



# Final Report on Technical assistance to efficiently implement, monitor and report the functional unbundling of network operators

*EXERGIA A.E.*

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**Technical assistance to efficiently  
implement, monitor and report the  
functional unbundling of network  
operators**

**FINAL REPORT**

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## ABBREVIATIONS

BoDs	Board of Directors
CEER	Council of European Energy Regulators
CEO	Chief Executive Officer
CON	Compliance Officers Network
CRE	Commission de Régulation de l'Énergie in France
DAO	Distribution Assets Ownership
DBU	Distribution Business Unit
DNO	Distribution Network Operator
DSO	Distribution System Operator
ECDSOE	Energy Community Distribution System Operators for Electricity
ECJ	European Court of Justice
EREGG	European Regulators' Group for Electricity and Gas
EU	European Union
HEDNO	Hellenic Electricity Distribution Network Operator
JRC	Joint Research Centre
QMS	Quality Management System
MS	Member States
NRA	National Regulatory Authority
PPC	Public Power Corporation
RAE	Regulatory Authority for Energy
RNM	Reference Network Models
SLA	Service Level Agreement
TSO	Transmission system operator
VIU	Vertically Integrated Undertaking



## INTRODUCTION

The present Report has been developed by EXERGIA S.A. in the framework of the project “Technical assistance to efficiently implement, monitor and report the functional unbundling of network operators” which was financed by the Energy Community. The project started on 11 April 2019 and ended on 6 June 2019.

The specific objective of the project was to provide technical assistance to Compliance Officers of the Electricity DSOs regarding procedures, know-how and best practices enabling them to effectively perform their tasks and responsibilities with reference to the development and monitoring of the Compliance Programme and submission of Compliance Reports.

The geographical area of the project was the Western Balkans i.e. Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro and Serbia. Nevertheless, for the development of the report, the Consultant took into consideration the information submitted by the DSOs of the Energy Community Contracting Parties (e.g. above Western Balkan countries, Ukraine, Georgia, Moldova). The information included energy legislation, energy market, filled in questionnaires as per Energy Community Template (Annex 1) etc. In addition, all the Compliance Officers of the Compliance Officers Network (CON) of the Energy Community Distribution System Operators for Electricity (ECDSO-E) were informed of the project outputs and made comments on the project outputs.

**It is noted that the findings and views expressed in this Report do not necessarily reflect those of the Energy Community.**



# 1 THE UNBUNDLING REGIME OF ELECTRICITY DSOS

Not much is known about the situation regarding the European Distribution System Operators (DSOs) and the networks they operate. The reasons for that is mainly due to the confidential nature of much of this information, as well as to the vast number and heterogeneity of electricity distribution systems in Europe. According to a Eurelectric study, there are well over 2,000 DSOs in Europe, connecting 260 million customers, operating 10 million km of lines, and supplying 2,700 TWh of energy per year. [1]

The DSOs situation varies radically from country to country, due to historical as well as geographical, legal, political and economic reasons. In some Member States (MSs) there is only one DSO, while in others there are tens or hundreds of them operating their networks on a regional or even municipal basis. Differences concern also other aspects, e.g. the scope of the DSO activities, the level of unbundling, the operated voltage levels and other key technical information on the networks.

Year after year, an increasing number of institutions, and associations are focusing on DSOs. The Joint Research Centre (JRC), an EU body, launched an initiative – the DSO Observatory project - to fill in this knowledge gap, by collecting a variety of data directly from the DSOs restricted as a first step, to the main ones, i.e. those that have to comply with the unbundling requirements set in the EU Electricity Directive (i.e. the DSOs serving more than 100.000 customers), for the creation of representative distribution networks using Reference Network Models (RNM) that can reliably simulate the impact of different scenarios on European distribution networks without the need to have access to the actual technical data. The recent updated report gives an overview of most DSOs in EU [2].

Moreover, CEER, except for the benchmarking reports concerning Quality of Energy, publishes a lot of documents on the roles of DSOs, their regulation and the unbundling situation ([3], [4]).

## 1.1 Provisions related to the unbundling of Electricity DSOS

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The provisions regarding the unbundling of DSOs are included in Article 26 of the Electricity Directive 2009/72/EC (hereinafter referred to as **Directive**) [5]. As per Article 26§1 of the Directive:

*“where the distribution system operator is part of a vertically integrated undertaking (VIU), it shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to distribution. Those rules shall not create an obligation to separate the ownership of assets of the distribution system operator from the vertically integrated undertaking.”*

The unbundling regime provisions are further specified in the Commission’s Interpretative

Note on the Unbundling Regime on 22 January 2010 [6], according to which:

*“where the DSO is part of a VIU, the basic elements of the 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; (c) **accounting unbundling**: requirement to keep **separate accounts for** DSO activities; (d) possibility of **exemptions** from the requirement of legal and functional unbundling for certain DSOs.”*

## 1.2 Legal unbundling

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According to Article 26§1 of the Directive, legal unbundling is an **obligation for all** DSOs. An exception from the provisions of Article 26§1 exists for DSOs serving less than 100 000 connected customers or serving small isolated systems (Article 26§4 of the Directive).

The VIU is in principle **free to choose the legal form of the DSO**, provided that it ensures a sufficient level of independence of the management of the DSO from other parts of the VIU in order to fulfil the requirements of **functional unbundling** [6]. Other parts of the VIU may potentially be the supply and production activities, for which legal unbundling is not an obligation, therefore they can be implemented within the same company/ VIU.

It is noted that Article 26§1 does not prohibit the combined operation of transmission and distribution as long as the combined operator meets the specified unbundling requirements.

## 1.3 Functional unbundling

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The functional unbundling requirements are management separation (Article 26§2a-b of the Directive), independence and effective decision making right of a DSO (Article 26§2c of the Directive), development of a compliance programme (Article 26§2d of the Directive), separate identity in communication and branding (Article 26§3 of the Directive), preservation of confidentiality (Article 27 of the Directive).

## 1.4 Accounting unbundling

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The provisions of the Directives are very strict regarding the need for DSOs to be unbundled in terms of accounting. The DSO has to draw up, submit to the National Regulatory Authority (NRA), audit and publish its annual accounts. Regulatory overview and approval of accounting unbundling rules is another key requirement.

Unlike legal and functional unbundling, accounting unbundling (Article 31§3 of the Directive) is the minimum separation requirement to be respected by every network operator, without exception, which means that it includes also small DSOs in case they are

part of a VIU and closed distribution systems.

The scope of audit of unbundled accounts and financial report may be subject to specific regulatory requirements with the aim to ensure that there is no cross-subsidization between activities. In that case, an audit has to examine the way costs have been allocated, especially for activities that concern shared services. Therefore, it is vital that cost items are allocated in a transparent and accurate manner to the activities concerned. Notably, any costs not related to the network business must be excluded. In any other case, such as inaccurate cost allocation, is likely to lead to cross-subsidisation among other activities (generation, supply etc.) and thus distorting competition. [6]

Annual accounts are disclosed in accordance with the rules of national legislation concerning annual accounts of limited liability companies adopted pursuant to the Directive 2013/34/EU [7]. This provision for accounting unbundling, as explained in the Interpretative Note, requires accurate application of accounting principles. Standards defining segment reporting and related party disclosures are crucial in this exercise. Accounting policies have to ensure that transactions with related undertakings and internally procured or provided goods and services are recognized at fair value.

## 1.5 Exemptions for DSOs serving less than 100 000 connected customers

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An exception from the provisions of Article 26§1-3 exists for integrated electricity undertakings serving less than 100 000 connected customers or serving small isolated systems (Article 26§4 of the Directive). It is noted that the number of connected customers is aggregated, when the DSO is consisted of one or more subsidiaries, in which case the exception as per Article 26§4 of the Directive is annulled and legal and functional unbundling is an obligation.

It should be noted that the third-party access requirements, in relation to exempted electricity distribution networks mentioned above relate to requirements, contained not only in the Third Package Directives but also their 2003 ‘Second Package’ predecessors (repealed by the Third Package).

Certain MSs when transposing these ‘de minimis’ exemptions considered, that the European requirements were not intended to apply to legal persons covered by such ‘de minimis’ exemptions. However, in 2008, the European Court of Justice (ECJ), in its judgment in the ‘Citiworks’ case<sup>1</sup>, ruled that the German national law, which failed to impose third party access requirements on a distribution system within an airport, did not properly transpose the Directive’s requirements. In particular, the ECJ found that there is no general ‘de minimis’ exception to the requirements.

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<sup>1</sup> Citiworks AG v Sächsisches Staatsministerium für Wirtschaft und Arbeit als Landesregulierungsbehörde (C- 439/06)

In light of this judgment, third party access regimes in respect of exempted electricity distribution networks, should be introduced as part of the implementation of the Third Package.

Additionally, taking into account the new Network Code (EU 2016/631) and the fact that in the future Local Energy Communities will expand, it is important to introduce the same third-party access requirements starting from now.

## 2 DSO POSITION IN THE VIU AND THREATS TO DSO INDEPENDENCE

According to Article 26 of the Directive, where the DSO is part of a vertically integrated undertaking (VIU), the basic elements of this unbundling regime are the following:

- (a) legal unbundling of the DSO from other activities of the VIU not related to distribution;
- (b) functional unbundling of the DSO in order to ensure its independence from other activities of the VIU;
- (c) accounting unbundling: requirement to keep separate accounts for DSO activities;
- (d) possibility of exemptions from the requirement for legal and functional unbundling for certain DSOs.

Furthermore, according to Article 26§2c of the Directive, a DSO must have, as a minimum criterion at its disposal,

*“the necessary human, technical, financial and physical resources in order to fulfil its tasks of operating, maintaining and developing the network”.*

Whereas per Article 2§21 of the Directive:

*“ ‘vertically integrated undertaking’ means an electricity undertaking or a group of electricity undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission or distribution, and at least one of the functions of generation or supply of electricity;”<sup>2</sup>*

The above provisions about the DSO unbundling regime, changes the operation of electric utility business, its management strategy as well as organizational structure. Following the implementation of the Third Energy Package provisions, the undertaking related to the distribution activities (DSO) is **legally unbundled**, i.e. operates as a **daughter** company (**DisCo**), under the **VIU**. However, there is no obligation for legal unbundling on the other parts of the VIU, i.e. the activities related to the supply and/or generation which may be operating either as separate affiliated companies under the umbrella of a **holding (mother) company**, or as unit(s) of the VIU organisational diagram, while in either case the DisCo is owned by the VIU but as a separate legal entity.

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<sup>2</sup> As per the spirit of the Law regarding the definition of the VIU (Article 2§21 of the Directive 72/2009 EC), the holding company and affiliated unbundled companies (distribution, generation, supply) under its umbrella may still be seen as VIU (e.g. Ukraine case). They constitute a Vertically Integrated Group of Companies.

The DSO as a subsidiary company, must have itself the necessary human, technical, financial and physical resources at its disposal in order to fulfil its tasks to operate, maintain and develop the network. Hence the DSO, in order to carry out its tasks, cannot unduly rely on the services (especially not regarding the tasks above) of other parts of the VIU.

In particular according to the Interpretative Note, provision of services by other parts of the VIU to the DSO can be limited and temporarily only accepted under the condition that competition is ensured, and conflicts of interest excluded. In order to avoid potential cross-subsidies given by the DSO to other parts of the VIU, the shared service should be provided at “*market conditions*” and laid down in a “*contractual arrangement*”.

Thus, there is a need for improved corporate rules in order to ensure the independence of network operators and the decision-making process, on investments necessary for distribution system development, upgrading, and maintenance regardless who owns the assets of the network. If the management of the DSO decides, based on expert analyses, to develop the network so that network access can be provided to all applicants, and the Regulatory authority approves a development plan followed by the corresponding financial plan, then the respective DisCo shareholders are obliged to adopt and support this decision.

Due to the fact that network activities are regulated, and their revenues are approved by the NRA or another official body (according to country law), this adoption and support of the DSO management’s decision, by the respective shareholders, is safeguarded. The authority to agree with the financial plan, does not include the right to undermine a need-based and reasonable system development plan through an insufficient budget or to impose sanctions on the DSO. In situations when it autonomously takes on a loan for the implementation of the plan mentioned above, such sanctions would constitute a serious infringement of the provisions of the Directives, according to which system investment decisions are taken by the management of the network operator exclusively without commitment to guidelines by the integrated group.

The requirement of effective decision-making rights does not prejudice the supervision rights of the VIU in respect of the return on assets in a subsidiary. Regarding the scope of these supervision rights, Article 26§2c of the Directive expressly states:

*“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 37§6, 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 distribution system operator and to set global limits on the levels of indebtedness of its subsidiary”.*

However the enactment of the VIU right, as owner of the DSO and the assets (directly or indirectly through the DisCo), to approve the financial plan and to set global indebtedness limits, must be compatible with the clear Directive requirement to ensure that the DSO has sufficient financial resources to maintain and extend the existing infrastructure.

To this effect, the above provision of Article 26§2c makes a direct reference to the appropriate regulated return on assets in accordance to Article 37§6, which provides for the network tariffs regulation by the NRA, and specifically that:

*“Article 37 - Duties and powers of the regulatory authority...6. The regulatory authorities shall be responsible for fixing or approving sufficiently in advance of their entry into force at least the methodologies used to calculate or establish the terms and conditions for: (a) connection and access to national networks, including transmission and distribution tariffs or their methodologies. Those tariffs or methodologies shall allow the necessary investments in the networks to be carried out in a manner allowing those investments to ensure the viability of the networks;”*

Guidance for this is the relevant Directive provision for the transmission system owner in the case of the ISO Unbundling scheme for the TSO (Article 37§3d), namely that:

*“...ensure that network access tariffs collected by the independent system operator include remuneration for the network owner or network owners, which provides for adequate remuneration of the network assets and of any new investments made therein, provided they are economically and efficiently incurred;”*

The tariffs for the distribution network as regulated by the NRA, should include funds for the adequate remuneration of the assets owner, in order to finance the development plan. So the adoption of the financial plan by the VIU, must be compatible with the requirement, to ensure that the DSO has sufficient financial resources to maintain and extend the existing infrastructure.

In conclusion, the VIU's oversight as shareholder of the DisCo whether as direct or indirect owner of the assets, is strictly limited and the Directive is clear that any involvement in day-to-day operation of the network function by parts of the VIU other than the DSO is not permitted.

## 2.1 Potential unbundled DSO structures, when the DSO is part of the VIU

The unbundling provisions in the Third Energy Package refer to vertically integrated energy supply companies and legally independent but affiliated operators of network systems (it does not require “ownership unbundling”, as it does for the transmission activity<sup>3</sup>). The VIU is obliged to establish independent legal entity/ies. Since the legal organisation alone is not sufficient in providing for financial independence, it is furthermore proper to undertake functional unbundling as well. The system operator must have the sole decision-

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<sup>3</sup> However, in the Netherlands, the Government imposed ownership unbundling also for DSOs, in Belgium also for ownership unbundling by local administrations, and in the UK ownership unbundling has been voluntarily implemented in certain cases.



making power in terms of the network business and must be organizationally independent from other parts of the undertaking.

**The potentially alternative structures regarding the unbundled DSO, when it is part of the VIU group, should refer only to the ownership or not of the distribution assets.** Such ownership refers to the financial aspect of assets ownership only, as the DSO is required by the Directive to have the necessary human, technical, financial and physical resources at its disposal in order to fulfill its tasks to operate, maintain and develop the network. **Hence, as described above the DSO in order to carry out its tasks can rely on the services of its company (the DisCo) and not on other parts of the VIU group.**

The first option is for the VIU to retain the distribution assets ownership, and for the DSO to execute all distribution related activities, while the VIU continues to have the network assets on its balance sheet (Legal-Lean<sup>4</sup> unbundling). The other option is for the DSO, to have the network assets on its balance sheet (Legal -Fat unbundling). It is important to note that in both options the DSO is in the VIU group, usually as a subsidiary.

Below are mentioned the **2 alternatives** for the VIU (which includes both DSO activity and asset ownership).

### 2.1.1 DSO Unbundling Alternative 1 (Legal -Fat): VIU, DSO (with Distribution assets ownership, DSO & DAO)

In this structure the DSO is licensed both as Operator and distribution network asset owner (DAO) (Figure 2-1). Most of the EU VIU companies, when they implemented their obligation for DSO legal unbundling, have chosen this option.

**Figure 2-1 DSO Unbundling Alternative 1 (Legal -Fat): VIU, DSO (Operator with assets ownership)**



### 2.1.2 DSO Unbundling Alternative 2 (Legal-Lean): VIU (Distribution assets owner, DAO), DSO (operator)

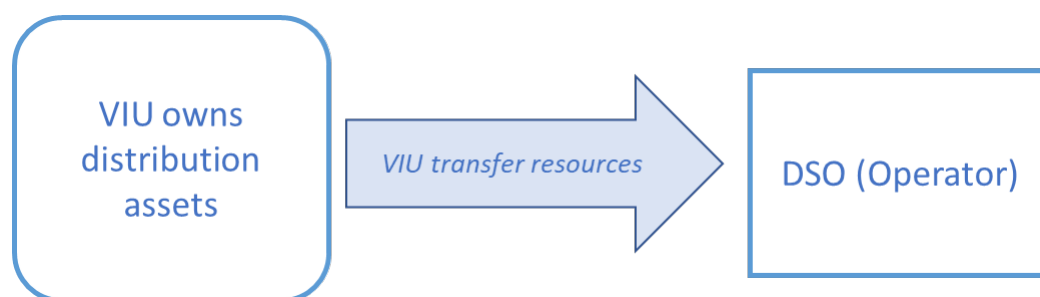
The VIU remains the owner of the distribution assets and puts these at the disposal of the DSO (Figure 2-2). The asset owner enters the assets in its balance sheets, while all the decisions concerning the assets, must remain with the DSO. This alternative has been chosen by Greece and Latvia only.

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<sup>4</sup> lean, i.e. do not have economic ownership of their assets.

In this structure, the VIU is licensed as Distribution network asset owner (DAO), while the DisCo is licensed as Distribution network Operator. The VIU and the DisCo conclude and sign a concession contract to determine the rights and obligations for DSO as Operator and the VIU rights and obligations as asset owner. The contract is approved by the NRA which also supervises its proper execution. Such contracts are usually called “Contract for Operation of Distribution Network (System)”.

**Figure 2-2 DSO Unbundling Alternative 2 (Legal-Lean): VIU or VIU subsidiary (Distribution assets owner), DSO (operator)**



A version of the “Legal-Fat” option, the “Legal-fat Plus” involves financial ring fencing of the DSO versus its VIU shareholder, which is defined as “a process undertaken to determine the total asset and resource base and liabilities and obligations of a particular functional unit and the revenue and operational costs associated with the unit as if it were to operate independently” [8]. Financial ring fencing secures that the networks, being essential facilities, do not run into financial difficulties due to financial losses in other activities of its shareholder. Ofgem considers that financial ring fencing of networks, protects the licensee from certain events that might otherwise lead to its insolvency of the, thereby protecting consumers from the associated uncertainty and disruption. It also allows the licensee to retain access to financial markets on reasonable terms, thereby facilitating the funding of future investment programmes. Implementing such a measure is a matter of national policy.

## 2.2 Possible Threats for DSO Independence

### 2.2.1 Provisions related to DSO independence

As per Article 26§1 of the Directive, “Where the distribution system operator is part of a vertically integrated undertaking, it shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to distribution”.

Furthermore, as per Article 26§2 of the Directive:

*“In addition to the requirements under paragraph 1, where the distribution system operator is part of a vertically integrated undertaking, it shall be independent in terms of its organisation and decision-making from the other activities not related to distribution. In order to achieve this, the following minimum criteria shall apply:*

- a) those persons responsible for the **management of the distribution system operator must not participate** in company structures of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, transmission or supply of electricity;
- b) appropriate measures must be taken to ensure that the **professional interests** of the persons responsible for the management of the distribution system operator are taken into account in a manner that ensures that they are capable of **acting independently**;
- c) *the distribution system operator must have **effective decision-making rights, independent** from the integrated electricity undertaking, with respect to assets necessary to **operate, maintain or develop the network**. In order to fulfil those tasks, the distribution system operator shall have at its disposal the **necessary resources** including human, technical, physical and financial resources. 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 37(6), 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 distribution system operator and to set global limits on the levels of indebtedness of its subsidiary<sup>5</sup>. 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 distribution lines, that do not exceed the terms of the approved financial plan, or any equivalent instrument;*

### 2.2.2 Possible threats for DSO independence

Taking into account the above provisions, potential threats for DSO independence where the DSO is part of a VIU are associated with independence in terms of **management separation from other activities** not related to distribution (i.e. mother company, supply and generation), **effective decision-making and independent operation of the DSO**, **preservation of confidentiality and separation of identity and branding**. Threats for DSO independence have been identified, taking into account:

- the provisions of the Directive and the Commission's Interpretative Note on the Unbundling Regime
- the indicators contributing to the fulfilment of the four obligatory functional unbundling pillars (Energy Community "Unbundling of Distribution System Operators, Guide and Requirements for Practical implementation, 2016") and

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<sup>5</sup> Article 26§2c of the Directive does not require that the DSO must own the assets. The part of the VIU (that is the owner of the assets) has supervision rights, the scope of which concerns only the annual financial plan of the DSO (or any equivalent instrument) and setting global limits on the levels of indebtedness.

- the Consultant's experience in the implementation of the unbundling regime in EU MS and Energy Community Members.

Significant areas where threats to DSO independence may be created, and indicative relevant examples are listed below.

### **Management separation**

Further to the main requirements for management separation laid out in the aforementioned Article 26 of the Directive, it is noted that in accordance to the Interpretative Note on the Directive [6], article 26§2 refers more generally to a wider group of persons, including both the top management (e.g. members of the Board) as well as the middle (operational) management of the DSO.

The Member States (MS) are free to determine the measures mentioned under Article 26§2b ensuring that the top or middle management persons are acting independently. In determining those measures, situations such as the following need to be addressed:

- Independence of the persons responsible for the network management may be put into jeopardy by their salary structure, notably if their salary is based on the performance of the holding company or of the production or supply company, as this may create conflicts of interest.
- The transfer of managers from the DSO to other parts of the company and vice versa may entail a risk of conflicts of interest and requires rules and measures safeguarding independence.
- Conflicts of interest for the network management may also arise if the DSO directly or indirectly holds shares in the related supply or production company and obtains a financial interest in its performance. Likewise, the issue of shareholding on a personal basis of the managers of the DSO can give rise to concerns as far as independence of management is concerned.
- Decisions of the parent company to replace one or more members of the management of the DSO may also undermine the independence of the DSO in certain circumstances, notably if the reasons for replacement of members of the management have not been established beforehand in the charter of the DSO.

The capacity of DSO for independent management may be affected:

- Directly, in case that participation of the VIU or the affiliated companies in the top supervision or management bodies of the DSO enables them to control management or day to day operation decisions of the DSO
- Indirectly, in case that, members of the DSO management bodies, can be influenced by the VIU or its affiliated companies, and therefore not act independently.

*Indicative cases where such risks may appear include:*

1. Appointment of top and middle level management staff of the DSO as members to management structures of the VIU or the affiliated companies, including supervisory and management boards,
2. Employment of the Managers of the DSO by the parent company or its affiliated companies engaged in generation/ production and/or supply.
3. Holding of shares by the DSO management, directly or indirectly, in the VIU or affiliated entities engaged in the generation and/ or supply, may lead to an interest in the performance of those entities, thus causing conflict of interest for DSO managers. Likewise, the holding of shares of the VIU or affiliated entities on a personal basis by the managers of the DSO can give rise to concerns as far as independence of their management is concerned.
4. Involvement of the parent company in the Management Boards of the DSO regarding day-to-day DSO-related decisions.
5. Transferring of DSO managers to the VIU or other affiliated companies and vice versa without applying measures to safeguard confidentiality and potential conflict of interest.
6. The right of the parent company to replace a member of the top management of the DSO, especially in cases where the reasons for replacement have not been established beforehand.
7. The association of the salary of the DSO Managers and employees with the performance of other parts of the company e.g. parent company.
8. The existence of decision lines and authority lines for Managers/ employees of DSO outside of the DSO (e.g. from other parts of the company).
9. Decision-making rights regarding evaluations, promotions and sanctions of the managers / employees of DSO coming outside of the DSO (e.g. from other parts of the company or the parent company).
10. The exercise of direct or indirect influence and the existence of instruction rights from the mother company in day-to-day DSO-related activities e.g. network planning, operation and maintenance, etc.

### **Effective decision making and independence of operation of DSO**

The requirements for effective decision making and independence of operation of the DSO are laid in the aforementioned Article 26§2c.

The requirements entail two main issues:

- The capacity of the DSO to making independent decisions with regards to the development, maintenance and operation of the distribution network.

- The availing to the DSO of the necessary human, technical, physical and financial resources.

With regards to the first issue above, it is noted that the Directive does not require that the DSO is the owner of the network assets. In such cases however, the part of the VIU (that will be the owner of the assets) can have only supervision rights, the scope of which will concern only the annual financial plan of the DSO (or any equivalent instrument) and setting global limits on the levels of its indebtedness, in the course of ensuring its economic and management supervision rights with regards to the return on the network assets.

Lack of measures that will ensure that the extent of VIU involvement in decisions related to development and maintenance of the network are limited to the above rights and that the DSO's can make independent decisions concerning the construction or upgrading of distribution lines, to the extent that such decisions are within the limits of the approved financial plan, is a significant threat to DSO independence.

With regards to the availing of the necessary resources to the DSO in order to carry out its duties, *it is noted that*, typically, the legal unbundling of the DSO from the VIU is accompanied with the transfer of the VIU personnel which had been performing the DSO activities till the moment of unbundling. A common relevant issue regards the use of common services, facilities and infrastructure that are shared between the various parts of the VIU (e.g. between the parent company and the DSO or between the DSO and supply company). Typically, such services include IT, accounting, finance, legal services, human resources management. They may also include shared use of infrastructure, e.g. IT hardware and software, buildings, transportation means, etc.

*Indicative related issues which can potentially create risks for DSO's independence include:*

1. Personnel is seconded rather than transferred from the VIU to the DSO, i.e. while the personnel is working for the legally unbundled DSO, it remains an employee of the VIU.
2. Hiring of employees/ external consultants by the DSO is subject to approval by the VIU.
3. Personnel not sufficiently trained on the regulatory framework, operational procedures and code of conduct of the DSO related to his compliance with the principle of non-discrimination, especially with regards to behaviour towards customers of the DSO and other market players, etc.
4. Lack of an effective quality assurance system documenting all the operational procedures of the DSO which are affected by the functional unbundling requirements, including interaction of consumers and suppliers, data management, transfer and promotion of employees, etc.) in order to safeguard the independence of the DSO.
5. DSO uses administrative or support/backstopping services (e.g. human resources management, accounting, legal services, IT, etc.) performed by the parent



company, and this is not based on specific financial criteria e.g. lower costs and documented through precisely defined contracts<sup>6</sup> the Service Level Agreements (SLA) does not include terms that bind the parent company to execute its service in adequate timing by imposing the appropriate clauses.

### **Separation of information and IT systems**

Independent operation of the DSO is strongly related to an effective separation of IT systems used by both VIU and DSO and of relevant information that was held by the VIU prior to the unbundling and which should be put under the direct and exclusive supervision and responsibility of the DSO. This separation refers both to electronic and physical information files.

Dealing with the volume and disbursement of the physical information files, which in most cases are distributed in the local offices of the VIU is a challenge and a potential source of risk. The separation of electronic data is also challenging as the historical customer data files typically include the information in an integrated manner without discriminating between data relevant to the distribution grid and electricity supply.

A related issue is the separation of the IT systems (hardware and software) used by DSO from those used by the VIU or the affiliated companies and their transfer to the direct control and supervision of DSO. This separation refers both to the separation of server hardware and server and application software which up to the moment of unbundling was used jointly by distribution and supply.

Separation of server hardware requires in several cases the replication of part of the server infrastructure in the VIU and the DSO. Separation of server and application software could also require replication of existing systems (e.g. accounting software, etc.) and the procurement of new and potential modification of existing software in order to serve the needs of DSO, e.g. asset management (including consumption meters management), metering data collection and management, etc.

Ineffective or insufficient information and IT systems separation creates risks for discriminatory conduct by allowing potentially access of the VIU (or the affiliated supply company) to confidential data regarding DSO customers.

### **Preservation of confidentiality**

As per Article 27 of the Directive,

*“without prejudice to Article 30 or any other legal duty to disclose information, the distribution system operator must preserve the confidentiality of commercially sensitive information obtained in the course of carrying out its business, and shall*

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<sup>6</sup> Certain services, especially strategic ones, such as the legal, regulatory and controlling services have to be established in the DSO [12].



*prevent information about its own activities which may be commercially advantageous being disclosed in a discriminatory manner.”*

Confidential information may include among others:

- Financial and technical conditions of grid access (individual grid access contracts);
- Financial and other conditions of energy supply
- Metering data, load profiles of consumers
- Inactive and planned new connections to the grid
- Customer contact details, billing records, bank data

The main issues that needs to be taken care of appropriately in this respect is the establishment of appropriate procedures and codes of conduct, as well as appropriate training of DSO personnel for identification and management of confidential data.

*Indicative situations creating threats to the preservation of data confidentiality are:*

- Missing or unclear rules of conduct regarding the management of confidential data as per Article 27 of the Directive.
- Absence of a list of types and/or characteristics of information that is to be considered confidential as well how to manage such information.
- Absence of sanctions to be imposed in case of non-respect of confidentiality rules
- Absence of formal commitment of the DSO Managers and employees regarding handling confidential data.
- Lack of established rules related to the behaviour of the DSO staff vis-à-vis network customers so as to ensure that employees refrain from any reference to the related supply business in their contacts with customers of the DSO.
- Clear procedures regarding physical and IT access to confidential information, etc.

### **Separate identity in communication and branding**

Establishing a distinct identity, clearly distinguishing the DSO from the supply company of the VIU, is very important for avoiding distortion of competition, with independent suppliers and the creation of confusion to consumers.

*Indicative related issues which can potentially create risks for DSO's independence include:*

- Lack of sufficient markings and branding of DSO installations, buildings, transport means, etc.,
- Lack of a separate web site of the DSO, with clear presentation of its functions and services, etc.
- Lack of own communication and public relations services.

### Key points:

- The branding name of the DSO which is consisted of the name of the VIU and the term “distribution” is no longer accepted by the EC and thus the DSOs using such names, have changed them.
- In cases, when the DSOs and suppliers are located in the same legal address, there are two options that are usually requested by the NRA with reference to the unbundling:
  1. The DSO or suppliers should move to another building
  2. Separation of the existing building through separate entrances, separate offices e.g. on different floors, no internal connection between supply and DSO, different tel/ support centers, different call centers.

It should be noted that both options have a financial impact on the DSO. For example there is a cost for reconstruction remaining to the same building (in option 2), which may, sometimes, be higher than moving to another location (option 1). In any case, if the VIU holds the building, then the DSO has to pay a rent via a SLA.

All of the above are under the NRA's approval. If it is not possible to implement one of the options, all the reasons should be presented to the NRA and be under NRA's consideration for approval. For instance, the NRA in Greece has accepted an exception on the above issue as regards two very small islands.

### Organizational structure

Another field that can entail threats for the DSO's independence is the type of legal separation that will be chosen and the potential perils that may result from the relations with the parent company. If the assets remain in the parent company, and, consequently, it receives the profit from the invested capital, then the DSO revenue from the network access tariffs is its Operating expenses as a contractor, and, potentially, a contractual margin above that, which should be included as a term in the original contract and readjusted each year. In case the contractual margin does not cover potential damages, the liquidity and the financial result of the DSO may be threatened.

In that case, the financing (own funds and loans) for the realization of the business plan depends exclusively on the parent company. The DSO has no ability to receive the loan on its own, because it has no assets that could serve as collateral. Even loans for working capital are not easily accessible. The lack of the ability to borrow, may hinder proper execution of its tasks.

Also, in case the DSO is an asset- lean company, the imposition of a regulatory fine or a remuneration of third parties for damages that may be caused, by DSO negligence while carrying out its licensed functions, becomes virtually meaningless considering its revenues.

## 3 FUNCTION OF THE DSO COMPLIANCE OFFICER

### 3.1 Relevant Provisions

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As per Article 26§2d of the Directive:

*“the distribution system operator must establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored. The compliance Programme shall set out the specific obligations of employees to meet that objective. An annual report, setting out the measures taken, shall be submitted by the **person or body responsible for monitoring the compliance Programme, the compliance officer of the distribution system operator**, to the regulatory authority referred to in Article 35§1 and shall be published. The compliance officer of the distribution system operator shall be **fully independent** and shall **have access to all the necessary information of the distribution system operator and any affiliated undertaking to fulfil his task.**”*

According to the Interpretative Note, “if the Programme is to be successful, its effectiveness needs to be regularly monitored. This is essential not only as a means of ensuring that the Programme is working properly but also to enable the identification of those areas that present the highest risks of non-compliance. The evaluation process must be carried out in a transparent manner, and may indicate to employees that their conduct is being reviewed against the terms of the compliance Programme on a continuous basis.”

### 3.2 Appointment of the Electricity DSO Compliance Officer

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Article 26§2d of the Directive requires that a **person or body** should be appointed responsible for **monitoring the compliance programme** of the DSO and that he shall be fully independent and shall have access to all the necessary information of the DSO and any affiliated undertaking to fulfil his task. Other than that requirement, the VIU is free to determine the details of his appointment ensuring his independence such as: legal form of the Compliance Officer (e.g. natural or legal person), working relationship with the DSO (e.g. internal employee(s) or external consultant(s)), details of his mandate (e.g. duration of the mandate, reasons for dismissal, replacement), etc.

At EU level, two possibilities exist:

1. **DSOs have appointed existing employee of DSO as Compliance Officer.** This means that the Compliance Officer is engaged full time on the implementation and monitoring of compliance of the DSO without any other duties related to

distribution network activities. For this reason, companies use Senior, experienced employees<sup>7</sup>.

2. **DSOs have appointed an external employee.** It is common practice to use retired ex-employees.

The benefits in appointing an existing DSO employee as Compliance Officer is that he has better knowledge of the company's procedures and more acceptance by the employees. Nevertheless, he may have a conflict of interest due to his employment by the DSO.

On the other hand, the benefits of appointing an external employee are that he has more acceptance by the NRA and no conflict of interest, although it may take time to understand the company's procedures.

In Greece, the Compliance Officer of the Greek DSO (HEDNO S.A., Hellenic Electricity Distribution Network Operator S.A.) is an **internal employee** of the DSO. The provisions related to his appointment are included in Article 124 of Law 4001/ 2011 that transposes Article 26 of the Directive 2009/72/EC. Regarding his appointment, the following are mentioned:

- The Compliance Officer is a natural or legal person appointed by the Board of Directors of HEDNO, within two (2) months from its first meeting after its establishment and is subject to approval by the regulatory authority (RAE) (Article 124§8).
- The regulatory authority may refuse the approval of the Compliance Officer only due to lack of independence or professional capacity, and may, at any time, require the replacement of an appointed Compliance Officer for the same reasons, taking into account his performance in exercising his duties. HEDNO is obliged to ensure that the Compliance Officer has unhindered access to all information held by HEDNO or any affiliated company and has access to the offices of the aforementioned companies without prior announcement in order to exercise his duties (Article 124§9).

It is noted that the underlined parts of the above provisions derive from the requirements laid down for the Compliance Officer of the ITO as per Article 21 of the Directive.

In France, the Compliance Officer of Enedis, who is in charge of ensuring that the DSO's practices comply with the Code of Conduct (which is the equivalent of the Compliance

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<sup>7</sup> It is not recommended that the Compliance Officer is from the Compliance Department (typical Audit Department for ex-ante or ex-post audits. As presented in the above, the DSO's Compliance Officer should not have any other responsibilities. A person in the Audit Department, will not be independent (but, under the director of Audit Department) and will probably be involved in the day to day operation. However, in case there are no resources (internal or external), a series of provisions for independence etc. should be presented to the NRA and be subject to its final approval.

Programme), is the Head of the Compliance Department and is assisted by colleagues. According to Article 19 IV of the statutes of Enedis S.A.:

- *The Chair of the Board of Directors is responsible for **setting out and implementing the Code of Conduct**, as required under paragraph 2 of Article L111-61 of the French Energy Code. The **Compliance Officer shall report annually on this to the Commission de Régulation de l'Énergie** in accordance with Article L111-62 of the French Energy Code.*

In addition, according to Articles L. 111-61 and L. 111-62 of the French Energy Code:

- *Any company managing an electricity distribution network that serves [...] over 100,000 customers [...] shall bring together in a Code of Conduct, for the attention of the French energy regulator (Commission de Régulation de l'Énergie), all internal organizational measures taken to prevent discriminatory practices with regard to third-party access to that network. Such companies shall appoint a **compliance officer** in charge of adhering to the commitments set out in that Code of Conduct [...]. Each year, this officer shall draft a report on the implementation of the Code of Conduct, and shall submit this report to the Commission de Régulation de l'Énergie. This report shall be made public.”*

**Note:**

In case two or more DSOs are separate legal entities owned by the same holding company, which is a DisCo legally and functionally, unbundled from generation and supply interests, it is possible to have one Compliance Officer (internal employee of the DisCo or external company under contract with the DisCo).

If the DisCo is owned by a holding Company that controls also legal entities active in generation and/or supply or by a VIU that performs also the activities of electricity generation and/or supply, such DisCo must be legally and functionally unbundled as mentioned above, and the Compliance Officer must also ensure the DisCo's Compliance and not only that of its subsidiaries DSOs.

This case may arise in countries where there is a company that covers distribution over all or a part of one country, through setting up regional DSOs. Evidently as the mother company of such regional DSOs has no other activity but only that of electricity distribution, the Compliance Programmes refer to the legal, functional and accounting compliance of the mother DisCO and the regional DSOs versus the Holding or VIU (and their generation and supply affiliated companies) that owns this DisCo.

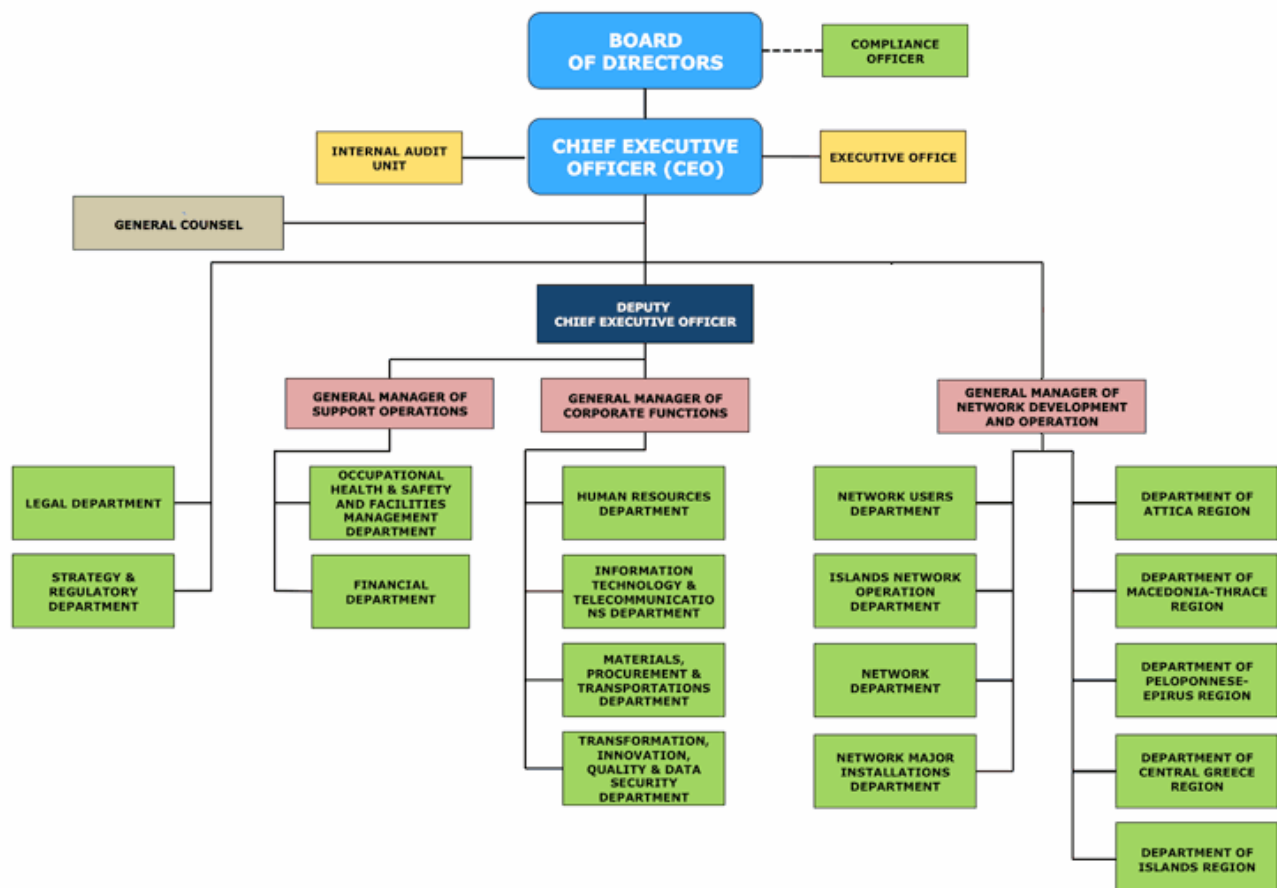
Such an example is Ukraine's structure in which many DSOs are under a “Mother Company” which is in turn under a Holding company.

### 3.3 Position and status of the DSO Compliance Officer

Article 26§2d of the Directive requires that a Compliance Officer shall be fully independent and shall have access to all the necessary information of the DSO and any affiliated undertaking to fulfil his task. In order for these conditions to be fulfilled, the position and status of the Compliance Officer should be such as to enable direct access and reporting to the senior management of the DSO (BoD or Supervisory Board) and not any other business unit or lower management. In addition, the Compliance Officer is an intermediary between the NRA and the DSO, considering the requirement for submitting an annual compliance report to the NRA (Article 26§2d).

The organisational chart of HEDNO S.A. shows the position of the Compliance Officer of the Greek DSO (Figure 3-1). He directly reports to the Board of Directors of DSO and his appointment is subject to approval by the Greek NRA (RAE).

Figure 3-1 Organisational chart of HEDNO S.A. and position of the Compliance Officer



In France, the Compliance Officer in the biggest DSO “enedis” refers to the Supervisory Board (<https://www.enedis.fr/gouvernance>).

## 3.4 Role of the DSO Compliance Officer

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According to Article 26§2d of the Directive, the role of the Compliance Officer is to monitor and report on the compliance programme. A Compliance Officer has to be endowed with plenty of duties in order to be effectively productive. Below duties are proposed:

### ➤ General duties:

- Development, implementation of the compliance programme as per Article 26§2d of the Directive:
  - The Compliance Officer shall be engaged in the design of the compliance programme i.e. identification of all measures to ensure adherence to compliance principles as described in Chapter 4 .
  - With regards to the **development** of the Compliance Programme, the Compliance Officer shall set objectives and create a schedule for the measures to be taken to correct any deviations detected in attaining the planned results and continuing to improve the processes.
- Monitoring and reporting on the effectiveness of the compliance programme
  - The Compliance Officer monitors and assesses the processes, compares them to the requirements set in the law and regulations and draws up reports on the results [9].

### ➤ Duties vis-à-vis the senior management of the DSO:

- Reporting on the Compliance Report to the senior management of the DSO.
- Providing advice and information to the DSO for the purpose of facilitating its adherence to the Compliance Programme.
- Elaboration of and reporting on proposals on disciplinary sanctions to the DSO senior management in the event of violation of the compliance programme.

### ➤ Duties vis-à-vis NRA:

- Reporting regularly to the NRA, either orally or in writing, on the degree of independence of the DSO, on any substantial violations with regard to the implementation of the compliance programme.
- Elaboration and submission of an annual compliance report to the NRA, setting out the measures taken in order to implement the compliance programme, assess their adequacy and implementation by the DSO in respect to achievement of its objectives.

### ➤ Operational duties:

- Monitoring of the Compliance Programme regarding the compliance of employees and management of the DSO with respect to the relevant measures.



- Monitoring the effectiveness of the practices, procedures and systems adopted by the DSO in accordance with the Compliance Programme required under 26§2d of the Directive.
- Advising whether, to the extent that the implementation of such practices, procedures and systems requires the co-operation of any other person, they are designed so as reasonably to allow the required co-operation.
- Receiving and investigating any complaint from employees/customers in case of actual or suspected discrimination, disputes or queries and breaches of the compliance programme.
- Recommending and advising on the remedial action that investigation of complaints has demonstrated to be necessary or desirable.
- Organisation of training to existing and new DSO employees on compliance issues.

## 3.5 Requirements and restrictions related to the independence of the DSO Compliance Officer

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Article 26§2d of the Directive requires that the Compliance Officer of the DSO shall be fully independent and shall have access to all the necessary information of the DSO and any affiliated undertaking to fulfil his task. In addition, according to the Interpretative Note [6] when shaping the specific rules and guarantees for the independence of the Compliance Officer of the DSO, the rules laid down in Article 21§2 of the Directive regarding the Compliance Officer of the ITO may serve as a point of reference, where appropriate.

### 3.5.1 Requirements safeguarding the independence of the Compliance Officer

Below are mentioned requirements and restrictions that can be introduced into corporate governance rules, in order to ensure that the Compliance Officer is sufficiently independent to comply with the requirements of Article 26§2d of the Directive. Considering that the Compliance Officer is usually an internal employee of the DSO appointed as such, the **requirements safeguarding his independence** are crucial and should be clearly documented:

- The appointment of the Compliance Officer, as well as the conditions governing the mandate and the employment/ dismissal of the Compliance Officer shall be subject to approval by the NRA.
- The NRA may refuse the approval of the Compliance Officer only for reasons of lack of independence or professional capacity, and may, at any time, require his replacement for the same reasons.
- During his mandate, the Compliance Officer shall have no other professional position or responsibility, interest or business relationship, nor receive any financial benefit, directly or indirectly, from any part of the VIU or its controlling shareholders, other than the DSO.

- The reasons for the dismissal of the Compliance Officer by the DSO management should be established beforehand and should be justified on grounds of lack of independence or professional capacity.

### 3.5.2 Arrangements facilitating the access of the Compliance Officer to necessary information

In addition, below **arrangements may facilitate the access of the DSO Compliance Officer to the necessary offices, systems, information and documentation** enabling the fulfilment of the duties and tasks assigned to him:

- The Compliance Officer shall have unhindered access:
  - to the offices of the DSO without prior announcement.
  - to all information (data, documents) of the DSO.
  - to all systems of the DSO regarding recording, processing or storing data.
  - to the services of any persons, who are (whether or not as their principal occupation) contractors, or sub-contractors engaged in, or in respect of, distribution network related activities.
- The Compliance Officer may attend all meetings of the DSO management or administrative bodies especially those that discuss subjects interrelated, directly or indirectly, with the principles of non-discriminatory conduct.

It is also recommended that the obligation of employees in supporting the Compliance Officer in fulfilling his tasks are clearly described in internal mandatory Guidelines of the DSO [9].

#### Note:

Following the end of his mandate, in case the Compliance Officer is an external audit consultancy, the provisions in confidentiality agreement apply (e.g. prohibition to share information on violations related to discriminatory behavior in supply).

Otherwise, if the Compliance Officer is an internal employee, he should abide with the provisions that are applied to the DSO personnel in general after the end of his mandate. In case the Compliance Officer leaves entirely from the DSO to work for another company, then he should also abide with the provisions that are applied to the DSO management too (e.g. cool-off period, confidentiality of data etc.).

## 3.6 Compliance Officer before the establishment of the DSO as a new legal entity

At the early stage when, the DSO hasn't been established as a new legal entity yet, the VIU will develop a road map in order to implement effectively the provisions of the Directive for the legal and functional unbundling of the DSO. This road map is also called "Compliance Programme". For this report's purposes this programme will be referred

to as “Unbundling Compliance Programme”. For clarification reasons it is important to pay attention to this distinction.

The person responsible for the Unbundling Compliance Programme is also called Compliance Officer. The appointment of the Compliance Officer for this stage and his role differ to the one, after the establishment of the DSO company (the DisCO) as presented in the above.

### **3.6.1 Appointment of the compliance officer of the Unbundling Compliance Programme**

It is common practice for this stage to appoint as Compliance Officer an existing employee experienced in the functioning of the distribution business unit. The Compliance Officer is not necessarily engaged full time on the implementation of this programme.

### **3.6.2 Position and status of the DSO Compliance Officer of the Unbundling Compliance Programme**

The Compliance Officer is reporting to the BoD of the VIU or to a Supervisory Board, or to a Committee which is set responsible for the legal unbundling.

### **3.6.3 Role of the DSO Compliance Officer of the Unbundling Compliance Programme**

The role of this DSO Compliance Officer is:

- To contribute to the development of the Unbundling Compliance Programme and possibly to assist in its implementation.
- To monitor all the actions and measures, that have been defined in the road map as necessary for the creation of the DSO and the transfer of the assets (if this is the option) and the necessary resources to it.
- To report potential issues that have arisen to the BoD, the Supervisory Board or the committee and cooperating with them for their resolution.
- To contribute to the preparation of the necessary reports to relevant authorities (NRA, Ministry) about the progress of the Unbundling Compliance Programme.

### **3.6.4 Requirements and restrictions related to the independence of the DSO Compliance Officer of the Unbundling Compliance Programme**

Not specific requirements. They are not subject to approval by the NRA.

## 4 COMPLIANCE PROGRAMME OF THE DSOs

### 4.1 Key Segments and minimum content of a Compliance Programme

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#### 4.1.1 Provisions related to the establishment and contents of the compliance Programme

As per Article 26§2d of the Directive:

*“the distribution system operator must establish a **compliance Programme**, which sets out measures taken to ensure that **discriminatory conduct is excluded** and ensure that observance of it is adequately **monitored**. The compliance Programme shall set out the **specific obligations of employees** to meet that objective. An **annual report**, setting out the measures taken, shall be submitted by the person or body responsible for **monitoring the compliance Programme**, the compliance officer of the distribution system operator, to the regulatory authority referred to in Article 35(1) and shall be published. The compliance officer of the distribution system operator shall be fully independent and shall have access to all the necessary information of the distribution system operator and any affiliated undertaking to fulfil his task.”*

According to the Commission’s Interpretative Note on the Unbundling Regime:

*“The **main purpose** of a compliance Programme is to provide a **formal framework** for ensuring that the **network activities** as a whole, as well as individual **employees and the management of the DSO**, comply with the principle of **non-discrimination**. The compliance Programme contains **rules of conduct** which have to be respected by staff in order to exclude **discrimination**. Such rules relate, for example, to the obligation to preserve the confidentiality of **commercially sensitive and commercially advantageous information** (Article 27 of the Directive). The compliance Programme may lay down in detail the kind of information that is to be considered confidential in this sense and how the information should be treated. It may also refer to the **sanctions** imposed under national legislation in case of non-respect of confidentiality rules. Another set of rules which, for example, can form part of a compliance Programme relates to the **behaviour of staff vis-à-vis network customers**. Employees of a DSO must refrain from any reference to the related supply business in their contacts with customers of the DSO.*

The compliance Programme must be **actively implemented and promoted** through specific policies and procedures. Such policies may consist, inter alia, of the following elements:

- active, regular and visible **support of the management** for the Programme, for example through a personal message to the staff from the management stating its commitment to the Programme;

- **written commitment of staff** to the Programme by signing up to the compliance Programme;
- **clear statements that disciplinary action** will be taken against staff violating the compliance rules;
- **training on compliance** on a regular basis and notably as part of the induction Programme for new staff.”

#### 4.1.2 Principles of the Compliance Programme

Taking into account the relevant provisions of the Directive and the Interpretative Note (Chapter 4.1.1), the Compliance Programme **should prescribe and refer to specific measures (i.e. practices, procedures/ processes, policies, internal acts, systems, rules of conduct)** adopted by the DSO to ensure, how it will comply with the principle of **non-discrimination** which is applied to the network activities as a whole, as well as on individual employees and the management of the DSO. The principle of non-discrimination relates to:

- Ensuring compliance with the functional unbundling requirements i.e.
  - management separation,
  - independence and effective decision-making right,
  - separate identity in communication and branding
- Protecting the commercially sensitive data and clients’ confidential information including ensuring non-discrimination among market participants, avoiding potential discriminatory behaviour, facilitating market competition, avoiding distortion of competition, ensuring the transparency, objectivity, and impartiality of the DSO.

#### 4.1.3 Proposal on key segments of the Compliance Programme

Article 26§2d of the Directive and the Interpretative Note do not foresee any strict requirements for the content and key segments of the Compliance Programme other than setting out measures to ensure that discriminatory conduct is excluded.

According to ERGEG, “the contents of the Compliance Programme differ widely among Member States. The diversity of programmes shows quite well that DSOs decide on their programmes independently. It is therefore not surprising that especially on “soft” aspects of unbundling, such as communication policy, compliance reports do not contain sufficient information. This complicates proper oversight of compliance by national regulators.” [10]

Proposed **key segments** of the Compliance Programme include:

1. Compliance Principles
2. Organisational Structure of the DSO and internal relations
3. Measures regarding Management Separation
4. Measures regarding Independent operation and effective decision-making right
5. Measures regarding Separate identity in communication and branding

6. Measures regarding Preservation of confidentiality of commercially sensitive and commercially advantageous information
7. Measures to ensure proper implementation and adequate monitoring of the Compliance Programme

As evidenced, key segments No. 3-6, are based on the compliance principles mentioned in Chapter 4.1.2. Obviously DSOs can break them down into further categories according to the level of detail in each issue (e.g. use of common services, separation of IT systems and information etc., instead of incorporating them in the above proposed segments.

#### 4.1.4 Proposal on contents of the Compliance Programme

Below are mentioned the **contents** of the Compliance Programme per key segment.

##### 1. Compliance Principles

The DSOs shall establish the principles of the Compliance Programme. Potential ones are mentioned in Chapter 4.1.2 but it can be broken down into further categories such as use of common services, separation of IT systems etc.

DSOs should afterwards define measures in each segment of the Compliance Programme, taking into account the compliance principles.

When defining each measure, it is recommended that the DSO follows below **methodology**:

- Clearly identify situations that can potentially create risks for DSO's compliance with the non-discrimination principle, considering the governance of the DSO and the relations with the VIU and affiliated entities.
- Assess the maturity of the regulatory framework concerning the DSO activities. It is very important that the primary and secondary legislation exist and that it is custom made for the DSOs (Network Code, official contract for the access etc.).
- Identify and clearly describe all potential measures (indicating objectives, results, systems to be used, implementation schedule) that can alleviate above risks.
- Assign the person/ body responsible for the implementation of the above measures.
- Assign the body responsible for monitoring the compliance in relation to the measure.
- Describe method for checking the compliance in relation to the measure including identification of data to be examined, frequency of conformity checks, etc.

The information related to each one of the above methodology steps shall be included in the Compliance Programme.



### Key points:

- As already mentioned above, some DSOs develop the Unbundling Compliance Programme, when the VIU is in the process of legal separation of the DSO or combine both of them in one Compliance Programme. It is likely that certain compliance principles (e.g. management separation, independence of the DSO, separation of IT systems) are the same but the measures for each Programme differ. Therefore, the Compliance Programme is not to be considered as a document carved in stone as it evolves and improves along with the maturity of unbundling of the DSO, the assessment of the effectiveness of the measures implemented and the assessment of the risk of non-compliance by the Compliance Officer.
- Measures that foresee the development of processes, rules, practices, codes will have to be defined and referenced in the Compliance Programme but are not necessarily part of it. An **action plan** for implementing each measure should be included in the Compliance Programme.
- The Compliance Programme must not be limited to employees of the DSO only and shall be extended to internal or external service providers too, thus related measures shall be also foreseen.
- The Compliance Programme shall have the status of a management directive or an equivalent rule in the corporate culture. It has to be a legally binding part of the employees' obligations. The main target of the Compliance Programme is to secure the implementation of the established unbundled processes in the company. [11]
- It is obvious that a detailed and well elaborated Compliance Programme that includes thoroughly described measures, facilitates the monitoring and reporting process since it allows for clearly monitoring the implementation of each measure against set objectives, results and timeline. Obviously, the scope of the Compliance Programme depends highly on the complexity of the legal unbundling, the type of transactions with the affiliated entities, the level of functional unbundling achieved etc.

## 2. Organisational structure of the DSO and internal relations

The Compliance Programme shall include the organisational structure of the DSO and of the VIU which illustrates the Affiliated Entities engaged e.g. in generation and/or supply activities.

In addition to the above, the DSO shall clearly describe:

- the organizational / legal and financial relationships with the parent company and the Affiliated Entities e.g. type of financial control exercised by the VIU over the DSO (licenses, concession contract)
- information on asset ownership indicating also the structure of the DisCO (legal - lean, legal - fat, legal -fat Plus)



- the common services (personnel, finance, IT services, accommodation, transport) that are eventually shared between the DSO and supply and/ or generation activities operating under the umbrella of the VIU and how these shared services are provided e.g. through contracts or Service level Agreements where the amount, the pricing etc. are determined. This content is very significant, since the DSO shall assess which services are critical (e.g. Legal, Regulatory, Audit, IT) for the DSO as a company, and which services will eventually be provided by the parent company.

### 3. Management separation

The DSO management separation is laid down in provisions 26§2a, b of the Directive and in the Interpretative Note. The main concern of the DSO shall be to **maintain managerial independence** of the Distribution Business from any other Affiliate, Related Undertaking or shareholder (e.g. the VIU or affiliated companies that perform competitive activities such as generation and supply).

Therefore, the DSO shall foresee measures in the Compliance Programme that ensure that both the top management and middle (operational) management of the DSO are acting independently from the VIU and its affiliates. Measures that can be proposed include:

- Development of a **code of conduct** safeguarding the prohibition<sup>8</sup> from (a) holding any position in the management or supervisory board of the VIU and (b) working for competitive branches of VIUs e.g. through a code of conduct
- Development of a **human resources management policy** including specific rules, reasons and circumstances which justify the replacement of the management of the DSO by the VIU.
- Signed statements by
  - DSO's top and middle management, that they are not involved in the management of VIU,
  - DSO's top and middle management that they do not own VIU shares
  - DSO's top and middle management to ensure compliance with the Code of Conduct.

### 4. Independent operation and effective decision-making right

The independent operation and effective decision-making right of the DSO is laid down in provisions 26§2a, b of the Directive and in the Interpretative Note. A main concern of the DSO is to ensure that the VIU or other parts of the company do not interfere in day to day management and that the DSO must have the necessary resources (human, technical, physical and financial), in order to fulfil its tasks of operating, maintaining and developing the network.

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<sup>8</sup> In some countries, such provisions are included in relative Laws (energy, corporate). Also the Law may provide for such prohibitions to be determined by the secondary Regulation including Codes and /or NRA Decisions with a Regulatory character (i.e. Decisions that are not addressed to a single stakeholder).

Also, a significant aspect in this context is to ensure that the common services are limited, provided at “market conditions” and laid down in contractual arrangements so that conflicts of interest are excluded. It is noted that certain services, especially strategic ones such as the legal, regulatory and controlling services, have to be established in the DSO and not be provided through the common services [12]. This is particularly important, taking into account that the DSO shall be able to fulfil its day to day operation, without being limited and obstructed by the availability of resources of the common services and the decisions of the management of the relevant departments.

Indicatively below measures are proposed in the Compliance Programme with regards to this compliance principle:

- The development of an employee evaluation regulation incorporating the new unbundling regime and enabling only the DSO to have full power in assessing the performance of his employees and request their promotion.
- The development of a human resources management policy including
  - rules regarding the movement of the employees, and particularly of the DSO management, between different entities within the VIU safeguarding DSO independence such as cooling-off periods
  - Rules enabling only the DSO to have full power on imposing sanctions to the employees.
- Rules, conditions and procedures describing the provision of common services to the DSO, such as having in place processes for requesting offers from the market, selecting the most financially competitive solution and employing the services of external consultants, if needed. Another measure is the submission of the common services contracts to the NRA.
- Separate and clearly branded offices in case of sharing buildings between the customer service centers of the affiliated supply company and the DSO
- Separation of the IT systems (hardware and software) used by DSO from those used by the VIU or the affiliated companies
- Rules related to the behaviour of the DSO staff vis-à-vis network customers, in order to make it clear that the DSO is a distinct business than the supply/ generation and that its employees represent exclusively the DSO, refraining from any reference to other parts of the VIU.
- Measures related to access prohibitions and limitations of staff that is not involved in the network business to the premises (or parts) of the DSO.

## 5. Separate identity in communication and branding

The separate identity in communication and branding is laid down in provisions 26§3 of the Directive and in the Interpretative Note. The main concern is to not create confusion in respect to the separate identity of the supply branch of the VIU. According to ERGEG “Gog: *Network companies shall have their own identity; nothing shall imply a link from the system operator to the supply business. This involves clearly separate branding strategies, communication policies, and separate contact routes to the network and supply business such*

*as separate telephone numbers, separate call centres and home pages (including transparent linking policies).” [9]*

Indicative measures proposed to be included in the Compliance Programme with regards to this compliance principle:

- Establishment of a DSO website with clear presentation of the DSO functions and services
- Establishment of separate call centres and telephone numbers.
- Own advertising and communication activities in relation to DSO operation e.g. addressed to consumers regarding the role of the DSO and the provisions to guarantee fair treatment.
- Separate branding of DSO offices, transport, etc.

## **6. Preservation of confidentiality of commercially sensitive and commercially advantageous information**

The preservation of confidentiality of commercially sensitive and commercially advantageous information is laid down in Article 27 of the Directive and in the Interpretative Note. This provision relates to the unbundling of information which concerns the publication of data, respecting data protection rules and non-discriminatory access to data. [10]

With regard to transparency of information, ERGEG considers that information shall generally be made available to market participants unless there is a clear reason against it (e.g. in cases of legitimate commercial reservations or system security issues), or it is a proven fact that the cost of providing the information is significantly higher than the expected benefit. Concerning unbundling the confidentiality and disclosure of information have to be specified in a well-defined data management system in order to avoid any discrimination. [10]

The following table lists the different kinds of information which may be available to DSOs, their respective principles for their handling and general procedural solutions. [10]

**Table 4-1 Kind of information which may be available to DSOs, their respective handling principles and general procedural solutions [10]**

	<b>Third-party information</b>	<b>Generic network information</b>
<b>Definition</b>	<b>Commercially sensitive information</b>	<b>Commercially advantageous information</b>
<b>Treatment</b>	<b>Confidentiality (disclosure upon agreement)</b>	<b>Disclosure</b>
<b>Non-discriminatory implementation</b>	<b>Data access rules</b>	<b>Rules for data disclosure</b>

Indicatively below measures are proposed to be included in the Compliance Programme with regards to this compliance principle:

- Publication in the DSO's site of all the relevant information concerning the access to the network, metering etc.
- Separation of databases of the DSO and of the competitive business allowing equal access to information for all market participants.
- Data management system including the third-party and generic network information (e.g. metering data, load profile and load forecast of the clients, financial and technical conditions of grid access, billing records suggesting payment behaviour of the customer, etc.).
- Processes in place regarding handling the management of information from their creation to data processing, updating, access rules and formats, prices, protocols, monitoring, reporting and training.
- Data access rules to allow accessing commercially sensitive/ third party information on equal terms including timeline of provision, updating, content of information, data formats used as well as prices for accessing the information.
- Rules for data disclosure of commercially advantageous information guaranteeing non-discriminatory access.
- Access in the systems for the recording, processing or storage of sensitive and confidential information of the DSO only to authorized DSO's personnel.
- Training of the DSO staff on the treatment of the third-party and generic network information.
- Clear procedures regarding physical and IT access to confidential information.
- Access to commercial information only by authorized DSO's personnel.

## **7. Ensure proper implementation and adequate monitoring of the Compliance Programme**

The Compliance Programme shall include information regarding how to monitor its implementation and ensure conformity of the DSO to it. Indicatively below measures are proposed to be included in the Compliance Programme with regards to this compliance principle:

- Continuous training of the DSO employees on the measures taken to insure adherence to the Compliance Programme and potential sanctions in case of breaching confidentiality rules.
- The Commitment of the DSO management that it takes all reasonable steps to ensure that it complies with the terms of the Compliance Programme through a personal message to the staff etc.
- Written commitment of the employees of the DSO to comply with the principles of the Compliance Programme.
- Clear statements on sanctions to be taken in case of violating the compliance principles.
- Data collection and monitoring methodology regarding the implementation of the Compliance Programme and its reporting by the Compliance Officer.

## 4.2 Review of the Compliance Programmes of the Electricity DSOs of Western Balkans against the minimum content

The Compliance Programme, is the tool that enables the continuous observance that the unbundling requirements for DSO independence from competitive activities and non-discriminatory conduct are effectively implemented in the day to day activities of the distribution network operation.

**To this effect the Compliance Programme follows on the respective high-level principles identified by Law and specified by the DSO License and sets out specific policies, measures and procedures to be promoted, actively implemented and effectively monitored, in order to ensure the desired compliance to the unbundling requirements.**

Inter alia the compliance Programme shall set out the specific obligations for management and employees to meet that objective and should contain rules of conduct which have to be respected by staff in order to exclude discrimination, such as for example a set of rules as part of a compliance Programme related to the behavior of staff vis-à-vis network customers.

*Below are mentioned the Consultant's views and recommendations on the improvement of the Compliance Programmes submitted by the Electricity DSOs of the Western Balkan Contracting Parties:*

The Compliance Programmes reviewed could be more thoroughly elaborated in order to ensure that they are tools, enabling monitoring the adherence of the DSO to the requirements set in Article 26§2d of the Directive. The key segments and content of the Compliance Programmes cannot be deemed exhaustive as to guarantee appropriate legal, functional, managerial, financial, accounting and other objectives for the independent, and non-discriminatory operation of the DSO.

### 4.2.1 Review of the key segments and contents of the Compliance Programmes

Certain Compliance Programmes do not include key segments such as:

- **The organisational structure of the DSO including ownership of the distribution network assets, financial relationships and internal relations with the parent company and the Affiliated Entities (4.1.3).**
  - For instance, some Compliance Programmes do not clarify whether the above assets are accounted in the balance sheet of the DSO or the VIU. This is important, since, in the second case a sort of a leasing agreement has to be concluded between the two companies under terms and conditions approved

by the NRA and monitored under the Compliance Programme which should include provisions also for the VIU as assets owner.

- Certain Compliance Programmes do not clarify the relation of the DSO with the VIU regarding financial issues e.g. what type of financial control is exercised over the DisCo, what are the rights of the VIU as owner of the DSO company e.g. in determining the indebtedness level, dividend policy and other financial aspects. It may be inferred that the VIU as sole shareholder retains without any due restriction regarding the public service character of the DSO company, all rights a shareholder may exercise through the General Assembly of a Ltd company. This is also important for the appointment and dismissal of the DSO management.
- Another example is that no procedures and criteria are applied to the Supervisory Board, which is an organ of the VIU<sup>9</sup>, ensuring non-interference with the independent operation of the DSO when for example one such decision is the dismissal of the managing Director of the DSO or the enactment of the VIU rights as Shareholder at the DSO General Assembly.
- The activities of the DSO other than operating, maintaining and developing the network should also be clearly specified and monitored at least for the character of these activities and appropriate accounts unbundling to ensure for proper cost and revenue allocation.

➤ **Compliance principles** such as the independent Operation of the DSO e.g.

- Certain Compliance Programmes did not include the requirement to separate the IT systems (hardware and software) used by the DSO, if not already owned and operated as part of the DisCo, from those used by the VIU or the affiliated companies, as well as the separation of information and databases.

➤ **Proper implementation and adequate monitoring of the Compliance Programme** which includes training of the employees, signing statements for compliance, audits etc. (4.1.3).

In addition, an important aspect of independent operation of the DSO is the provision of common services which must be kept to the minimum in order to ensure the independence and the autonomy of the DSO versus its owner and its affiliated and related companies as well as versus any licensed generator and/or supplier. In some Compliance Programmes, common services offered to the DSO are not clearly defined. There should be:

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<sup>9</sup> In the first stage (unbundling), the relevant Compliance Programme (which is monitored by the VIU) is recommended to include a Code of Conduct for the VIU's Supervisory Body of the DSO.

Its content differs from the content of the Code of Conduct for DSO management which is included in the DSO's Compliance Programme (and is monitored by the DSO Compliance Officer).

In the second phase, the VIU obligations to act in a way that does not jeopardise the proper execution of the DSO activities including its independence, etc. shall be included in the terms of the VIU License as owner of the DSO. And is upon the NRA to monitor compliance.



- reference to limited number of specific services. Services that are crucial for the independent function of the DSO (such as legal, IT), are considered strategic ones and have to be established in the DSO.
- if the DSO is the recipient, the services should be awarded following a tender to ensure lower cost at market terms,
- if the DSO is the provider it would be advisable to publish general terms and conditions including pricing methodology for the DSO to provide such services without discrimination in favor of the VIU and its affiliated companies to any interested stakeholder,
- the personnel of any company that shall perform services for the DSO must be specified and commit to the confidentiality rules of the DSO,
- If personnel of the VIU (e.g. Human Resources, Communication, Financial Services etc.) is occupied on a permanent basis for the execution of a common service for the DSO, then such personnel should be employed directly by the DSO and perform the service as an employee of the DSO.

#### **4.2.2 Review of the measures of the Compliance Programmes**

A general substantive remark is that the Compliance Programmes shall prescribe and refer to the specific measures, policies, internal acts and processes that are required to achieve the high-level Compliance principles and/ or to satisfy the terms and conditions set by the DSO License and the DSO Statute.

Needless to say, in cases where measures are not clearly prescribed, compliance monitoring is difficult, not to say endangered as it is not based on tangible results, rather leaves room for mis- interpretation of the various compliance principles by the DSO departments assigned with the implementation of the Programme.

For instance, it has been observed in some Compliance Programmes, that no measures are described (e.g. development of a Code) or reference to documents has been made, with regards to ensuring non-discriminatory conduct against distribution system users. In other cases, measures have been included in Compliance Programmes but there are not deemed adequate to ensure adherence to the Compliance Principle. A separate identity for instance does not include merely the development of a corporate identity, rather separate call centers, separate branding of DSO offices etc.

A positive example of a reference to a measure, on the other hand, is foreseeing that employees (internal or external to the DSO) sign a statement confirming that they are familiar with the provisions of the Compliance Programme, as well as the legal consequences in case of violation in case of concluding an employment contract. Such a statement enables the training of new staff with the provisions of the Compliance Programme.



## 4.3 Available tools (measures) to ensure separation and non-discrimination

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The DSO shall establish and shall thereafter maintain the **full managerial and operational independence** from each other Affiliate, Related Undertaking or shareholder (e.g. the VIU or a Holding of the DSO and companies that perform competitive activities, generation and supply). **Activities and rights of the mother company on the DSO as well as regulation to secure her financial interest (supervisory function) have to be limited by law.** Interference by the mother company outside this supervisory function in the network business and knowledge of the day-to-day network business is not allowed. Prohibition shall also apply by law and regulation for the DSO (a) in fulfilling its obligations related to network operation to seek permission by any company that performs competitive activities, generation and supply, including parts of the VIU, or for such companies (b) to impede or prejudice the DSO from complying with its obligations related to network operation.

It is noted that the terms “tools and measures” are used interchangeably throughout the report. In addition, certain tools (measures) are part of the Compliance Programme and have already been mentioned in Chapter 4.1 above.

### 4.3.1 Operational procedures

#### Ensuring complete and effective separation

The DSO shall secure and maintain the **complete and effective separation** of the Distribution Business from each other Affiliate, Related Undertaking or shareholder, subject to arrangements approved by the NRA in the interests of economic efficiency, and arrangements approved under the Operation Agreements, concluded with the VIU if it retains distribution assets ownership.

This separation shall include, but not be limited to:

- a) access to and exchange of information including (without limitation) commitments by individual employees regarding the non-disclosure of information;
- b) information systems;
- c) resources including (without limitation) staff, premises, finance;
- d) the DSO owns and operates the Meter Management System;

#### Ensuring non-discrimination

The DSO in carrying out its functions under its License, shall secure that its management and its employees shall not discriminate unfairly between persons or groups of persons, or between system users or groups of system users, particularly in favor of its associated or Affiliated or Related Undertakings, joint ventures or shareholders.

To ensure the above, the DSO shall prepare a **code of conduct**, subject to the approval of the NRA, which **shall apply to its management and to every person** it employs under a permanent or part-time contract of employment. To this effect it shall ensure that the code of conduct is included as part of each such contract of employment and shall take all reasonable steps to ensure compliance with the code of conduct.

### **Ensuring independent operation/ availability of resources**

The DSO shall at all times act in a manner that secures it has sufficient human, technical, financial resources to enable it:

- a) to carry on the Distribution Business; and
- b) to comply with its obligations under the law, the regulation, and its License (s).

To this effect it shall **submit annually to the NRA a certificate** approved by a resolution of the Board of Directors (BoDs), accompanied by a statement of the principal factors which its BoDs have taken into account in giving that certificate. The certificate shall, depending on the resolution of the BoDs, certify that after making enquiries and taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, have a reasonable expectation that (a) the DSO will have available sufficient resources and financial facilities to enable it to carry on the Distribution Business for a period of 12 months from the date of the certificate, or (b) that they would like to draw attention to the factors which may cast doubt on the ability of the DisCo to carry on the Distribution Business, or (c) that in their opinion the DisCo will not have available to it sufficient resources and financial facilities to enable the Licensee to carry on the Distribution Business for a period of 12 months from the date of this certificate.

### **Compliance Programme**

The DSO must have at all times a Compliance Programme in place, approved by the NRA. Following issues are included in the Compliance Programme.

### **Full managerial and operational independence of the Distribution Business**

For Management (upper and middle), independence entails:

- a) the prohibition from holding any position in the management or supervisory board of the VIU and,
- b) prohibition from working for the competitive branches of VIUs.

In addition, it is not allowed to have incentives that relate to the performance of the VIU. This includes also the provisions if any that the VIU is legally allowed to dismiss the upper management of the DSO e.g. without prior justification and whether for any dismissal to become effective, the prior consent of the NRA is required.

### **Branding of the Distribution Business**

Full independence of branding means disposing different enough means, so as not to create confusion among customers between the supply part and the regulated part. In

brief to be physically separated from competitive business structures, to have clearly separate branding and communication strategies such as separate and different names and logos, different home pages and phone numbers.

### **Employees of the Distribution Business**

Regarding employees employment terms, it should be clarified whether employees work for the DSO and the competitive business at the same time, and/or if DSO employees are prohibited from holding any managerial or other position in the VIU, as well as whether wages and incentives for DSO employees as also for the management, are based exclusively on the result of the DisCo. Also whether by law or regulation, promotions and sanctions of DSO personnel should be decided by the DSO management only. Furthermore what are the provisions, if any, by law or regulation or by the DSO license regarding the transfer of a DSO employee to an affiliated company (for example, on the disclosure of commercially sensitive and advantageous information). In relation also to confidentiality whether the DSO management and/or employees are legally allowed to participate in any internal activities of the VIU in which information can be disclosed (e.g. board meetings, strategic meetings) and vice versa whether the management or employees of the VIU are legally allowed to participate in any internal activities of the DSO.

### **Non-disclosure of confidential information**

The DisCo shall preserve the confidentiality of Commercially Sensitive Information held and/or obtained by it, in the discharge of its functions as DSO in accordance with the law, the Regulations, and its License. To this effect it must put in place and at all times maintain managerial and operational systems that will clearly identify the confidential information as Confidential (e.g. as commercially sensitive - where it is owned by third parties or commercially advantageous - where it is owned by the DSO itself), and also that Confidential Information is only disclosed to authorised recipients, classes of authorised recipients or authorized advisors. It shall also prevent any additional copies to be made of the Confidential Information, whether in hard copy or computerised form.

The DSO shall take all reasonable steps to ensure that every authorized recipient or authorised adviser to whom it discloses Confidential Information, including employees of the VIU as shareholder and/or as the Distribution Assets Owner (if the VIU retained assets' ownership), does not use that Confidential Information for any purpose other than that for which it was provided and does not disclose that Confidential Information otherwise than in accordance with the provisions of this Condition.

### **Meter Registration System**

The DSO shall establish, operate and maintain a Service regarding meter point registration (e.g. Meter Point Registration Service), that shall perform the following functions:

- a) the maintenance of a register of technical and other data as is necessary to facilitate supply by a Supplier to any premises. The register shall contain, inter alia, the following data in relation to all Meter Points :

- (i) the Meter Point Reference Number; and
  - (ii) the identity of the Supplier responsible under the relevant market code for the supply of electricity to each premises; and
  - (iii) the class of metering equipment installed at each such premises; and
  - (iv) the address of each such premises.
- b) the amendment of the above register to reflect Supplier switching in respect of any premises; and
- c) the provision, in a timely and efficient manner, of such data contained in the register as is reasonably required and requested to:
  - (i) any Supplier; and
  - (ii) any person identified in accordance with the relevant electricity market trading and settlement Code as an appropriate person for the receipt of data for settlement purposes; and
  - (iii) any person identified in the respective meter registration agreement as entitled to such data for the purpose of facilitating Supplier switching in respect of any premises; and
- d) the maintenance of an enquiry service for the provision to any Final customer, on request, of such data contained in the register as is relevant to electricity supply to premises which are (or are to be) owned or occupied by the Final Customer.

### **Provision of Metering and Data Services**

The DSO shall provide the following services to customers, Suppliers, the TSO and the Market Operator as may be required:

- a) the provision of Metering Equipment; and
- b) the installation, commissioning, testing, repair and maintenance of Metering Equipment; and
- c) data collection; and
- d) data transfer, data processing and data aggregation services; and
- e) the provision of Meter Data for the purposes of, and in accordance with, the relevant market trading and settlement Code.

Any question arising as to the services to be provided under this function shall be determined by the NRA and the DSO is obligated to comply with.

### **Detection and Prevention of Theft of Electricity, Revenue Protection**

The DSO shall take and shall also ensure that its agents take, all reasonable steps to detect and prevent, the theft of electricity meaning the dishonest use, waste or diversion of electricity, as well as damage to any electrical plant, electric line and Metering Equipment;

and prepare and submit for approval by the NRA a code of practice for revenue protection and shall comply with the relevant provisions of this code. This code of practice shall determine inter alia the procedure used to ensure the accurate recording of electricity consumption and production.

Where the Licensee has reason to believe that: (a) the theft of electricity is taking or has taken place; or (b) there has been interference with the metering equipment to alter its register or prevent it from duly registering the quantity of electricity supplied or produced; the DSO shall as soon as reasonably practicable, inform the affected Supplier of the subject incident.

### 4.3.2 Decision-making procedures

Law, regulation and the DSO License shall establish and shall require the DSO thereafter to maintain, the full managerial and operational independence of the DSO from each other Affiliates, Related Undertakings or shareholder. In particular the Law shall authorize the DSO to take independent decisions on all commercial and operational issues related to the operation, maintenance and development of the distribution network without involving the related VIU. It shall also clarify that the DSO is authorised to take independent decisions on all issues related to day-to-day business and to the assets (physical and human) without involving the related supply business or the VIU.

In particular the Compliance Statement regarding available resources, shall refer to, how it is by law, regulation or the License, and applied in practice that the VIU is prohibited to interfere on the day to day business of the DSO(s) or on individual decisions concerning the distribution network.

### 4.3.3 Internal relations

The Disco shall prepare a **code of conduct**, subject to the approval of the NRA, which shall apply to every director and to every person employed by it under a contract of employment. It shall ensure that the code of conduct is included as part of each contract of employment with the Disco and shall also take all reasonable steps to ensure compliance with the code of conduct. The Disco shall also provide the NRA with any information or access to information the NRA may deem necessary for compliance with this condition.

### 4.3.4 Cost-sharing

The DisCo shall procure that the Distribution Business does not give any subsidy or cross-subsidy (direct or indirect) to any of its Affiliate or Related Undertaking or shareholder. For the purposes of this condition, the NRA shall determine whether or not subsidisation or cross-subsidisation is taking place. Where the NRA determines that a subsidy or cross-subsidy involving the Distribution Business is taking place, the NRA may issue a direction to that effect and require the cessation of same.

The NRA must have full access to minor forms of affiliation and to economic interest between the network company and competitive business in order to see whether any form

of direct or indirect influence on daily or major investment decisions is possible. Influence therefore does not only include direct influence from one company on the other one but also influence on decisions because of economic interest in the other company.

ERGEG has proposed the Guidelines G2, G3 referred to below [13]:

**G2: forward all structural elements of affiliation to the regulator**

- Exact kind of affiliation with competitive parts of the gas and electricity value chain
  - Active (network company is shareholder in other company, extent of direct and indirect shareholding)
  - Passive (other company is shareholder in network company, extent of direct and indirect shareholding)
- Other relations such as credits, loans, guarantees, long term contracts, usage rights (description of kind of service)
- Small affiliations may be published in summary reports.

**Contracts – Service Level Agreements**

Certain network operators, even after becoming a separate legal entity, will be closely linked to their affiliated companies via contracts. That will be the basis for shared services either produced by the mother company, the network operator or a third company which is owned by both or only one of the above-mentioned companies. While priority should be given to market-based procurement, the situation is comparable to an integrated business, where the regulator should have all means he normally needs to evaluate the competitiveness of the incurred cost.

**G3: explain and justify every allocation method or change of the method initiated by utilities. In general the method has to follow two major principles:**

- a clear definition of all necessary network services is the basis for deciding whether a service in principle is a network service; and
- costs have to be allocated according to transparent principles which allocate economies in an appropriate way.

All commercial and financial internal relations between the DSO and other parts of the VIU must comply with the market practice via Service Level Agreements with appropriate terms and clauses. These contracts or SLAs are subject to the approval of the NRA.

#### 4.3.5 Internal pricing

Ideally legally unbundled network operators would own their assets, do not share services with mother or affiliated companies and purchase external services and products through a tender procedure.

The Disco shall procure such assets and services as may from time to time be necessary to enable it to discharge its obligations under the Act, the relevant Regulations, and its License, from the most economical sources available to it, having regard to the quantity and nature of the assets and services required to enable it to discharge its obligations and to the diversity, number, timeliness of delivery and reliability of such assets and services.

Any provision of assets or services to the Disco, or by the DisCo for the purposes of discharging its functions under its License, by or to any Affiliate or Related Undertaking or shareholder shall be on arm's length terms. For the avoidance of doubt the arrangements provided for under the Operation Agreements are deemed to comply with this Condition.

ERGEG has proposed the Guidelines G1 and G3 referred to below [13]:

**G1: publish all major transactions with affiliated companies in their regulatory accounting statements. The publication should contain transactions such as:**

- Purchases and their value (description of purchases, including whether tendering procedure was used)
- Kind of sales and their value (description of sales, including information on participation in tendering procedures)
- Financing costs (including dividends paid to affiliated companies, derivatives etc.).

In case the legally unbundled DisCo performs different network businesses that face different degrees of competition (for instance combinations of telecom, district heating and electricity), while there are certain economies of scale and scope involved so that the allocation of costs and a “fair” allocation of economies is a key to successful unbundling of these economies is critical. Calculation of stand-alone cost can serve as a benchmark for other possibilities regulators might use (or have to use).

**G3: Every allocation method or change of the method initiated by utilities has to be explained and justified. In general the method has to follow two major principles:**

- a clear definition of all necessary network services is the basis for deciding whether a service in principle is a network service;
- and costs have to be allocated according to transparent principles which allocate economies in an appropriate way



## 4.4 Best practice and experiences to arrange relations with related undertakings

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A good starting point to highlight potential relations and interdependencies between the DSO and the VIU is the preparation of a graphical **functional model** that clearly shows the organisational chart of the DSO, **internal** relations and operational interconnections between its units and the respective units of the VIU.

The DSO shall document all the services, facilities and infrastructure that are shared with each one of the related / affiliated undertakings (especially for the electricity supply activities) and shall introduce measures to ensure separation and arrange the relevant relations as part of the Compliance Programme.

Potential measures to arrange internal relations with the undertakings of the VIU include the **DSO rules on the use of common services if any, and the Code of conduct** as presented below.

### 4.4.1 DSO rules (code) on the use of common services

For DSOs sharing services with the VIU, a set of rules (a Code) on the use of common services should be developed prescribing at least the following:

- **Section 1:** Procedure/ flow chart regarding the use of common services and functions which are provided to the DSO. Such services that can be performed are for example for the electrical connection of a RES unit or by the TSO in the substations HV to MV.
- **Section 2:** Necessary arrangements and systems required regarding the provision of common services to the DSO such as the SLAs.
- **Section 3:** the right of the DSO to offer or seek such services from the market under same conditions, the procedure to be followed by the DSO to decide which service provider to choose (market, VIU) and under what conditions should such a decision be made so that non-discriminatory conduct is ensured.

As already mentioned above, strategic services such as legal, regulatory and controlling ones must be established within the DSO and are not provided through common services [12].

#### Section 1

The DSO shall prepare a procedure/ flow chart regarding the process for the use of common services from the VIU (Figure 4-1). This process should be implemented after the DSO has taken offers from the market and has decided to opt for common services instead.

**Figure 4-1 Procedure/ flow chart regarding the use of common services**



The DSO shall then include information on specific SLAs that may potentially be concluded between the DSO and the VIU Departments that shall provide the Common Services. It is recommended that these SLAs are established beforehand, at least in their General Terms and become part of the Functional Model of the DSO submitted to the Regulator for its approval. Execution of the SLAs should be monitored under the Compliance Programme monitoring process.

## Section 2

The DSO shall prepare a template for the SLAs (an example is presented in Figure 4-2).

**Figure 4-2 Example of an SLA template**

<b>SLA</b> (title and code)
<b>Date</b> (initial and revisions)
<b>Department that offers the Common Service</b> (Provider) and <b>contact person</b> responsible for the SLA on behalf of the Provider
<b>DSO Department</b> (Customer) and <b>contact person</b> responsible for the SLA on behalf of the Customer
<b>Description of the SLA and the services to be provided</b>
<b>The period of validity of the SLA</b>
<b>The responsibilities of both parties</b> (Provider and Customer) including ToR of services to be provided, work plan, setting priorities and confidentiality conditions for the personnel of the Provider, etc.
<b>General terms and conditions governing the SLA</b> including managing deviations from the agreed work plan, confidentiality of data, body responsible for solving disagreements etc.

Every SLA shall have a unique serial number using coding that is easily recognizable. Potential information to be included in the coding is:

- No. of the SLA compared to the overall number of SLAs between the DSO (Customer) and the department offering the specific common service throughout the year (Provider),
- year in which the SLA has been concluded,
- abbreviations of the Customer and Provider Departments.

The DSO shall clearly describe (and agree with the NRA) the method for calculating the cost of common services to be provided by the VIU to the DSO. Such services shall be provided at “**market prices**”, therefore include profit margin and overhead costs. SLAs shall be stored and be easily retrievable for review by the NRA and the Compliance Officer.

Staff of the DSO involved in the provision of common services should abide by the Code of conduct and should be trained regularly on the confidentiality of information. The same applies to external contractors.

### Section 3

The DSO shall have the right to compare the cost of services provided from the respective VIU Departments with the equivalent one provided through the market (e.g. by external consultants). When he deems it necessary, he shall have the right to choose the most profitable offer based on his own criteria (e.g. profitability, availability of resources, duration for its implementation etc.). For this reason, a specific mechanism shall be in place, enabling the above requirements.

#### 4.4.2 Code of conduct

The Code of conduct applies to the DSO management, people directly employed by the DSO, employees of other companies seconded into the DSO including the employees of the VIU under an SLA. Other employees of third parties providing services to the DSO should be also obliged to abide by the Code of Conduct.

Contents of the Code of Conduct should include but not limited to the following:

- **Principles of the Code of Conduct** e.g. independent management, impartiality of the DSO, equality of treatment and objectivity towards customers and market players, transparency, data protection of commercially sensitive data, impartiality of the DSO, etc.
- **A list of the expectations of the DSO upon its employees** (e.g. act in a professional, honest and ethical manner when acting on behalf of the DSO, complete all required training in a timely manner and keep up-to-date on current standards and expectations; report concerns about possible violations of laws). A clarification that the Code forms an integral part of the contractual terms of engagement with DSO employees, board members, third parties and others who act on DSO's behalf should be included. A list of the expectations of the DSO upon those in management positions should also be included.
- **Provisions ensuring compliance to the Principles of the Code of Conduct** e.g. ensuring:
  - that the management of the DSO is acting independently from the VIU and its affiliates (not holding shares in the VIU or affiliated entities, not holding any position in the management or supervisory board of the VIU, working for competitive branches of the VIU etc.)
  - that employees don't discriminate unfairly between customers on the basis of their supplier, don't promote the services of one supplier over those of another, don't provide information/ support/ materials or service to the VIU affiliated entities other than on the same basis as provided to other market players etc.
- **A procedure for seeking guidance and reporting integrity violations.** An Integrity Line operated by an independent third party maybe also be provided. The Code should also provide for a culture of integrity when suspected or actual misconduct in good faith is reported in good faith. The Code should provide for a definition on "Reporting in good faith" e.g. that it means that all information to the reporting party has and believes is true is provided. The Code needs to be clear that individuals who retaliate against a person making a report in good faith or participating in an investigation will be subject to disciplinary action, up to and including termination of their contract.
- **Breaches of the Code** (distinction between inadvertent and deliberate breaching, solving cases per occasion, responsible body imposing sanctions, disciplinary procedures, Compliance Officer's role etc.)
- **Template** of a signed statement to ensure compliance with the Code of Conduct



## 5 MONITORING AND REPORTING ON THE COMPLIANCE PROGRAMME

### 5.1 Substance and content of the Compliance Officer's report

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According to Article 26§2d of the Directive, an annual report, setting out the measures taken to ensure that discriminatory conduct is excluded, shall be submitted by the Compliance Officer of the DSO, to the NRA and shall be published. Other than that, the Directive does not prescribe any strict and precise requirements on the **substance and content** of the Compliance Report.

According to ERGEG, “the contents of the Compliance Reports differ widely among MSs. All NRAs confirm that the promulgation of the compliance programme and non-compliance incidents is part of their annual report. The diversity of programmes shows quite well that in many Member States, DSOs decide on their reports independently. It is therefore not surprising that especially on “soft” aspects of unbundling, such as communication policy, compliance reports do not contain sufficient information. This complicates proper oversight of compliance by national regulators.” [10]

**ERGEG has proposed Guideline G21 regarding the contents of the Compliance Report [10]:**

G21: The annual report must provide information on the following issues:

- Promulgation of the compliance programme within the company
  - Information for employees about the compliance programme
  - Binding compliance programme
  - Signature of employees
- Training of the employees
  - Main issues
  - Organisation
- Report on all incidents
  - Number of sanctions imposed
  - Involvement of the Compliance Officer
- Cooperation from management
  - Support for the Compliance Officer
  - Consultation of the Compliance Officer
  - Number of consultations
  - Issues



- Presentation of the result of any process analysis, including any performed by external auditors

## 5.2 Best practice on monitoring and reporting on the implementation of the Compliance Programme

As it was mentioned above, the compliance regarding the Directive comprises two stages, i.e. when the VIU is in the process of legal separation of the DSO and when the DSO is established as a new legal entity.

It is likely that the content of the Programmes for both stages refer to same principles (e.g. management separation, independence of the DSO, separation of IT systems), but the measures for each one differ. For example, a potential measure for the 1<sup>st</sup> stage of compliance with regards to management separation could be the development of the code of conduct while for the 2<sup>nd</sup> stage of compliance, a potential measure could be introducing signed statements of the DSO's employees as well as top and middle management to ensure compliance with the code of conduct.

Some DSOs prepare Compliance Programmes separately for each stage. It is not unusual however for a company to combine both of them in one, but this should be in separate parts with different starting point for the implementation and the role of the Compliance Officer for each stage differ.

**In most EU countries, the DSO has been separated from the VIU, in compliance with the EU Directive 54/2003.** Therefore the 1<sup>st</sup> stage of compliance for most DSOs has long been completed and relevant information cannot easily be retrieved. Indicatively it is mentioned that Enedis France<sup>11</sup> and ESB Ireland<sup>12</sup> have developed the “Code of Conducts” in the frame of the 2<sup>nd</sup> Compliance stage which is the equivalent of the obligatory Compliance Programme pursuant to Article 26§2d of the Directive. For communication reasons (internal and external), these Programmes have been named as Code of Conduct but it is important not to confuse them with the typical code of conducts.

Consequently, at the current transformation stage where the Energy Community Contracting Parties are, it is not deemed advisable to mention countries who have long ago applied the separation, causing it to mature and differentiate considerably.

For this reason, the most recent cases will be mentioned: **Greece and Cyprus**. The following proposals derive from those cases and have been formed according to the Consultants' experience.

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<sup>11</sup> [https://www.enedis.fr/sites/default/files/Plaquette\\_Code\\_de\\_bonne\\_conduite\\_2018.pdf](https://www.enedis.fr/sites/default/files/Plaquette_Code_de_bonne_conduite_2018.pdf)

<sup>12</sup> [https://www.esbnetworks.ie/docs/default-source/publications/staff-compliance-code-of-conduct.pdf?sfvrsn=884b33fo\\_4](https://www.esbnetworks.ie/docs/default-source/publications/staff-compliance-code-of-conduct.pdf?sfvrsn=884b33fo_4)



## 5.2.1 Monitoring and reporting - stage 1

### Monitoring compliance - stage 1

Due to the fact that monitoring is very labor-intensive, it is important to determine the extent to which the VIU company itself is able to design and organize the work with internal resources and if there is a need for external consulting. It is also important to determine if individual issues (legal, HR, logistics etc.) will be dealt with internal resources or if a consultant will have to be hired.

For monitoring purposes it is mandatory to develop an Unbundling Compliance Programme. This Programme (tasks, timeframe etc.), is submitted and then approved by the NRA.

The process of the development and implementation of the Unbundling Compliance Programme, at a high level, can be distinguished in the following steps.

#### **Step A:** Definition of the new company's organizational structure, taking into account:

- Whether the organization of the previous distribution business unit will be maintained, or it will be revised to ensure its services' better function.
- Whether support services will be developed by the company itself or drawn from the parent company.

At this point of the transformation, the relations of the subsidiary company with other affiliate companies, and with the Parent company, need to be defined.

#### **Step B:** Development of constitutional issues

The articles of incorporation must be mapped out (e.g. company's statutes) and decisions must be made concerning governance. Among other things: whether the members of the Board of Directors designated by the owner are going to be executives or not, the duration of the BoD members' tenure, position of Compliance Officer etc.

#### **Step C:** Human resources issues

The personnel that will be transferred must be picked. Setting the Staff Regulation, securing that employee' rights will be transferred to the new company etc.

#### **Step D:** Accounting

Preparation of the financial statements of the subsidiary.

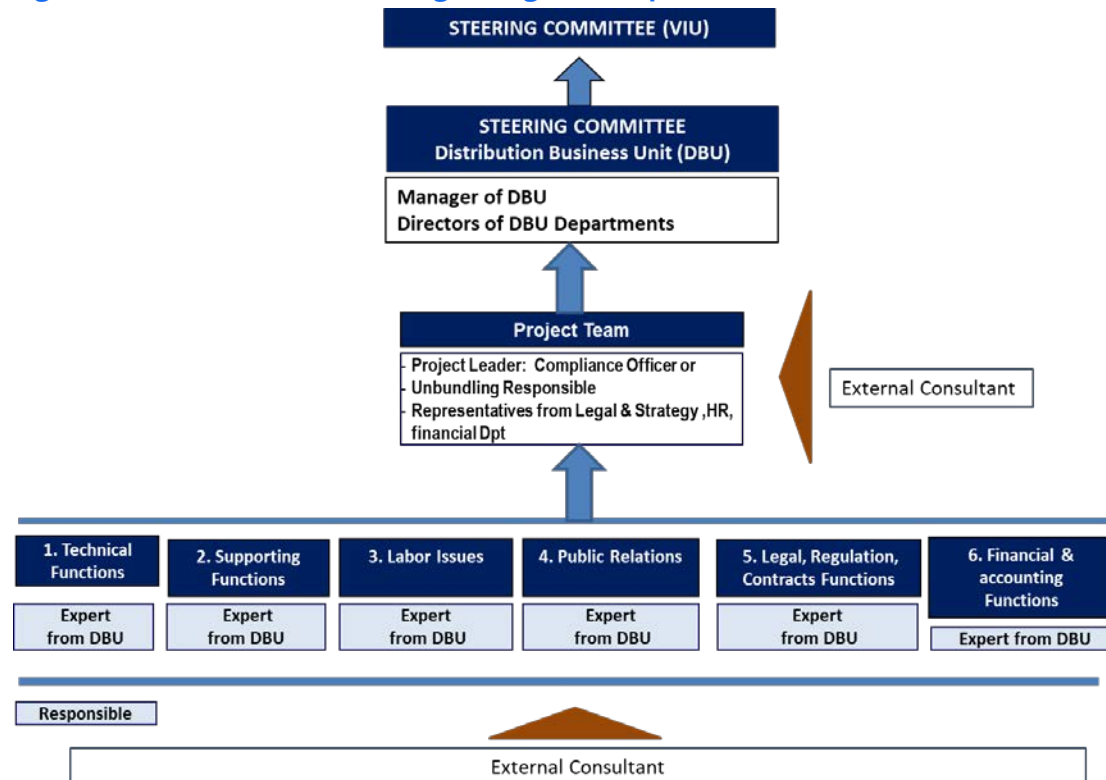
#### **Step E:** Other issues

Other tasks can be included at the current stage of separation, such as rebranding, separation of IT systems & offices, development of a code of ethics concerning the non-discriminatory treatment and protection of confidential data etc. This depends on the agreement with the NRA and its opinion on how necessary it is for the tasks to be

completed before the separation. The other possibility is for those issues to be included in the Compliance Program after the separation (Compliance stage 2).

A structure for monitoring the 1<sup>st</sup> stage of compliance is presented below (Figure 5-1):

**Figure 5-1 Structure for monitoring 1<sup>st</sup> stage of compliance**



### Greek DSO – HEDNO

HEDNO S.A. was formed by the separation of the Distribution Department from the Public Power Corporation (PPC S.A.), according to Law 4001/2011 which transposed the provisions of the Electricity Directive 2009/72/EC into the Greek legislation. HEDNO is a public limited company and **wholly owned subsidiary** of the PPC S.A.

PPC S.A. is a VIU which:

- performs both generation and electricity supply functions that are organised in distinct business units and
- has two wholly owned subsidiaries, HEDNO and PPC Renewables (PPCR)<sup>13</sup>. PPC S.A. holds the assets in lignite mines, power generation, transmission as well as distribution.

According to Law 4001/2011, the Greek DSO (HEDNO) must be completely independent from the parent company, as far as support services are concerned. **A five-year deadline** was granted by the Law, during which these services could still be provided to the DSO by the parent company via **SLAs** up until the DSO was able to develop them on their own. Thus, the organizational structure of the old distribution business unit was maintained, and only new departments for the audit, accounting, legal, IT and HR were created.

<sup>13</sup> Greece's largest power generation company which inherited all RES activities (wind, small hydroelectric, solar and geothermal) from PPC.

### Internal reporting - stage 1

Taking into account Figure 5-1, the Project Leader (Compliance Officer) is obliged to report and present the work progress at regular intervals to both the Steering Committees (at Group and DBU level, Figure 5-2).

**Figure 5-2 Internal reporting (to the Steering Committees, Unions) and external reporting (to NRA, State)- 1<sup>st</sup> stage of compliance**



He can also convene the Steering Committee of the DBU in case of a problem having arisen or in case there is need for decision-making in order for the transformation to continue and if the problem is still present, to convene the VIU Steering Committee.

The presentation of the work progress to the labor unions is very important to them and is implemented throughout regular meetings. Usually, it is common practice that presentations are made by the general manager of the DBU or in some cases by the CEO of the VIU.

### External Reporting - stage 1

Reporting and presenting the work progress to the NRA is the responsibility of the project leader. In case of delay in the progress an explanation for that must be given and if necessary, an approval from the NRA must be asked for.

Due to the state being liable to the EU, a briefing of the ministries responsible may be demanded. This type of briefing is much less frequently carried out than the one to the NRA.

For transparency reasons, a summary report with the progress may be published by the company in its website (ESB<sup>14</sup>).

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<sup>14</sup> [https://www.esbnetworks.ie/docs/default-source/publications/esb-networks-annual-compliance-report-2014.pdf?sfvrsn=c14533fo\\_4](https://www.esbnetworks.ie/docs/default-source/publications/esb-networks-annual-compliance-report-2014.pdf?sfvrsn=c14533fo_4)

**Important note:**

During the 1<sup>st</sup> stage of compliance, the NRA in certain MSs hires an external consultant to audit the company's progress in regular intervals, however this is not a general practice (e.g. in Greece, this procedure has not been followed by the NRA).

**Revision of the Compliance Report by the DSO Management - stage 1**

If the Compliance Report is about the unbundling process, it is possible for it to be approved before the submission to NRA by the relevant committee or the senior management of the VIU.

**Revision of the Compliance Report by the NRA - stage 1**

In case the Compliance Report concerns the DSO-VIU unbundling, then the NRA has the right to accept the report or not, because it concerns the separation, meaning that it agrees or does not agree with the fulfilment of its stages. Non-approval means that more elements or more measures are demanded.

### 5.2.2 Monitoring compliance - stage 2

At the second Compliance stage when the DSO Company has been established, one of the Compliance Officer's duties is to monitor the Compliance Programme.

To fulfill this role, the unobstructed access of the Compliance Officer to the entirety of the company is necessary. Usually, this right of the Compliance Officer is communicated to the employees via a letter signed by the CEO, as along with the employees' obligation to provide him with every data and assistance they need.

The **monitoring of the compliance program refers mostly to the audit of its measures.** Measures can be separated in two categories:

- **“Category 1”** refers to one-off measures (e.g. setting out guidelines, instructions, separation of IT systems) and the
- **“Category 2”** refers to measures that are subject to continuous monitoring of the process they concern such as supplier switching process, access to the network (first connection) for RES producers.

The audit must be carried out according to a **structured audit process. The audits are carried out by the Compliance Officer himself and potentially also additional trained and/or certified persons that belong to the Compliance Office Unit, or by an external specialized consultant.**

Because of the possibly significant volume of compliance measures and depending on the resources available, the measures that will be audited within a year, the frequency and the business units that will be involved must be chosen by the Compliance Officer.

The audit results should be kept in physical or electronic files, in compliance with the audit principles, so as to be able to certify every result, in case the NRA requests it or other inspection. Below is a sample of an Audit Sheet (Figure 5-3).

Figure 5-3 Sample of an Audit Sheet (2<sup>nd</sup> stage of compliance)

<b>DSO logo</b>		
<b>DSO COMPLIANCE PROGRAMME</b>		
<b>Audit Sheet</b>	<b>Date</b>	
<b>Version</b>		
<b>Updates</b>		
<b>Author</b>		<b>Approval by</b>
<b>Measure No</b>		
<b>Description of the Measure</b> Note could be shorter than the description in the Compliance Program		
<b>Responsible Department:</b> The business department responsible for the implementation of the measure  <b>Actions:</b> Description of the action should be done by the Department as described in the Measure of the Compliance Program		
<b>Audit procedure:</b> Short disruption E.g. the audit will be performed on measure X, once per year, in case there is a change in the regulation.		
<b>Detailed Audit procedure:</b> Step-by-step analysis What; When; How;  <i>Measures Category 1</i> E.g. Asking the Department to provide the relevant documents with the guidelines. > To prove officially when the completion done. > To prove officially that all the business units have been informed for this. > To provide an explanation when the target hasn't meet > Etc.  <i>Measures Category 2</i> How the sample will be selected (IT systems, physical files, period etc.) Necessary sample's data should be provided by the unit. The detailed questions to relevant employees concerning this measure (What, When etc.) should be included  Questions so as to take in the necessary information for any results that don't meet the targets		
<b>Archiving system</b> How the result of the audit should be archiving (physical, IT systems)		

## Internal Reporting - stage 2

A significant objective of the Compliance Programme's implementation is to improve the DSO's services. For this purpose, the reports to NRA are submitted by the Compliance

Officer to the CEO or the Chairman or the BoD, so that measures necessary for the elimination of potential negative findings is taken by the DSO administration.

Additionally, a report not falling within the category of typical reports sent to the NRA, but a detailed one, can also be sent out by the Compliance Officer to senior management, in case there are negative results by the audits that create the need for actions.

## **External Reporting - stage 2**

The official Compliance reports to the NRA shall be annual. They are published on the DSO site and mentioned in the company's annual reports. The NRA can impose intermediary reports for more efficient monitoring, particularly when the DSO is at the beginning of its operation as a new company or when the market conditions demand it.

The size of the annual report to the NRA differs from DSO to DSO from extensive reports like that of the French "enedis"<sup>15</sup> to medium sized ones like Greek "HEDNO"<sup>16</sup>. The size depends on the maturity of the DSO in the compliance provisions, if it wants to use it also for communication purposes to the Stakeholders etc.

The report's content must provide information about the implementation progress and year's audits results. The report for each measure may contain a short description, the responsible unit for its implementation, the timeframe for completion (Category 1) and inspection's results (both categories).

Due to annual reports usually being published by the NRA, it is desirable for those measures to include audits to core units (e.g. front offices) not mentioned in detail. It is advisable to present the summary results. Lastly, it would be helpful to include a resume of the Compliance Program's progress.

## **Revision of the Compliance Report by the DSO Management - stage 2**

If the report is established after the unbundling<sup>17</sup>, then the CEO or another person from the senior management of the DSO is not allowed to change the Compliance Report, because the results of the inspections' findings that consist the report's main content may be tampered and compliance of the DSO to the principles of non-discrimination, equal treatment, data protection etc. may be twisted.

That being said, the Management of the DSO may sign the Compliance Report only as a means of recognizing the whole procedure. If the DSO Management has comments, then these could be documented and submitted separately to the NRA.

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<sup>15</sup>[https://www.enedis.fr/sites/default/files/Rapport\\_2018\\_sur\\_la\\_mise\\_en\\_oeuvre\\_du\\_code\\_de\\_bonne\\_conduite\\_dEnedis.pdf](https://www.enedis.fr/sites/default/files/Rapport_2018_sur_la_mise_en_oeuvre_du_code_de_bonne_conduite_dEnedis.pdf)

<sup>16</sup> <http://www.rae.gr/site/file/system/docs/electricity/var/240401>

<sup>17</sup> like HEDNO's Compliance Program or ESB Network's Code of Conduct



In addition, the competence of the Compliance Officer has been assessed by the DSO management upon its assignment of the Office, which was also approved by the NRA and his independent function from the DSO management must be ensured. These provisions allow also for the Compliance Officer to be unbiased in the monitoring and the reporting of the Program.

## **Revision of the Compliance Report by the NRA - stage 2**

Article 26§2d of the Directive requires that the Annual Compliance Report is submitted by the DSO Compliance Officer to the NRA and published. This requirement implies a review and a publication of an eventual positive or negative decision on the Compliance Report by the NRA.

The NRA shall issue its Decision on the Compliance Report with its positive and/or negative comments. This involvement of the NRA does not imply continuous interference in the Compliance Report. If the Compliance Report is based on a robust Compliance Programme and the audits of the Compliance Officer are implemented efficiently and reported with the required analysis and documentation, then the submission to the NRA seldom constitutes a problem.

However, the NRA may exercise its right to ask the Compliance Officer to make improvements relating to the level of detailed analysis of each measure (the submission of audit sheets, units where the problem occurred etc.).

In addition, the NRA has the right in its approval decision to ask the Compliance Officer to include results from audits for measures that don't exist in this year's Report, in the next year's annual Report or in the intermediate reports (if applicable).

In case the NRA suspects that the Compliance Report is not developed by the Compliance Officer under the provisions of independency, the NRA has the right to ask for his replacement<sup>18</sup> and/or in an extreme case the Regulator may open Hearings to investigate further critical issues that stem from its review of the Compliance Report and carry out checks and audits in the DSO premises (CRE France).

In the Greek Law 4001/ 2011 which transposed the Article 26 of the Directive, it is stated that the Compliance Officer is responsible for submitting the annual Compliance Report to the NRA, which should be published on the NRA website within 5 days from submission.

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<sup>18</sup> The NRA may revoke its acceptance of the Compliance Officer and demand its substitution by a reasoned Decision following a Hearing to investigate the issue and allow the Officer to present his arguments. Evidently the Compliance Officer may submit his arguments for the revision of the Decision, and if such submission is rejected by the NRA, its Decision can be challenged in the competent Courts.

## 5.3 Quality Management System

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The Quality Management System (QMS) is a very significant tool that can be used by the DSOs regarding (a) the incorporation of the functional unbundling requirements in their Procedures and (b) monitoring of the Compliance Programme by the Compliance Officers.

In general, the DSO is responsible for all the Documents (Procedures, Manuals, Codes, etc.) of the QMS that are relevant to the distribution system development, upgrading, and maintenance as well as the provision of services from the VIU to the DSO.

As a first step, the DSO shall alter or establish for the first time QMS Documents taking into account the unbundling requirements and the upcoming liberalized environment, such as:

- The Application submitted by a customer requesting a change of Supplier
- Procedure on handling a Customer's Application requesting a change of Supplier
- Document to be submitted by Suppliers informing the DSO on the completion of an electricity supply contract
- Performance criteria of the DSO
- Managing the Call center of the DSO
- Handling complaints and requests by Customers etc.

The Compliance Officer could then perform compliance checks regarding the implementation of the revised QMS Documents during the day-to-day work and include in the Compliance Report instances, where non-compliance to the unbundling requirements is observed.

## ANNEX 1

### Checklist for functional unbundling (developed by the Energy Community)

	Check-list	Reference document – Evidence / Status	Explanation / observation	Comments / suggestions (on applicability, relevance, appropriateness of the check-list item)
<b>Separate company</b>				
1.	Is DSO activity properly identified in national classification system in accordance with <a href="#">NACE 2 classification</a> [Class D activity 35.13]	Classification of activities		
	Is a separate network company established to perform all functions related to the operation of the distribution network and provision of distribution-related services?	Act of establishment, indicating activities as written in the company founding act and court registration		
2.	Is the Company authorised by the NRA for the distribution system operation and provision of the distribution-related services?	License issued on__ valid through:		
3.	Does the DSO company have legal authorisation (registration) to conduct any other energy related activity? If yes, specify as indicated in the court registration act	List or other activities and indicate their code in NACE classification		

	Check-list	Reference document – Evidence / Status	Explanation / observation	Comments / suggestions (on applicability, relevance, appropriateness of the check-list item)
4.	Is the DSO company authorized by NRA for any other activity? If yes, please specify.	List activities and valid licenses issued on ___ valid through ____		
5.	Does the company earn any income from other activities falling in the D class NACE 2? If yes, please specify.	List the activities and share of annual turnover earned from respective activity [in %]		

Corporate status				
1.	What is the type of establishment of the DSO? (holding company, parent company, subsidiary, other)	Act of establishment and registration		
2.	How is the governing structure for the, vertically integrated company defined in national legislation? (the roles of management board, supervisory board, shareholders etc as defined in the legislation)	Corporate law, energy legislation		
3.	What is the ownership structure? Indicate any owner/shareholder possessing interest in production, transmission or supply business and his respective shares	List all shareholders with > 5% shares in equity and if any of them have interest in production, transmission or supply		
4.	Is the DSO related with any other energy undertaking, either as controlling or controlled entity? If yes, please list all related	List company's names and their main activities and type [parent company, subsidiary, controlling		

	undertakings and type of relation / association.	owners, controlled, etc]		
5.	Does any production, transmission or supply undertaking have interest (participating interest <sup>19</sup> or exercise significant influence) in DSO?			
6.	Does the DSO have any interest in undertaking operating in production, transmission or supply?			

Roles, powers and responsibilities				
1.	What are the corporate bodies?	Corporate law and Statute		
	What is the organisational structure of the DSO?	Chart of organisation		
2.	Appointment and competencies of management board –tasks and subordination lines for each assignment.	Procedure of appointment, code of conduct and job description		
3.	If supervisory board is (will be) established (respective law), specify the procedure for appointment, tasks, competencies and subordination lines per assignment, if any - to confirm that management of related undertakings has no influence on the appointment and members have no interest in any of its related undertakings	Corporate statute		
Independence of management <sup>20</sup>				

<sup>19</sup> Interest held by one organization in the shares of another organization, provided these shares are held on a long-term.

<sup>20</sup> refers to management and to the persons directly reporting to them on matters related to the operation, maintenance or development of the network

1.	Persons responsible for DSO (management and senior executives) are professionally independent from other parts of the VIU and capable to act independently.	Corporate Statute		
2.	Persons responsible for the management of the DSO do not participate in company structures of the vertically integrated undertaking responsible, directly or indirectly, for the day-to-day operation of production, transmission or supply activities.	Affidavit of not holding interest or receiving any financial benefit / shareholders register		
3.	Manager of the DSO, including all senior executive staff cannot at the same time be involved in managing the related transmission, supply or production company, or vice versa.	Affidavit [organisation chart of related undertakings on request]		
4.	Working conditions of the management of DSO can actually ensure such independence, including remuneration to management and senior managing staff:	Work Contract - to Verify that remuneration does not depend on operation of related businesses in VIU		
5.	Transfer of senior staff from DSO to related undertakings and vice versa –	Corporate Statute		
6.	The management of DSO cannot exercise any professional position or responsibility, interest or business relationship, directly or indirectly, with any part of the VIU, or with its controlling shareholders, other than the DSO, for a period of three years before its appointment and four	Corporate Statute		

	years after the termination of its term			
7.	Removal of management – procedure, justification and appeal	Law / Act on establishment / Corporate Statute		

Independent decision making on network operation				
1.	DSO must have at its disposal the necessary resources, including human, technical, physical and financial resources	Act on establishment / Corporate statute		
2.	The DSO must have effective decision-making rights, independent from other parts of the VIU, with respect to assets necessary to operate, maintain or develop the network.	Corporate statute / Code of conduct - Procedural rule on financial management		
3.	Responsibility for network development and powers to make investment decisions must not be shared with persons outside DSO in the VIU, except in respect of return on assets	Corporate statute / Rules on procedure		
4.	Supervision rights of the vertically integrated undertaking in a subsidiary remain limited on financial plan and level of indebtedness	Corporate statute / Procedural rule on financial management		
5.	DSO must have the power to raise money on the capital market sufficient to maintain and develop its infrastructure	Corporate statute		
6.	All commercial and financial relations between the DSO and other parts of the VIU must comply with market and must be revealed to the NRA upon request	Internal rules of procedure		



7.	Other parts of the VIU must refrain from any action impeding or prejudicing the DSO from complying with its obligations related to network operation	Internal rules of procedure		
8.	Other parts of the VIU must not require DSO to seek permission from it in fulfilling its obligations related to network operation	Internal rules of procedure		
<b>Additional measures</b>				
1.	Communication and branding - Separate identity of DSO	Corporate statute		
2.	Protection of confidentiality of commercially sensitive information	Rules on procedure certified under the quality assurance system		
3.	Regulatory oversight to confirm that DSO cannot take advantage from its vertical integration to distort competition	Sector law / rules of procedure of NRA		
4.	Rules of conduct which have to be respected by staff in order to exclude discrimination, prepared by DSO and approved by NRA	Compliance programme		
	Compliance officer (monitoring, reporting, proposing measures)	Report on yearly basis		
<b>Accounting unbundling</b>				
1.	Shared services	Internal rules on financial management / financial control		
2.	Procurement practice	Procurement legislation / Internal rules on procurement		
3.	Disclosure of internal transactions	Accounting policies in accordance with <a href="#">Directive 83/349/EEC</a>		
4.	Audit of financial statements	Financial legislation and Sector law		

## Electricity DSOs that submitted filled in questionnaires

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The electricity DSOs that submitted filled in questionnaires based on above template are:

- CEDIS (Montenegro)
- DTEK (Ukraine)
- ERPS (Bosnia and Herzegovina)
- EVN (North Macedonia)
- JSC “Energo Pro Georgia” (Georgia)

## Gas DSOs that submitted filled in questionnaires

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The gas DSOs that submitted filled in questionnaires based on above template are:

- PJSC Chernihivgas, PJSC Chernivtsigas, PJSC Dniprogas, PJSC Dnipropetrovskgas, PJSC Ivano-Frankivskgas, PJSC Kharkivgas, PJSC Kharkivmiskgas, PJSC Khersongaz, PJSC Khmelnytskgas, PJSC KREMENCHUKGAS, PJSC Kryvorizhgas, PJSC Kyivoblga, PJSC Lvivgas, PJSC Mykolaivgas, PJSC ODESAGAS, PJSC Rivnegas, PJSC Sumygas, PJSC Tysmenytsiagas, PJSC Vinnytsiagas, PJSC Volyngas, PJSC Zakarpatgas, PJSC Zaporizhgas, PJSC Zhytomyrgas (Ukraine)
- KazTransGas - Tbilisi (Georgia)
- LLC “Chisinau-gaz” (Moldova)

## ANNEX 2 - COMMON ISSUES THAT EU VIUS ARE FACING CONCERNING UNBUNDLING

The below text outlines the common issues that EU VIUs are facing with reference to the enforcement of the unbundling provisions and is based on the Consultant's working experience as well as information retrieved from relevant reports such as ERGEG's "Status Review of DSO Unbundling with Reference to Guidelines of Good Practice on Functional and Informational Unbundling for Distribution System Operators" developed in 2009.

### Organisational structure

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The VIU should define the new organisational structure, taking into account, whether the organization of the previous distribution unit will be maintained or revised and whether new departments (e.g. Legal, IT etc.) will be established. Should restructuring be needed, then this is a very time-consuming task which may involve the co-operation of external consultants and thorough discussions and agreements with labor unions prior to a potential approval by the NRA. In addition, these organisational changes may result to altering numerous documents of the DSO e.g. related to the role and responsibilities per employee etc.

In Greece, due to limited time for the unbundling, an initial organisational structure of the DSO, such as the one that existed in the distribution unit has been selected, adding only the necessary departments (accounting, IT, HR). Nevertheless up to now, the organisational structure of the DSO has changed several times, trying to find the appropriate one in its new role and standing as an independent company.

### Shared services and personnel

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Usually due to perceived economies of scale, DSOs request that they use shared services and personnel with the integrated undertaking. This issue is intensive since the DSO shall draft the SLAs, shall make improvements regarding the provision of common services and personnel and monitoring related expenses by the DSO as well as define/ adopt a procedure for receiving from the market or providing this services to the market under same conditions.

In Greece, the Law forced the DSO to be totally independent as is also the spirit and the letter of the Directive . A five-year period was granted in order for IT, Health & Safety, and Legal services to be established within the DSO, giving the time necessary for the DSO to develop its own capabilities on these sectors. A problem arose because there was a law preventing the hiring of new employees by state owned companies, so it wasn't possible for the DSO to cover these activities by itself. An extension was given for another three years after approval by the NRA.

## IT separation

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IT separation is a major concern for DSOs. In Greece, the IT separation was not included in the 1<sup>st</sup> stage of compliance prior to the legal unbundling of the DSO. The IT separation was included in the DSOs' Compliance Programme and lasted for over four (4) years.

## Premises separation

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The separation of premises is also a time-consuming task. In Greece, the separation of the premises was done in two stages. During the first stage, before the unbundling, most central offices, other than technical and customer service branches have been separated. The branding was implemented through a tender by the DSO. The separation of the rest was included in the DSO's Compliance Programme. It took 5 years to complete up to 95% of the branch's separation all over the country.

## External communication

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DSOs should establish a separate communication policy and provide consumers with sufficient information on the different roles of the DSO and of the competitive parts of the integrated company. This is usually a last neglected step for DSOs which is deemed important for market liberalization. In addition, in order to achieve non-integrated behaviour (i.e. different person responsible for supply and distribution).

It takes time for the consumers to understand this separation, especially if the call centres have not been separated (different number) before the campaign and the consumers call the same number for network and supply issues. It is recommended that the call centres and branches of service be separated before the campaign starts. Branding completion could also help.

## Transferring assets process

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Transferring the assets is a heavy accounting and legal process with plenty of notarial acts.

## Maturity of regulatory framework

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A series of regulatory aspects shall be developed, that may have existed as internal procedures and that must be modified and approved by the NRA and published. Such examples are:

- Network Codes

- New types of contracts for Consumers, prosumers, EV stations and RES producers, separated from commercial terms.
- Terms of connection for consumers and producers
- Quality of service (Guarantee standards)

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