

How can the recast Electricity Regulation set strong rules for the new 'EU DSO entity'?

Summary of key recommendations

Article 49:

- The Electricity Regulation must place a **clear obligation on the EU DSO entity to act as an independent body**, in line with the role of DSOs as independent and neutral market facilitators in the energy transition.
- Article 49 should impose a **formal mandate on the EU DSO entity to contribute to the achievement of wider Energy Union targets**, similar to the obligation imposed on ENTSO-E in Article 25(2) of the proposed Electricity Regulation. This would ensure that the day-to-day activities of the new entity are consistent with the objective of completing the internal energy market and attaining the recently agreed climate and energy targets.

Article 50a:

- To guarantee that the EU DSO entity works for the common European interest and does not serve the interests of particular stakeholders, the **meetings of the Board of Directors should be ring-fenced and should not be open to existing DSO associations as proposed under Article 50a(2)(b)**. Existing DSO associations have vested interests in advocating a particular policy orientation, which would be more transparently conveyed through the Strategic Advisory group referred to in Article 50a(2)(f).
- To ensure that the **EU DSO entity gathers a wide range of views** on the challenges and opportunities posed by the energy transition on distribution networks, Article 50a(2)(f) should ensure **adequate and balanced participation of all relevant interested stakeholders** in the Strategic Advisory group, including (designated) representatives of industry and consumers associations, traders, aggregators and environmental organisations.
- The co-legislators should maintain support for voting provisions and rules for the composition of the Board of Directors in Article 50a(2) that will ensure the **EU DSO entity guarantees fair treatment and representation of all member DSOs** – including smaller DSOs – in decision-making.

In its proposed recast Electricity Regulation,¹ the Commission has proposed to create a new EU-level body, the EU DSO entity, to promote coordination and cooperation amongst electricity distribution system operators (DSOs). ClientEarth welcomes this proposal: the creation of an EU DSO entity would provide a key opportunity to ensure a consistent direction of travel for the distribution sector as the energy market moves towards decentralisation, higher shares of renewable energy sources and other clean technologies, digitalisation, and flexibility.

However, to ensure that the benefits of the EU DSO entity are realised and that it does not result in industry capture of the energy transition, the **Electricity Regulation must set strong rules for the good governance of the new entity**.² In particular, the Electricity Regulation shall (i) ensure accountability and adequate supervision of the EU DSO entity; (ii) guarantee the independence of the new body; (iii) place a clear mandate on the new body to contribute to the achievement of energy and climate targets; (iv) ensure that the voices of smaller and independent DSOs are sufficiently represented in the governance of the EU DSO entity.

In their respective amendments to the proposed recast Electricity Regulation,³ both the Council and the European Parliament have strived to address the lack of accountability of the EU DSO entity (*point (i)*) by incorporating language to ensure that the activities of the newly created entity are adequately supervised by the 'Agency for the Cooperation of Energy Regulators' (ACER). Therefore, this aspect is not further discussed in this paper.

However, some other aspects of the Council and European Parliament's positions continue to pose a **risk of undermining the EU DSO entity's independence and representativeness, and the legitimacy of its mandate** (*points (ii) to (iv)*). Below, we highlight key aspects of Articles 49 and 50a of the proposed Electricity Regulation that the forthcoming negotiations between the co-legislators will need to address to minimise these risks.

1 Article 49: Mandate and obligations of the EU DSO entity

1.1 Ensuring independence of the EU DSO entity

The **EU DSO entity should be designed as an independent expert body**, thereby firmly affirming the role of DSOs as independent and neutral market facilitators in the market design legislation.

The Commission's initial proposal for a recast Electricity Regulation did not address the need for the new body to act independently when carrying out its regulated tasks. Therefore, in the absence of any independence requirement, the EU DSO entity would be able to simultaneously

¹ Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), 30.11.2016, COM(2016)861 final.

² Finkler, J (2017). Revisiting the proposal for a new EU DSO entity: the options, (ClientEarth). Available at <https://www.documents.clientearth.org/wp-content/uploads/library/2017-06-22-revisiting-the-proposal-for-a-new-eu-dso-entity-the-options-ce-en.pdf>.

³ See Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast) - General approach (15237/17 COR 1), Council of the European Union, 15.12.2017; Report on the proposal for a regulation of the European Parliament and of the Council on the internal market for electricity (recast) (COM(2016)0861 – C8-0492/2016 – 2016/0379(COD)), European Parliament, 27.02.2018, Committee on Industry, Research and Energy, 27 February 2018.

lobby for its own interests while taking a leading role in drafting regulations (i.e. network codes) and guidelines that will affect its members.

In its proposed amendments to Article 49, the Council has made it clear that the EU DSO should not represent or defend commercial interests, but rather should be operating as an “expert entity working for the common European interest”. However, unlike the European Parliament’s position, the **Council fails to place a formal and unambiguous requirement on the EU DSO entity to act independently** and to prohibit this new entity from promoting the particular interests of any national association, group of, or individual DSOs.

To create greater legal certainty, the aforementioned **position of the Council and of the European Parliament should be integrated** into the final wording of the Electricity Regulation so that it can be ensured that the new entity will act as an independent and neutral actor in the energy transition.

1.2 Mandating the EU DSO entity to contribute towards EU energy and climate objectives

Neither the Council’s and European Parliament’s amendments nor the Commission’s initial proposal for a recast Electricity Regulation would formally require the EU DSO entity to contribute towards climate and energy targets. This is in stark contrast with the approach being taken by the legislators in relation to the ‘European Network of Transmission System Operators for Electricity’ (ENTSO-E) in Article 25(2) of the proposed Electricity Regulation, which would impose such a requirement on ENTSO-E.

The difference in treatment between ENTSO-E and the EU DSO entity does not appear to be objectively justified given that both ENTSO-E and the new EU DSO entity will be entrusted with similar regulated tasks, including a duty to propose to the Commission drafts Union acts (i.e. in the form of network codes) and to develop best practices for the network industry. Both network codes and best practices will represent critical vehicles for creating a single energy market and ensuring that resources such as renewables and demand response are properly embedded into the internal energy market, and that technical rules do not discriminate small and non-conventional market players.

Therefore, the co-legislators **should impose a formal mandate on the EU DSO entity in Article 49 to contribute to the attainment of wider Energy Union targets**. Such a mandate would to ensure that the performance of **its tasks and day-to-day activities is consistent with the objective of completing the internal energy market and reaching the recently agreed climate and energy targets**.

2 Article 50a: Representativeness in the EU DSO entity

2.1 Composition of the Board of Directors - Guaranteeing fair treatment and representation of all DSOs members

Representativeness in the EU DSO is critical to **take account of the broad diversity of DSOs across the EU** and to ensure that smaller and independent DSOs are adequately represented. Promoting a balanced representation of all DSOs is also key to preventing entity-capture by larger DSOs, including alleviating concerns over who decides upon the entity's strategic decisions and guidelines.

In their respective positions on the recast Electricity Regulation, the European Parliament and the Council have proposed to lay down identical overarching requirements to which the EU DSO entity would be subject. One of the main objectives of these requirements is to ensure the internal governance of the new body guarantees fair treatment and representation of all member DSOs – including smaller DSOs.

The co-legislators have also proposed to include, in Article 50a of the proposed Electricity Regulation, more detailed governance-related provisions and safeguards to specify how adequate representation of DSO should be given effect to. These safeguards include, in particular, **explicit voting provisions and rules for the composition of the Board of Directors** that would apply to different categories of DSOs (including smaller and medium-size DSOs).

Such detailed rules are typically not specified in great detail in Union legislative acts. To prevent any excessive rigidity, these requirements are generally left to be interpreted by those developing the more easily adaptable statutes and rules of procedures of new bodies.

Nevertheless, proposing concrete numbers for the composition of the Board of Directors can provide strict direction for implementing the requirements laid down in the Electricity Regulation, thereby guaranteeing effective and full representation of all DSOs.

As such, the position of the Council and European Parliament shows that the co-legislators may be unwilling to accord a blank cheque to the DSOs that will control the pen in drafting the EU DSO entity's statutes and rules of procedures. The Council and European Parliament also seem to be conscious of the risk that the proposed overarching requirements could be interpreted in different manner and result in a less favourable seat allocation for smaller DSOs in the governance of the new entity.

Therefore, we recommend that the co-legislators **maintain support for detailed voting provisions and Board composition rules that will ensure the EU DSO entity speaks on behalf of all DSOs.**

2.2 Regulating external stakeholders' interests

The governance of the EU DSO entity should ensure that the influence of national and European lobbies is minimised to guarantee the independence of the new body and avoid inefficiencies in decision-making.

However, there are concerns that some of the provisions proposed by the Council and the European Parliament in **Article 50a may bring into question the independence of the EU DSO entity** and lead to the disproportionate representation of certain vested interests.

Article 50a(2)(f): Ensuring balanced stakeholder representation in the Strategic Advisory group

Under the proposed Article 50a(2)(f), both the Council and the European Parliament suggest to create a Strategic Advisory group, which would provide opinions to the EU DSO entity's Board of Directors and the Expert Groups. The Strategic Advisory group would consist of representatives of European DSO associations and representatives of those Member States, which are not represented in the Board of Directors.

The Strategic Advisory group could offer a **useful platform for collecting a wider range of views** on the myriad of challenges and opportunities, which the energy transition will pose on distribution networks. However, for the purpose of collecting these views, participation in the Strategic Advisory group should not be strictly limited to the above-mentioned stakeholders.

Rather, Article 50a(2)(f) should be worded in a more flexible manner to ensure **a balanced representation of all interested parties in the Strategic Advisory group**, including through designated representatives of certain stakeholder groups. Similar to ENTSO-E's Advisory Council, the EU DSO entity's Strategic Advisory group could be open to the proportional participation of representatives of industry associations, traders, aggregators, consumers associations, and environmental organisations.

50a(2)(b): Preventing lobbies from interfering with the work of the Board of Directors

Article 50a(2)(b) would allow "representatives of existing DSO associations [to] participate as observers to the meetings of the Board of Directors", and presents a **risk that lobbies will operate beyond the Strategic Advisory group** to influence the work of the Board.

To guarantee that the EU DSO entity works for the common European interest and that the Board of Directors does not serve the interests of particular stakeholders, Article 50a(2)(b) should not be supported.

Instead, there should be a strict differentiation between the membership of the Board of Directors and of the Strategic Advisory group. **Membership of and attendance to the meetings of the Board of Directors should be strictly ring-fenced and limited to members of the EU DSO entity.** Equally, the private interests existing DSO associations have in advocating a particular policy orientation should be conveyed in a transparent manner through the Strategic Advisory group referred to in Article 50a(2)(f).