

THE APPROVED 3RD ENERGY PACKAGE

FINAL CHANGES OR ANOTHER STEP?

“Unbundling” is now a familiar term to most in energy sector related markets and services. We are not at a time where the discussion of its definition is meaningful. We are at a time where its implementation might bring changes to our everyday life in the near future.

The European Parliament and the EU Commission have adopted the 3rd Energy Package (3EP) enacted on 13 July 2009 and composed of (i) Directive 2009/72/EC, on the community rules for the internal electricity market and repealing Directive 2003/54/EC (the “Electricity Directive” or “ED”), (ii) Regulation EC No 714/2009 on the conditions of grid access for cross-border electricity trade and repealing Regulation EC No 1228/2003, (iii) Directive 2009/73/EC on the community rules for the natural gas (NG) internal market and repealing Directive 2003/55/EC (the “NG Directive” or “NGD”), (iv) Regulation EC No 715/2009 on the conditions of access to the NG transmission grid and repealing Regulation EC No 1775/2005 and, finally, (v) Regulation EC no. 713/2009 setting up the Agency for Cooperation of Energy Regulators.

Based on the evolution of discussions since this issue was first raised and the adoption of a lighter version with the enactment of the 2003 2nd Energy Package, one might already have assumed that the unbundling policy is at the core of the structural modifications, being a means to an end, that end being a fully operational single Internal Energy Market in the EU (IEM) through

the eradication of conflicts of interest characteristic of vertically integrated companies, causing discriminatory practices and market distortions.

The 2003 2nd Energy Package had already established legal and accountancy unbundling with ownership unbundling being an option for Member States. However, years passed and analysis of the European regional and national markets (some of which have introduced ownership unbundling of their own free will) led to a certainty that a great deal had to change for the IEM to become a reality.

Vertical integration and monopolies have long delayed the establishment of fair competition and some argue that the result is the lack of investment in infrastructure and the continuing situation of tight markets allowing no opportunities to new entrants.

It is further argued that ownership unbundling or one of the other two alternative separation policies are a path to reducing consumer prices, ensuring security of supply and fencing out interference from non-EU members. It is also argued that it protects countries pursuing a more liberalised unbundling policy against those preserving vertical integration or an ambiguous form of the same. The independent character of national regulators plays a primary role in achieving these aims by means of their regulatory powers, supervisory functions and the certification of undertakings.

“Portuguese Law Firm of the Year”

Chambers Europe Excellence 2009, IFLR Awards 2006 & Who’s Who legal Awards 2006, 2008, 2009

“Corporate Law Firm of the Year - Southern Europe”

ACQ Finance Magazine, 2009

“Best Portuguese Law Firm for Client Service”

Clients Choice Award - International Law Office, 2008

“Best Portuguese Tax Firm of the Year”

International Tax Review - Tax Awards 2006, 2008

Mind Leaders Awards™

Human Resources Suppliers 2007

THE APPROVED 3RD ENERGY PACKAGE

Reference to existing vertically integrated companies is not an error; this 3rd Energy Package still allows the long-opposed and controversial vertically integrated companies to exist and operate within the sector. Currently, Member States may choose one of 3 types of separation and control. The following measures are to be applied to market players who own or control generation and/or supply companies and the final objective is for transmission activities to be separated/independent from any of the aforementioned players, thus providing a break in the ownership chain within the energy sector:

- full ownership unbundling – no participation in transmission activities/operations by players involved in generation and/or supply;

- Independent System Operator (ISO) - discussed for a long time and inserted in previous draft Directives;

- Independent Transmission Operator (ITO) - the third way, a variation on the proposal supported by France and Germany, with a heavy regulatory burden to be complied with.

What do these options mean to market players? What are the results of applying each of them?

On this matter, we have consulted a comparative analysis by Vattenfall, a well-known Swedish energy utility group, applying the ED and NGD legal provisions to the market¹ as a whole with the result that:

(i) **ownership unbundling** requires a complete separation of generation and supply activities from transmission activities (grid and grid operators); Member States having to ensure that specific measures on ownership and control of activities/system/system operator are to be in place as of 3 March 2012².

Member States that had a vertically integrated transmission grid by 3 September 2009 and legal provisions guaranteeing a stronger effective independence of the respective grid operator when compared to the ones provided for in the directives, may decide not to apply the measures referred to in (i).

(ii) the **ISO³ body option** ensures independence as to the legal status of the transmission company, its organisation and decision making-powers; the ISO, a body designated by the Member State and outside the vertically integrated undertaking, assumes the technical operation of the system and the capacity management and has full control over investments and maintenance. The Transmission System Operator responsibilities are thus ensured by the ISO.

In this case, the owner of the transmission activity and of its assets may be a vertically integrated undertaking complying with specific cooperation measures. The ISO staff shall not also be staff of the owning undertaking, the latter having the obligation to fund investments pursuant to the ISO's decisions.

(iii) The **ITO⁴** "third way" was not approved in the terms proposed initially. As in the ISO, the owner of the transmission activity may be a vertically integrated parent company, receiving 50% plus one vote on the supervisory board; the transfer of managers/directors between these companies is limited. A waiting period of several years has to be observed.

Another main difference when comparing the ITO to the ISO model is that, in the ITO, the parent company or group shall maintain some influence over investments, but plans (especially the 10-year mandatory plan provided for, which is to be submitted for approval by the national regulatory authorities) are subject to approval. The ITO shall have a Supervisory body composed of energy company representatives,

third party share-holders and representatives of transmission system operator and a compliance programme shall be set out and a compliance officer shall monitor the implementation of the said programme.

As regards distribution activities, distribution system operators are to be unbundled at least in terms of their legal status, organisation and decision-making, but no ownership unbundling being mandatory.

Unbundling may act as a natural incentive for investment in infrastructure to take place and so enhance security of supply and eventually lead to a solution for most of the above-identified vectors, which together cause the adoption of unbundling. However, it may lead to disadvantages such as eventual horizontal integration and diversion of the basis of existing economies of scale used by vertically integrated undertakings. This may result in an increase in the cost of capital⁵.

Arguments against ownership although valid, do not diminish the validity of the argument for the implementation of such policy as a measure leading to competition in wholesale and retail markets, the guaranteed establishment of third-party access and the implementation of more effective market competition helped by data confidentiality rules. Another argument in favour is the long-awaited opening up of regions to activities through the evolution of interconnection and cross-border transmission operators that may be created under the policy.

The EU Member States deciding to follow the ownership unbundling way are placing their trust in (i) the EU Competition Commission's ability to

¹ Vattenfall - German grids, Background Information for the Press, n.d, available at http://www.vattenfall.com/germangrid/downloads/OU_ISO_ITO_en.pdf, accessed on September 8, 2009.

² Please refer to art.s 9 of both the ED and the NGD.

³ Art.s 13 et seq. of ED ad 14 et seq. of NGD.

⁴ Art.s 17 et Seq. of ED and NGD.

⁵ Saule Milciuviene and Agne Tikniete, *The Ownership Unbundling of Electricity Transmission System Operators: the European Union Policy and the Case in Lithuania*, Paper in ISSN 1392-2785 Inzinerine Ekonomika-Engineering Economics (2), 2009, available at <http://internet.ktu.lt/lt/mokslas/zurnalai/inzeka/62/1392-2758-2009-2-62-82.pdf>, 8, referring Pollit, Michael Gerald, The arguments for and against ownership unbundling of energy transmission networks Energy Policy, 2008, (36), 704-713.

Whether or not this energy package is the last one, there is no doubt that it sets out a course of action which, if or when followed by the Member States, will lead to an integrated EU energy market.

supervise concentrations, markets and regulatory matters, (ii) the long-discussed "Gazprom clause" incentivising non-EU members to fully unbundle so as to be able to invest in European energy markets and ensuring that the EU enters into an agreement with the respective third-party state of origin, ensuring reciprocity and more security of supply. All will depend on the Member States' policies to be monitored at many levels and reported back to EU bodies for supervision.

Consumers rights are also contemplated by this 3EP in the hope that liberalised markets will bring (i) energy costs down, (ii) a guarantee that consumers may change NG and electricity suppliers more quickly and free of charge with associated billing obligations to be fulfilled in a timely manner by former suppliers, (iii) a system for compensation to be provided where the required quality of service is not met, (iv) universal service guarantee for electricity, and (v) protection to vulnerable consumers with Member States being required to address energy poverty by means of implementation of National Action Plans or benefits in social security systems⁶.

The ED and NGD shall be transposed by member States by 3 March 2011, except for provisions related to the certification of third countries which are to be implemented by 3 March 2013.

This package does, however, provide for exceptions to it and makes allowances for differences between the structures and limitations of the Member States' differing energy markets. The ITO option may become popular during the economic crisis as investment is hindered at this time and assets would be valued in accordance with investors' limited financial capacity and tighter credit conditions. Portugal is one of the countries that has already implemented ownership unbundling and may thus gain from this head start which allows it to "concentrate on the development of the market rather than [on] the inward focus of having to [implement the ITO model]⁷".

Whether or not this energy package is the last one, there is no doubt that it sets out a course of action which, if or when followed by the Member States, will lead to an integrated EU energy market.

⁶ ED, "Whereas", para. 53, NGD "Whereas" para. 50

⁷ Groenendijk, *Unbundling under the Third Energy Package paper*, University of Utrecht, EU Energy Policy Blog, May 17, 2009, available at: <http://www.energypolicyblog.com/?p=701>, last visited on September 9, 2009.

This Informative Note is intended for general distribution to clients and colleagues and the information contained herein is provided as a general and abstract overview. It should not be used as a basis on which to make decisions and professional legal advice should be sought for specific cases. The contents of this Informative Note may not be reproduced, in whole or in part, without the express consent of the author. If you should require further information on this topic, please contact [Ana Oliveira Rocha-aor@plmj.pt](mailto:Ana.Oliveira.Rocha-aor@plmj.pt).

