described, these contracts would contradict the principle of cost-efficient provision of service and have to be prohibited by the federal network agency.

With an appropriate ISO-system, an energy supply undertaking could not induce the infrastructure-companies to increase the system fees for the competitors above the competitive price. The fees are rather charged on the basis of effective network costs, in a way adequate to the input involved and proportional. Any subcutaneous relocation of internal general costs or distributive cost-elements towards the “account” of network costs – aiming at creating artificially high access charges and impairing competing undertakings – is not to be expected under realistic consideration. Any claim of future behaviour restricting competition pursuant to Art. 81(1) and Art. 82 EC, should not be assumed on mere speculative grounds.⁴⁸ The ECJ asserted in its judgment dated 15 February 2005⁴⁹ expressly, that any alleged abusive behaviour for the future is only to be regarded, if the structure of the respective markets makes abusive behaviour possible and if this appears economically sensible. It is only where, despite effective unbundling-control, it seems likely and economically reasonable that railway companies will be discriminated or excessive fees will be charged, that the regulation authority may take this danger into account. The authority is not allowed to readily suspect the concerned undertakings of a future infringement of law. It may

⁴⁸ Cp. Säcker, K&R 2006, p. 49, 52 ff. with further references referring to the relevant case-law.

⁴⁹ EuGHE Slg. I 2005, p. 987, recital 81 = WuW/EU-R 875, recital 81.

be assumed, that those will respect the provisions of competition and regulation law and particularly will not exploit their dominant position as a violation of Art. 82 EC.⁵⁰ This applies to regulated sectors in particular, where an effective regulation control by the respective authorities and severe sanctions make a breach unprofitable and therefore unlikely.

6. Summary

Ownership-unbundling eliminates all incentives for discrimination, but carries – contrary to the Commission’s perception⁵¹ – the risk of higher charges and lower investments. Considering current provisions of EU law, it is not realisable offhand, since it would lead to an illegitimate interference with the freedom of property (Art. 295 of the EC Treaty). The same applies to the creation of a completely independent network operator, that would be able to decide without profitability control by the responsible owner or the leaseholder of the business. Normative reinforcements of the management’s independence are also necessary to preclude conflicts of interest on network-related decisions.⁵² The unbundling of integrated undertakings in terms of corporate law and function-wise is – if these requirements are realised – a suitable replacement instrument in the energy as well as in the railway sector. Suitable corporate governance for the management of network operating companies is needed to establish these provisions in reality. Considering this aspect, it appears to be reasonable to adopt the form of a stock company (*Aktiengesellschaft* – AG). Thereby, the independence of the leadership of the system operator would be strengthened to some extent, since the board of the stock company is not subject to instructions by the supervisory board, nor by the shareholder’s meeting (§§ 76, 119(2) of the German stock corporation Act - AktG). Hence, it cannot be forced to take measures contradicting an independent operation of the network. The independence from the group would thereby be preserved.

The principles displayed above and the control of compliance to them by two supervisory authorities (the Federal Network Agency – *Bundesnetzagentur*

⁵⁰ Cp. Säcker, K&R 2006, p. 49, 52 ff. with further references.

⁵¹ Cp. DG Competition Energy Sector Inquiry, p. 12 ff. and 3rd energy package, COM (2007), 528 final, p. 5 ff

⁵² This corresponds with the so-called deep ISO model by the EU Commission in the 3rd energy package of September 2007.

and the Federal Competition Authority – *Bundeskartellamt*), supported by the private legal means of competitors and customers (§§ 33 GWB), provide a legal framework that is able to eliminate dangers for competition (provided the operational unbundling functions in practice). The unbundling provisions as controlled by the authorities allow a network operation independent from the parent company, provided that adequate corporate governance is developed. It further makes it possible to ensure that legally and functionally unbundled network operators are not used as vehicles for preventing entry by competitors on the sales markets of the parent company by demanding discriminatory system fees.

Appendix

(Paper of 8 EC Member States)

Effective and Efficient Unbundling of Transmission System Operators

German and French Proposal for a Directive of the EP and the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity and repealing Directive 96/92/EC

Unbundling of transmission systems and transmission system operators

1. In order to ensure the independence of transmission system operators Member States shall ensure that as from [*date of transposition plus one year*] vertically integrated undertakings have to comply either with the provisions of lit. (a) – (d) of art. 8 on ownership unbundling (OU) and art 10 on independent system operators (ISO) or with the following provisions on effective and efficient unbundling (“EEU”).

Effective and efficient unbundling of transmission systems

Assets, equipment, staff and identity

2. TSOs shall be equipped with all human, physical and financial resources of the vertically integrated undertaking necessary for the regular business of electricity transmission , in particular:
 - (i) Assets that are necessary for the regular business of electricity transmission shall be owned by the TSO.
 - (ii) Personnel necessary for the regular business of electricity transmission shall be employed by the TSO.
 - (iii) Leasing of personnel and rendering of services, from and to any

branch of the vertically integrated undertaking performing functions of generation or supply, shall be limited to cases with no discriminatory potential and be subject to approval by national regulatory authorities in order to exclude competition concerns and conflicts of interest.

(iv) Appropriate financial resources for future investment projects shall be kept available in due time.

2bis. The activities deemed necessary for the regular business of electricity transmission mentioned in paragraph 2 shall at least include:

- representation of the TSO and contacts to third parties and the regulatory authorities
- granting and managing third party access
- collection of the access charges, congestion rents and payments under the inter transmission system operator compensation mechanism in compliance with Article 3 of Regulation (EC) No. 1228/2003
- operation, maintenance and development of the transmission system
- investment planning ensuring the long-term ability of the system to meet reasonable demand and guaranteeing security of supply
- legal services
- accountancy and IT services

3. TSOs shall be organised in the legal form of a joint-stock company.
4. The TSO shall have its own corporate identity, significantly different from the vertically integrated undertaking with separate branding, communication and premises.
5. TSO's accounts shall be audited by another auditor than the one auditing the vertically integrated undertaking and all its affiliated companies.

Independence of the TSO management, chief executive officer / executive board

6. Decisions on the appointment and on any premature termination of the employment of the chief executive officer / members of the executive board of the TSO and the respective contractual agreements of the employment and its termination shall be notified to the regulatory authority or any other competent national public authority. These decisions and agreements may become binding only if, within a period of 3 weeks time after notification, to the regulatory authority or any other competent national public authority has not used its right of veto. A veto may be issued in cases of appointment and respective contractual agreements if serious doubts arise as to the professional independence of the nominated chief executive officer / member of the executive board, or in the case of premature terminations of employment and respective contractual agreements, if serious doubts, exist regarding the reasoning for this measure.
7. Effective rights of appeal to the regulatory authority or another competent national public authority or to a court shall be guaranteed for any complaints by the management of the TSO against premature terminations of their employment.
8. After termination of employment in the TSO, chief executive officers / members of the executive board shall not participate in any branch of the vertically integrated undertaking performing functions of generation or supply for a period of not less than 3 years.
9. The chief executive officer / members of the executive board shall not hold any interest in or receive any compensation from any undertaking of the vertically integrated company other than the TSO. His/their remuneration shall in no part depend on activities of the vertically integrated undertaking other than those of the TSO.
10. The chief executive officer or the members of the executive board of the TSO may not bear responsibility, directly or indirectly, in the day-to-day operation of any other branch of the vertically integrated undertaking.
11. Without prejudice to the provisions above, the TSO 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 of return on assets, regulated indirectly in accordance with Article 22 c, 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 transmission 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 transmission lines, that do not exceed the terms of the approved financial plan, or any equivalent instrument.

Supervisory board / Board of directors

12. Chairmen of the supervisory board/board of directors of the TSO shall not participate in any branch of the vertically integrated undertaking performing functions of generation or supply.
13. The supervisory boards / boards of directors of TSOs shall include independent members, appointed for a term of at least 5 years. Their appointment shall be notified to the regulatory authority/ or any other competent national public authority and become binding under the conditions described in paragraph 6.
14. For the purpose of paragraph 13, a member of the supervisory board / board of directors of a TSO shall be deemed independent if he is free of any business, or other relationship with the vertically integrated undertaking, its controlling shareholders or the management of either, that creates a conflict of interest such as to impair his judgement, in particular:
 - (a) has not been an employee of any branch of the vertically integrated undertaking performing functions of generation and supply in five years prior to their appointment as supervisory board / board of directors member;
 - (b) does not hold any interest in and does not receive any compensation from the vertically integrated undertaking **or** any of its affiliates

- except the TSO;
- (c) does not hold any relevant business relationship with any branch of the vertically integrated company performing functions of energy supply during his appointment as supervisory board / board of directors member ;
 - (d) is not a member of the executive board of a company in which the vertically integrated undertaking appoints members of the supervisory board / board of directors.

Compliance officer

15. Member States shall ensure that TSOs establish and implement a compliance programme which sets out measures taken to ensure that discriminatory conduct is excluded. The programme shall set out the specific obligations of employees to meet this objective. It shall be subject to approval of the regulatory authority or any other competent national public authority. Compliance of the program shall be independently monitored by the compliance officer. The regulatory authority shall have the power to impose sanctions in case of inappropriate implementation of the compliance program.
16. The chief executive officer / executive board of the TSO shall appoint a person or a body as a compliance officer in charge of :
 - (i) monitoring the implementation of the compliance programme ;
 - (ii) elaborating an annual report, setting out the measures taken in order to implement the compliance programme and submitting it to the regulatory authority ;
 - (iii) issuing recommendations on the compliance programme and its implementation.
17. The independence of the compliance officer shall be guaranteed in particular by the terms of his employment contract
18. The compliance officer shall have the opportunity to regularly address the supervisory board/board of directors of the TSO, of the vertically integrated undertaking and the regulatory authorities.
19. The compliance officer shall assist to all sessions of the supervisory board / board of directors of the transmission system operator that

address the following areas :

- (i) conditions for access and connection to the grid, including the collection of access charges, congestion rents, and payments under the inter transmission system operator compensation mechanism in compliance with Article 3 of Regulation (EC) No 1228/2003 ;
 - (ii) projects undertaken in order to operate, maintain and develop the transmission grid system, including interconnection and connection investments ;
 - (iii) balancing rules, including reserve power rules;
 - (iv) energy purchases in order to cover energy losses.
20. During these sessions, he shall prevent information about generators or suppliers activities which may be commercially advantageous from being disclosed in a discriminatory manner to the supervisory board/board of directors.
21. The compliance officer shall have access to all relevant books, records and offices of the TSO and to all the necessary information for the fulfilment of his task for the proper performance of his duties.
22. The compliance officer shall be nominated and removed by the chief executive officer / executive board only after prior approval by the regulatory authority.

Grid development and powers to make investment decisions

TSOs shall elaborate a 10-year network development plan at least every two years. They shall provide efficient measures in order to guarantee system adequacy and security of supply.

23. The 10-year network development plan shall in particular :
- a. indicate to market participants the main transmission infrastructures that ought to be built over the next ten years;
 - b. contain all the investments already decided and identify new investments for which an implementation decision has to be taken in the next three years.
24. In order to elaborate this 10-year network development plan, each TSO makes reasonable hypothesis about the evolution of generation,

consumption and exchanges with other countries, and takes into account regional and European-wide existing network investment plans. TSO shall submit in due time the draft to the competent national body.

25. The competent national body shall consult all relevant network users on the basis of a draft for the 10-year network development plan in an open and transparent manner and may publish the result of the consultation process, in particular possible needs for investments.
26. The competent national body shall examine whether the 10-year network development plan covers all investment needs identified in the consultation. This authority may oblige the TSO to amend his plan.
27. Competent national body in the sense of paragraphs 24, 25 and 26, may be the national regulatory authority, any other competent national public authority or a network development trustee constituted by TSOs. In the latter case, TSOs shall submit the drafts of the statutes, of the list of members and of the rules of procedure to the approval of the competent national public authority.
28. If the TSO rejects to implement a specific investment listed in the 10-year network development plan to be executed in the next three years, Members States shall ensure that the regulatory authority or any other competent national public authority have the competence for one of the following measures, either :
 - 1/ request by all legal means the TSO to execute his investment obligations using his financial capacities, or
 - 2/ invite independent investors to tender for a necessary investment in a transmission system and may oblige the TSO :
 - to agree to financing by any third party,
 - to agree to building by any third party or to build the respective new assets and
 - to operate the respective new asset.

The relevant financial arrangements shall be subject to the approval of the regulatory authority or any other competent national authority.

In both cases, tariff regulation shall allow for revenues that cover the costs of such investments.

29. Competent national public authority shall monitor and evaluate the implementation of the investment plan.

Decision making powers regarding the connection of new power plants to the transmission grid

30. TSOs shall be obliged to establish and publish transparent and efficient procedures for non-discriminatory connection of new power plants to the grid. Those procedures shall be subject to the approval of national regulatory authorities or any other competent national public authority
31. TSOs shall not be entitled to refuse the connection of a new power plant on the grounds of possible future limitations to available network capacities, e.g. congestion in distant parts of the transmission grid. The TSO shall be obliged to supply necessary information.
32. TSOs shall not be entitled to refuse a new connection point, on the sole ground that it will lead to additional costs linked with necessary capacity increase of grid elements in the close-up range to the connection point.

Regional cooperation

33. When the cooperation between several countries at a regional level encounters significant difficulties, following the joint request of these countries the Commission may designate, in agreement with all Member states concerned, a regional coordinator.
34. The regional coordinator shall promote at a regional level the cooperation of, regulatory authorities and any other competent public authorities, network operators, power exchanges, grid users and market parties. In particular, he shall :
 - (a) promote new efficient investments in interconnections. To this end, he shall assist TSOs while elaborating their regional interconnection plan and contribute to the coordination of their investments decisions and, where appropriate, of their open season procedure;

- (b) promote the efficient and safe use of the networks. To this end, he shall contribute to the coordination between TSOs, national regulatory authorities and other competent national public authorities with the elaboration of common allocation and common safeguard mechanisms;
- (c) submit a report to the Commission and Member states concerned every year on the progress achieved in the region and on any difficulty or obstacle that may hinder progress.