COUNCIL OF THE EUROPEAN UNION

Brussels, 25 February 2008

Interinstitutional Files:
2007/0195 (COD)
2007/0196 (COD)
2007/0197 (COD)
2007/0198 (COD)
2007/0199 (COD)

6324/1/08 REV 1

ENER 44
CODEC 181

NOTE

from :	Presidency
to :	Delegations
No Cion. props.	13043/07 ENER 221 CODEC 948 13045/07 ENER 222 CODEC 949 13046/07 ENER 223 CODEC 950 13048/07 ENER 224 CODEC 951 13049/07 ENER 225 CODEC 952
Subject :	**TTE (ENERGY) COUNCIL ON 28 FEBRUARY 2008** a) Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity b) Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC concerning common rules for the internal market in natural gas c) Proposal for a Regulation of the European Parliament and of the Council establishing an Agency for the Cooperation of Energy Regulators d) Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1228/03 on conditions for access to the network for cross-border exchanges in electricity e) Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1775/05 on conditions for access to the natural gas transmission networks - Policy debate

I. Introduction

1. Building on the progress report endorsed at the December TTE Council the Presidency intensified the work on the 3rd internal energy market package, focusing on the Electricity sector and the Agency, with a view to transferring to the gas legislative instruments the solutions found for the Electricity sector, where relevant. Parallel to the detailed discussions and drafting work conducted by the Working Party on Energy, the Presidency held a series of consultations with delegations on the main issues identified in the progress report.

2. After summarising the main concerns expressed in relation to key elements of the package examined so far (section II), this Note outlines (section III) what could be, in the Presidency's view, the elements to retain in an overall compromise, on the basis of which fully drafted texts could be developed in time for the June (TTE) Council.

II. Main concerns [1]

3. The positions expressed on the main elements of the Electricity Directive and Regulation for an Agency could be summarised as set out below; while the Commission has been constructively engaged in discussions it maintains reservations on the changes that were suggested to its proposals:

   a. effective separation (art. 8):

   Although a large number of Member States can support the ownership unbundling model proposed by the Commission (subject for some to adequately addressing the issues of minority shareholding and public ownership) eight Member States tabled, on 29 January, an alternative (Effective and Efficient Unbundling - EEU) to achieve the effective separation of activities [2] and provided clarifications in response to questions on this alternative. Other Member States and the Commission have confirmed their willingness to explore this alternative. Some of them and the Commission have however

[1] Unless otherwise indicated article numbers refer to the latest draft of the Directive on Electricity (doc. 16613/2/07).

[2] This alternative, designed for both the gas and electricity sectors, is based on two pillars, one related to the organisation and governance of the undertaking and related to the assets, staff, financial resources and identity of the TSO, and the other related to grid investments, market integration and connection of new power plants.

noted that, in any event, it should adequately remove potential conflict of interest within the vertically integrated undertaking, ensure a fair, efficient and transparent operation of the grid and remove disincentive to invest. At the present stage several delegations and the Commission remain doubtful about the possibility for this alternative to achieve what was requested by the European Council and whether the 3rd package would achieve real progress with this alternative. Besides what is foreseen in this alternative model and full implementation of existing requirements various suggestions were made regarding the role of the regulator concerning the implementation and financing of transmission investment, the organisation of regional markets and additional safeguards to ensure the effective independence of the TSOs

b. minority shareholding:

Several delegations believe that minority shareholding of supply/generation undertakings in the TSO should be allowed, under certain conditions, as long as this does not entail significant influence and conflict of interest. This issue is of particular concern to one delegation which considers that, even without decisive influence, the minority shareholder should not be deprived of all the rights attached to its shares (e.g. voting rights, appointments).

c. public ownership:

Although the proposals were designed to be neutral regarding the nature (public or private) of the ownership of the undertakings concerned, several delegations felt, in relation with the issue of ownership unbundling, that the possibility to achieve ownership unbundling with two separate public bodies should be clearly recognised in the operative part of the Directive, not simply in its preamble.

d. third country clause (art. 8a):

While this clause is of crucial importance to a few delegations, concerns were raised in relation to the negative signal the clause, especially with its current wording, could give to investors, to the nature of the agreements envisaged by the Commission to enable control by third country undertakings and to the criteria (such as non-discrimination, protection of investors, reciprocity) that the countries concerned should fulfil, and to the applicability of this provision to existing investments. Following preliminary explanations, further clarifications on these issues are awaited from the Commission before delegations can take a final stand.

e. Certification/designation of TSOs, including ISOs (art. 8b and 10):

Apart from those supporting the third alternative, which do not support provisions on certification/designation, the certification procedure is generally welcome although several delegations stressed that the final decision (on the certification that undertakings comply with full unbundling or ISO requirements and may be designated as TSO or ISO) should be left to the national level and that arguments presented during the national phase of the procedure should be taken into account when the Commission steps in and, in the case of ISOs, designates it; as noted by two delegations the procedure should not imply that Member States favouring ownership unbundling have to accept ISO permanently. Besides, the more demanding ISO procedure is still a problem for a few delegations as they consider that the designation of the ISO should remain a national competence, with the Commission having at best an advisory role.

f. derogations:

Derogations notably from unbundling requirements are allowed by the current Gas and Electricity Directives for small and isolated markets. The continuation of such derogations has been explicitly requested by CY/LU/MT on the basis of their market size, geographical characteristics or on proportionality grounds. Other, possibly transitional derogations could be envisaged by Member States that are not (yet) connected to the main part of the internal energy market.

g. investment planning:

Delegations generally acknowledged the need for consistency between national investment plans and long-term plan at EU level and that regulators may have to be involved. It remains however important to stress the non-binding nature of the EU ten-year investment plan; the extent of the regulators' involvement varies from *ex post* monitoring to *ex ante* approval, largely reflecting divergences in national systems.

h. regulatory powers/duties:

Some of the duties or powers envisaged for national regulators are still causing concern as certain delegations would rather see them exerted by other national authorities (e.g. art. 22c para. 1(l) [compliance of supply tariffs with art. 3], para. 1(m) [access to consumer data], para. 1(n) [rules for TSOs/DSOs, suppliers and customers], para. 1(o) [security of supply], para. 5 [fixing tariffs] or clarified e.g. para. 3(b) [measures to promote effective competition], para. 7 [referral of complaints] or para. 13 [body of appeal]). In any event the possibility for national regulators to cooperate with these other authorities should be preserved. The reference to the Agency and/or Commission in relation to these duties is seen by some as undermining the independence of regulators.

i. multiple regulators:

The designation of a single regulatory authority to carry out the various tasks foreseen (e.g. under Art. 22c) runs counter the internal organisation in certain Member States where, because of the federal/regional or geographical organisation of regulatory competences, several regulators are acting.

j. handling of cross-border cases [regulatory regime / exemptions for infrastructure]:

A number of delegations are concerned with the role given to the European level (Agency) for what they see as falling primarily under national competence, even though these provisions concern cases of a cross-border nature.

k. Comitology procedure for the adoption of guidelines:

Most delegations are of the view that, even if made optional, the use of comitology should be significantly streamlined, duly justified and with a clearly limited scope. Several articles such as art. 3 (public service obligations), 15 (unbundling of distribution system operators) and 22c (tasks of regulators) were noted as not justifying the adoption of guidelines.

l. compliance with guidelines adopted by comitology (art. 22e):

Some concerns were expressed as to the potentially very broad scope of this provision, its impact on the independence of regulators and the role of the Agency in this respect.

m. the Agency

- **principle:** three delegations still maintain reservations on the establishment of the proposed Agency as certain matters (e.g. exemptions) are too political for being left to supranational level; this body would have no added value compared to existing cooperation mechanisms and could undermine regulators independence
- **tasks**: should be focused on issues involving more than one Member State as far as the adoption of binding decisions is concerned; mixed-views were expressed as to the Agency possible involvement in technical matters (codes); several delegations stressed that certain issues (e.g. certification, exemptions) should be left to decisions at the national levels, the Agency being limited to an advisory role only. Others were pleading for a more powerful Agency, including on technical matters, with a refocusing of its tasks on the supervision of TSOs. A number of delegations could support the role of the Agency as decision-maker of first instance for issues such as new interconnections.
- **internal balance of powers:**
  - delegations generally support a strong, independent Regulatory Board, with the Director acting in accordance with its guidance; the principle of equal weight of national regulators has wide support.
  - most delegations were of the view that the composition of the Administrative Board should be more favourable to the Council and that it could comprise a rather small number of members, with some mechanism to ensure adequate participation of all Member States over time.

III. Towards a workable compromise

4. In light of the above views as well as recent views expressed in the European Parliament, without prejudice to further drafting and clarification and bearing in mind the orientations set out by the 2007 Spring European Council for the gas and electricity internal market (paragraph 1 of Annex I to the Presidency conclusions), the Presidency considers that a workable compromise would have to comprise the elements listed below[1]. It should be stressed that these elements constitute one single framework:

[1] Unless otherwise indicated the content of these elements refer to the latest draft of the Directive on Electricity (doc. 16613/2/07)

a. effective separation:

While the ownership unbundling and the ISO options are the preferred ones it seems worthwhile to include for consideration the options that can be used to achieve the effective separation of activities provisions based on the third alternative, complemented by a number of additional safeguards that would need to be implemented to ensure the structural independence of decision making of the TSO, so that no conflict of interest can arise and that, in practice, it is operated as a truly independent company. The third alternative would be an option for Member States where the transmission system belongs to a vertically integrated undertaking on entry into force of the Directive. It is recalled that the Commission, on 19 February, tabled a non-paper outlining essential elements that, in the Commission's view, must be applied in any alternative to ownership unbundling [1].

b. minority shareholding [2]:

The principle of minority shareholding of producer/supplier in TSO should be retained as long as this does not entail significant influence and cannot lead to conflict of interest, along the lines of the current art. 8.

c. public ownership:

A provision (such as art. 8(5a)) should explicitly recognise that two distinct public bodies can be considered as two persons for the purpose of implementing ownership unbundling.

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[1] This non-paper is structured along the following prerequisites:

- Effective unbundling must cover both gas and electricity.
- The TSOs must be truly independent as regards investment decisions and management of the grid.
- The possibility for the national regulatory authority to require the TSO to decide on and implement investments in the network should be clearly stated, as well as the possibility for it to act on behalf of interested third parties. In the case of cross-border investments, a proper role should be defined for the Agency.
- Regional cooperation needs to operate effectively, despite vertical integration of some TSOs, to offset the inherent resistance to cross-border activity and to allow the gradual development of regional TSOs which are independent of vertically integrated national TSOs.
- There must be no reversal of existing requirements set out in the acquis.

[2] The Commission maintains reservations on any modification that would weaken the substance of ownership unbundling.

d. third country clause:

The political importance of addressing this issue in a balanced, non-protectionist way should be recognised as long as limitations to TSO control by companies from third countries do not discriminate against these companies and exist to guarantee that these companies respect the same rules that apply to EU undertakings. This clause should be relevant for undertakings operating under any of the options, in one shape or another.

e. certification/designation of TSOs, including ISOs:

The procedure as outlined in art. 8b should be retained as long as the final (formal) decision is left to national level and arguments presented during the national phase of the procedure are taken into account when the Commission steps in. Regarding the designation of ISO (art. 10), it could be clarified that as the procedure only allows for the temporary designation of an ISO, it does not imply that Member States favouring ownership unbundling have to accept a permanent ISO . For the designation of the ISO it might be useful to distinguish between the substance of the decision, where the Commission is involved after a first step at national level, and its formalisation, by the national authorities concerned.

f. derogations:

Derogations for small and isolated systems should be confirmed, with nominative derogations for CY/MT and a similar derogation for LU; the corresponding provisions could possibly be amended to reflect the temporary situation of (Baltic) Member States for which the lack of connections would justify transitional derogations upon request and following the Commission's assessment.

g. investment planning:

The non-binding nature of the European-wide ten-year network investment plan should be stated; national regulators should *ex ante* review and (*ex post*) monitor TSOs investment plans and assess their consistency with the European-wide ten-year plan.

h. regional cooperation:

The importance of this level of cooperation should be acknowledged, with a flexible definition of the geographical scope of the cooperation. Due account of the outcome of this cooperation should be taken, notably in relation with the tasks conferred upon the Agency. Regional cooperation should be reinforced to ensure that it is effective for the TSOs operating under any of the options.

i. regulatory objectives/powers/duties: [1]

In the pursuit of general objectives focusing on the efficient functioning of a secure, competitive and environmentally sustainable internal market (art. 22b) regulators should carry out the comprehensive series of duties and be granted the powers, stated in art. 22c. When carrying out these duties regulators should have the possibility to act, where relevant, in close cooperation with other authorities, such as competition ones, while preserving their independence. They should not duplicate tasks (e.g. monitoring) usually carried out by other authorities as long as they have access to the information collected by these authorities.

j. multiple regulators:

A formulation (in art. 22b) is being developed that will clarify that the principle of a single regulator at national level combined with unique representation (e.g. at the Agency) is compatible with the current existence in some Member States of regulators at regional/federate level or for small and isolated parts of the territory.

[1] The Commission maintains reservations on any modification of its proposal that would weaken the independence or the powers of the regulators.

k. handling of cross-border cases (regulatory regime, exemptions for interconnectors):

Regarding the regulatory regime for cross-border infrastructure the main components of this regime should be identified in the Directive. The proposed Agency should only intervene as a last resort after attempts to solve the issue between the national authorities concerned or when they so decide. While bearing in mind the benefits of a one-stop-shop approach the same approach could be considered when exemptions are to be granted to new interconnectors. Where appropriate it might be useful to distinguish between the substance of the decision, prepared by the Agency, and its formalisation, by the national authorities concerned.

l. comitology: [1]

Adopting guidelines by comitology should be an option. The number of articles where this procedure may apply should be reduced and what is left duly justified; it does not seem necessary for the implementation of the Directive to retain this procedure for art. 3 [public service obligations], art. 15 [unbundling of DSOs] and art. 22c [duties/powers of regulators].

m. compliance of regulators with guidelines adopted by comitology:

The scope of art. 22e should be more focused, on cross-border and related issues as well as issues of direct interest (no cases raised for academic reasons) to regulators challenging another regulator's decision.

n. Market functioning:

The Directive should include provisions regarding extended record keeping (supply undertakings need to keep at the disposal of regulators the relevant data relating to transactions in supply contracts and gas/electricity derivatives) and regarding consumers' rights (guaranteeing that customers are properly informed on their energy consumption and costs frequently enough to regulate their electricity consumption, give them the right to change supplier at any time and require energy companies that bills are sent within three months after a consumer switches supplier).

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[1] The Commission maintains reservations on any suppression of the possibility to adopt guidelines under comitology.

o. The Agency [1]

- **principle:** a regulatory Agency, independent from the Member States and the Commission, with well circumscribed tasks, has a useful role to play.
- **tasks**: the Agency shall focus on issues involving more than one Member State as far as binding decision-making is **concerned**; its involvement in technical matters (codes) should be of an advisory nature; it should generally allow for the national levels to play their parts (e.g. two-step approach for defining regulatory regimes and proposing ISOs). In all these tasks market participants and authorities at national level should be consulted and due account taken of the outcomes of regional cooperation between TSOs and between regulators.

Internal balance of powers:

- a strong Regulatory Board, comprised of representatives of the national regulators, with decision-making rules giving them equal weight and a Director of the Agency acting in accordance with the Regulatory Board
- the Administrative Board should be lean and efficient with 12 members or less, most of them being appointed by the Council and the rest by the Commission, with partial rotation ensuring adequate participation of Member States over time

- **Transparency**: with a view to improving democratic control transparency provisions need to be significantly strengthened, e.g. on the interests of Boards members.
- **Review clause:** given the novelty of the Agency and the transition period that will be experienced by the energy market during the implementation of the new legislative framework, a review mechanism, with strong input from the Regulatory Board, is desirable.

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5. The Council is invited to assess the viability of the framework suggested by the Presidency as outlined in section III, allowing then the rapid completion of drafting work in time for the June TTE Council.

It is expected that the Council will focus its discussion on the principles underlying options that could be retained in the Directive to ensure the effective separation of transmission activities from generation/supply activities, in line with the orientations set by the 2007 Spring European Council, without prejudice to other concerns of particular importance to one or the other delegations.

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[1] The Commission maintains reservations on any modification of its proposal that would weaken the Agency or modify its governance (including the representation of the Commission).