

# Revisiting the proposal for a new EU DSO entity: the options

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One of the main novelties of the proposed Recast Electricity Regulation<sup>1</sup> is the creation of a new EU-level entity for distribution system operators (DSOs). In a previous paper,<sup>2</sup> ClientEarth outlined the main characteristics of the EU DSO entity (EU DSO) as well as the potential risks of creating such a new body along the lines of the Commission's proposal. This briefing builds on this previous paper and presents options for revisiting the Commission's proposal.

## Background to the Commission's proposal for a new EU DSO

With the ongoing decentralisation trend, DSOs are likely to move away from their traditionally passive roles. In particular, they are likely to be called upon to take on new roles in operating the European electricity system in a more flexible, smart, and efficient manner and in promoting the completion and smooth functioning of the internal energy market (IEM). The creation of a new EU DSO provides an opportunity to bring DSOs together at EU level to work on issues that affect distribution networks and to enhance cooperation with transmission system operators (TSOs) on planning and operation of their power networks, including EU level infrastructure planning. Such cooperation is all the more important as DSOs' impacts on transmission networks is likely to increase.

In addition, the creation of a EU DSO presents an opportunity to promote transparency on DSOs' activities (e.g. in how grid fees for consumers and producers are designed) and to ensure a consistent direction of travel for the further deployment and integration of renewables, the growth of demand response, decisions on grid tariffs and connection charges for prosumers, and customer data protection and privacy.

As currently proposed, the EU DSO would be a membership-based body composed of DSOs from across the EU. Its tasks would include, *inter alia*, the following:

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

<sup>2</sup> ClientEarth (2016): The proposed EU DSO entity: what is it and what's at stake? Available at: <http://www.documents.clientearth.org/wp-content/uploads/library/2016-12-12-the-proposed-eu-dso-entity-what-is-it-and-what039s-at-stake-ce-en.pdf>

- Responsibility for developing and submitting proposals for EU Network Codes (NCs) that the Commission determines are mainly related to distribution networks;
- Participating in NCs' 'drafting committees' or convening these committees on areas which concern DSOs;
- Monitoring the implementation of NCs on areas which concern DSOs, along with the European Network of Transmission System Operators for Electricity (ENTSO-E);
- Cooperating with ENTSO-E on issues of mutual concern, such as coordinated operation and planning of transmission and distribution networks data management, balancing, planning, congestion, etc.
- Identifying best practices on areas such as integration of renewables, deployment of smart grids, demand response, digitalisation, and cybersecurity etc.

An EU DSO with these powers would have a significant impact on the integration or curtailment of renewables, demand response, storage, electric vehicles (EVs), etc at distribution level, the deployment of smart grids, and on the rules on how different market actors can provide non-frequency ancillary services, etc. However, **if badly designed, the proposed EU DSO could be in a privileged position to develop rules that could be disadvantageous to other players in the power market.**

## Is the Commission's proposal problematic?

ClientEarth has previously outlined significant regulatory risks of creating an EU DSO along the lines of the Commission's proposal.<sup>3</sup> The most prominent issues identified are as follows:

### 1. Conflicts of interest in the drafting and monitoring of NCs:

Under the proposed Recast Electricity Regulation, the EU DSO will be in a privileged position to draft NCs, which will govern the DSOs' own conduct, as well as the conduct of other market participants such as generators, suppliers, consumers, and aggregators. In addition, the EU DSO would be in a position to influence the drafting of NCs that may significantly impact the deployment of renewables and demand response, and the ability of prosumers to participate in the market.<sup>4</sup> Given the lack of independence requirements for the EU DSO, this would be problematic because the EU DSO could design **NCs that impose additional barriers to demand response and self-consumption, which not all DSOs are fond of.**

Furthermore, it is unclear who would monitor NCs developed by the EU DSO. Though the Agency for the Cooperation of Energy Regulators (ACER) and national regulators are required to monitor the implementation of NCs, the DSO entity is also given the task to cooperate with ENTSO-E on monitoring the implementation of specific NCs and guidelines pertaining to distribution networks and the coordination between distribution and transmission networks.<sup>5</sup>

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<sup>3</sup>ClientEarth (2016): The proposed EU DSO entity: what is it and what's at stake? Available at: <http://www.documents.clientearth.org/wp-content/uploads/library/2016-12-12-the-proposed-eu-dso-entity-what-is-it-and-what039s-at-stake-ce-en.pdf>

<sup>4</sup> For instance through the draft of potential NCs on distribution tariff structures and connection charges, on the provision of non-frequency ancillary services, or on aggregation, energy storage and demand curtailment among other things.

<sup>5</sup> Proposal for a recast Electricity Regulation, supra note 1, at Article 51(2)(a).

Granting such a responsibility to the EU DSO raises conflict of interest issues as it wouldn't be appropriate for a private industry membership-based organisation to monitor the implementation of NCs that could significantly impact other players in the market, including potential market disruptors and competitors.

## 2. Concerns surrounding unbundling and competition rules

The membership of the EU DSO presupposes that DSOs are not part of a vertically integrated undertaking or that they are unbundled according to the provisions of Article 35 of the Recast Electricity Directive<sup>6</sup>. However, unbundling rules for DSOs under Article 35 are not as strict and far-reaching as for TSOs. In particular, Article 35 allows DSOs to maintain connections to their utility counterparts due the lesser risk (compared to TSOs) of DSOs acting as market participants until now (though the increasing share of distributed resources arguably provides new opportunities for DSOs to engage with the market). This means that **DSOs attached to parent utilities could become members of the EU DSO** and might try to use the entity to exert discriminatory influence. Given the powers ascribed to the EU DSO, there is a risk that members of the EU DSO – and particularly larger DSOs connected to energy suppliers – might try to **develop rules that could disfavour other market players**, and put in place additional barriers to dominate markets for aggregation, storage and EV charging infrastructure.

## 3. Concerns about representativeness of the EU DSO

There is a lack of clarity around the membership composition of the organisation and around whether or not the membership will be mandatory for all DSOs.<sup>7</sup> The fact that not all DSOs may be represented in the EU DSO raises some **concerns about the representativeness of the entity**, particularly as small, less resourced DSOs may have less incentive to apply for membership. This is compounded by the fact that there are no provisions guaranteeing that the membership of the EU DSO will reflect the broad diversity of DSOs among European countries.<sup>8</sup> Yet, **the ability of the EU DSO to speak on behalf of all DSOs and to ensure that smaller or independent DSOs are adequately represented, including in decision-making, is fundamental to its legitimacy**.

In addition, the Commission's proposal does not give any indication about **how the EU DSO will be governed and how decision-making will be made practicable** if all DSOs become members of the entity. Without clear guidelines on this point, the potentially large number of member DSOs<sup>9</sup> could slow down the internal decision-making process and, indirectly, the development of NCs and guidelines.

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6 Proposal for a Directive of the European Parliament and of the Council on common rules for the internal market in electricity (recast), Brussels, 30.11.2016, COM(2016) 864.

7 While Article 49 of the proposed Recast Electricity Regulation mandates DSOs to participate in the EU-DSO entity ("shall cooperate at Union level through a European Entity for Distribution system operators ("EU DSO entity)"), it also provides that "Distribution system operators who wish to participate in the EU DSO entity shall become registered members of the entity", whereby the use of the word "wish" should be interpreted as presupposing that the membership is voluntary.

8 Recital 38 of the proposed Recast Electricity Regulation states that the entity should ensure representativeness among the DSOs. However, recitals are not legally binding.

9 There are approximately 2,750 DSOs across the EU.

#### 4. Insufficient regulatory oversight to ensure the entity does not abuse its position of influence

Under the current proposal, ACER and the Commission will have some role in checking the activities of the EU DSO, in particular the drafting of NCs.<sup>10</sup> However, a set of comprehensive rules to ensure formal regulatory oversight of the EU DSO – both over its establishment and its operation – is missing from the proposal. This lack of formal oversight may exacerbate the likelihood of discriminatory treatment and that DSOs will try to impose additional barriers to the development of demand response.

#### Aim of this briefing

In light of the concerns over the creation of the EU DSO, the proposed framework for the new entity should be revisited to ensure that the entity promotes an efficient functioning of the IEM, ensures non-discrimination and a level playing field for all resources (e.g. demand-side, renewable, etc.), and that it contributes to the achievement of the EU's wider climate and energy objectives and targets.

The aim of this briefing is to discuss and assess four legal options for improving the Commission's proposal concerning the EU DSO. The four options assessed are as follows:

- **Option 1:** Scrapping the Commission's proposal for an EU DSO;
- **Option 2:** Turning the EU DSO into an independent technical advisory group on distribution networks;
- **Option 3:** Embedding strong regulatory safeguards to improve the governance of EU DSO;
- **Option 4:** Limiting the mandate of the EU DSO and transferring tasks presenting conflicts of interest to ACER.

These options have been selected to illustrate different possible scenarios for revising the proposal. In practice, they are not mutually exclusive and could be combined if designed appropriately.

N.B.: This briefing looks exclusively at the proposed rules concerning the EU DSO and the governance of NCs when the subject-matter of the NCs is related to the operation of distribution networks. It does not assess options for improving ENTSO-E's governance and for preventing TSOs from embedding their vested interests into the development of NCs.

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<sup>10</sup> In drafting Network Codes, the DSO entity will need to follow the non-binding framework guidelines issued by ACER, plus certain 'conditions' that may be imposed by the Commission. However, it is unclear what these conditions would be related to or what implications they would have. ACER must also be represented in drafting committees to support the Network Code development process. Furthermore, ACER will amend the Network Code before it submits the final version to the Commission to ensure consistency with the framework guidelines.

# 1 Scrapping the Commission's proposal

One relatively simple option to eliminate the risks of conflicts of interests arising from the creation of a new EU DSO would be to **scrap the Commission's proposal entirely and remove any references to the entity from the proposal.**

This implies that no new entity would be created and that DSOs would not be given a legal mandate to cooperate through a new EU DSO. Instead, DSOs would continue collaborating on a voluntary basis through the existing DSO associations (EDSO, Eurelectric, GEODE, and CEDEC) and have their interests represented by these associations.

Option 1 would have the advantage of not allowing DSOs a leading role in the drafting and monitoring of NCs and guidelines related to distribution issues. This would **significantly reduce the risk of competition being obstructed and discrimination on sensitive issues** (in particular on issues relating to consumers and treatment of distributed energy resources, such as solar PV and demand response).

Nonetheless, this option **raises a number of issues and legal questions** that are considered below.

## 1.1 Lack of common platform to support DSOs cooperation and engage with other stakeholders

Option 1 would be a missed opportunity to create an entity that could ensure a consistent direction of travel for the distribution sector, more specifically by developing best practices and recommendations on how to operate the distribution networks, integrate renewables, demand response, storage, electric vehicles, etc. Equally important, this option would fail to establish an entity that enhances the cooperation between DSOs and improves transparency with respect to their activities.

Scrapping the proposal for an EU DSO would also be a missed opportunity to strengthen cooperation with TSOs/ENTSO-E, in particular with regards to how they operate and plan their networks. Additionally, and although the Commission, ACER, ENTSO-E have considerable in-house expertise in developing NCs, they could still value a more coherent and structured input provided by a formal EU DSO on issues which are relevant to the operation and planning of the distribution networks. Such an input would be even more important as DSOs will be called to play a more active role in the overall management of the electricity system.

## 1.2 Legal questions regarding the responsibility for drafting and monitoring NCs related to distribution networks

If the legislators decide to scrap the EU DSO, amendments would need to be made to provisions which currently allow the EU DSO to submit proposal for NCs, to convene the NCs' 'drafting committees', and to monitor the implementation of NCs.

However, it is unclear who would be assigned the responsibility of drafting and monitoring the implementation of NCs related to distribution networks. There is a strong assumption that this responsibility could fall back on ENTSO-E, as the ‘default stakeholder’, and as presently the case. Under the Third Energy Package, ENTSO-E is responsible for elaborating all NCs in line with ACER’s relevant framework guideline and has already developed NCs that have major impacts on distribution networks (e.g. NCs laying down the requirements for grid connection<sup>11</sup>).

If ENTSO-E retains this responsibility, the risk of conflicts of interest and discrimination would remain. Since many of the NCs have a direct effect on the commercial conditions surrounding the business model of TSOs, giving ENTSO-E a leading role in drafting and implementing the network rules on distribution issues could also contribute to the embedding of bias or vested interests in the development of NCs.

### 1.3 Risks of limited engagement of individual DSOs in NCs’ governance

Even without an EU DSO, it will be important for DSOs to be given formal opportunities to provide (technical) input into NCs’ development. Under Option 1, DSOs would have the opportunity to take part in **public consultation processes at various stages of the NCs’ development**. As such, ACER is required to formally consult relevant stakeholders in regard to framework guidelines for the development of NCs<sup>12</sup> and on the revised version of the NCs to be submitted to the Commission.<sup>13</sup> In a like manner, while preparing NCs, ENTSO-E is required to conduct an extensive consultation process, at an early stage and in an open and transparent manner, involving all relevant stakeholders.<sup>14</sup>

In addition, the proposed Electricity Regulation requires ENTSO-E to **convene a NC ‘drafting committee’** that must include "a limited number of the main affected stakeholders"<sup>15</sup>. Assuming DSOs fall within the definition of “affected stakeholders” – given their increasingly important role in operating the European electricity system – they would have the opportunity to participate in the ‘drafting committees’, either individually or through their existing industry associations. That said, these processes tend to lead to very limited stakeholder participation (beyond large industry representatives and the regulatory community). Experience with the development of NCs has shown that DSOs have had difficulties in formally engaging in their development.

Hence, without a formal representation of DSOs at EU level, it would still be particularly difficult for smaller less-resourced DSOs to participate in these NCs’ ‘drafting committees’ and public consultations. This issue is compounded by the fact that the requirement to include "a limited number of the main affected stakeholders" in drafting committees is unclear and potentially narrowly-tailored, and does not provide assurance that all DSOs will be able to participate, despite the major impact of the NCs on distribution networks.

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11 Commission Regulation (EU) 2016/631 establishing a network code on requirements for grid connection of generators, OJ L 112, 27.4.2016, p 1.

12 Proposal for a recast Electricity Regulation, supra note 1, at Article 55(4).

13 Proposal for a recast Electricity Regulation, supra note 1, at Article 55(10).

14 Proposal for a recast Electricity Regulation, supra note 1, at Article 28.

15 Proposal for a recast Electricity Regulation, supra note 1, at Article 55(9).

## 2 Turning the EU DSO into an independent Consultation Forum on distribution networks

An alternative option to improve the proposal for an EU DSO is to **turn the entity into an independent Consultation Forum on distribution networks**.

This option would remove the obligation on DSOs to establish a new EU DSO, but would require the Commission to form a new Consultation Forum on distribution networks, similar to the Consultation Forum created under the Ecodesign Directive<sup>16</sup>.

The Consultation Forum would not **represent DSOs' interests but act as a platform for discussions** and would involve stakeholders who have an interest in issues related to distribution networks and the operation of the distribution system. DSOs would have their interests represented by existing DSO associations such as EDSO, Eurelectric, GEODE, and CEDEC, and will continue collaborating informally through these associations.

The current provisions concerning the EU DSO would need to be substantially amended to reflect the purpose of this new body, its composition, and the scope of its mandate. Specifically, the Commission's proposal would need to be amended to **limit the remit of the new Consultation Forum to strictly defined advisory functions**. On the basis of a specific mandate, this new Consultation Forum would be required to provide opinions and recommendations involving high-level input from a wide range of stakeholders operating at distribution level, including DSOs but also demand response and storage providers.

The creation of a Consultation Forum on distribution networks would enable a **wide range of stakeholders to engage in discussions** pertaining to distribution issues. Nevertheless, this option contains **many of the same deficiencies as Option 1** (i.e. scrapping the proposal for an EU DSO) because there would still be no formal platform to ensure cooperation between DSOs and other stakeholders.

### 2.1 Participative governance as a key feature of the Consultation Forum

Under Option 2, **new provisions on the creation and composition of the advisory group** would need to be inserted into the Recast Electricity Regulation. In particular, the Recast Electricity Regulation would need to require the Consultation Forum to be composed of stakeholders concerned with issues related to distribution networks and the operation of the distribution system. To ensure that a wide range of stakeholders were involved, there would need to be a requirement to observe a **balanced representation of all interested parties**. For instance, the Electricity Regulation could require the Consultation Forum to be composed – at a minimum – of representatives of DSOs, TSOs, storage providers, aggregators, and consumers.

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<sup>16</sup> Directive 2009/125/EC of the European Parliament and of the Council of 21 October 2009 establishing a framework for the setting of ecodesign requirements for energy-related products (Ecodesign Directive), OJ L 285, 31.10.2009, p 10.

Following the lead of the Consultation Forum under the Ecodesign Directive,<sup>17</sup> the Commission could be empowered to establish, through Decisions, more details on the functioning, the rules of procedure, and the membership of the Forum.

## 2.2 Limited mandate of the Consultation Forum

The current provisions proposed in the Recast Electricity Regulation would need to be significantly amended to reflect the new, purely advisory function of the new body (e.g. by removing references of the entity taking the lead in drafting NCs). More specifically, changes would need to be made to the Recast Electricity Regulation, notably to:

- (i) require ACER, ENTSO-E, the Commission<sup>18</sup> to consult the Consultation Forum when preparing and implementing NCs and guidelines. An analogous requirement exists for the Ecodesign Consultation Forum, whereby it is required to give opinions to the Commission in particular as regards the elaboration of Ecodesign Implementing Regulations and to advise the Commission on questions related to the implementation of the Ecodesign Directive;<sup>19</sup> and,
- (ii) empower the Consultation Forum to develop best practices and formulate recommendations on technical issues and challenges at distribution level.

Compared to the current Commission's proposal, Option 2 would **significantly reduce the risk of self-regulation given the fact that the new Consultation Forum would be purely advisory in nature**. In addition, Option 2 would have the advantage of including a wider range of stakeholders in the Consultation Forum. This would limit the risk that monopolistic energy companies be successful in 'capturing' influence and advancing their interests.

## 2.3 Accountability and oversight of the Consultation Forum

Specific provisions would need to be inserted in the Recast Electricity Regulation to ensure that the **Consultation Forum commits to openness and transparency**, for instance by requiring:

- (iii) the Consultation Forum to publish agendas, meeting minutes and documents, as well as to allow public access to meetings. These requirements could be reflected in the Forum's rules of procedures;
- (iv) the Commission to annually report to the European Parliament and the Council on the work carried out by the Consultation Forum.

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<sup>17</sup> Ecodesign Directive, supra note 18, at Article 18.

<sup>18</sup> The Commission could consult the Consultation Forum before the Commission consults with Member State experts and submits the proposal for scrutiny TO the Council and the European Parliament.

<sup>19</sup> Commission Decision of 30 June 2008 on the Ecodesign Consultation Forum, OJ L 190, 18.7.2008, p. 22.

## 2.4 Lack of formal platform for enhancing cooperation between DSOs and with other stakeholders

**Creating a Consultation Forum instead of a formal EU DSO would create many of the same deficiencies as Option 1.** One of the main shortcomings of this option is the lack of a formal platform facilitating communication and cooperation between DSOs and between DSOs and the Commission, ACER, and ENTSO-E, particularly in the context of NCs and network planning and operation.

As for Option 1, it is unclear, in the absence of an EU DSO, who would assume the responsibility for drafting and monitoring NCs related to the operation of the distribution system. If ENTSO-E takes on this responsibility (as is presently the case under the Third Energy Package) the risk of conflicts of interest and discrimination would not be fully eliminated as its members (the TSOs) may also have a commercial interest in these NCs.

# 3 Embedding strong regulatory safeguards to improve the governance of EU DSO

If a formal EU DSO is created, **additional regulatory safeguards should be incorporated into the Commission's proposal in order to strengthen the governance of the new entity.**

On this model, the Commission's proposal should be revised to **ensure that the EU DSO is well designed and complies with good governance principles**, such as transparency, legitimacy, and accountability. In addition, new arrangement should ensure that the new entity does not abuse its position of influence and that it contributes to the completion of the IEM and the achievement of wider Energy Union objectives and targets.

Enhancing the framework for regulating and monitoring the tasks of the entity is all the more important if the EU DSO retains a pivotal role in proposing NCs and supporting the monitoring thereof. More specifically, enhanced regulatory safeguards are **necessary to prevent conflicts of interest in the NCs' development process** (to prevent, for example, NCs to represent the interests of energy companies with the largest and highest value stake in the distribution system – and not necessarily those aiming to make the grid more efficient).

Below, we describe the **key regulatory safeguards** that are needed to ensure good governance of the entity:

## 3.1 Composition of the EU DSO reflecting the broad diversity of DSOs

More detailed and robust **rules regarding the composition of the EU DSO** are needed to ensure that the entity speaks on behalf of all DSOs. In particular, the language used in Article 49 of the proposed Electricity Regulation should be amended to clarify whether the membership of

the EU DSO is mandatory for all DSOs (regardless of whether they are able to participate directly or indirectly through existing industry associations representing DSOs).

If the membership is not mandatory, the Electricity Regulation should require the EU DSO to promote a **balanced representation of all DSOs** across the EU to ensure that smaller or independent DSOs are adequately represented and to prevent entity-capture by larger DSOs.

Because the concept of balanced representation as a guiding principle remains vague and often most difficult to achieve, this requirement should be supplemented by a definition of various categories of membership. For instance, the Electricity Regulation could require the EU DSO to ensure diverse representation of different DSOs in decision-making based on size, regulatory framework, geography, and ownership.

### 3.2 General objectives of the EU DSO

A new provision should be inserted in the proposed Electricity Regulation to ensure that the technical input provided by the EU DSO, including on the elaboration of NCs, aligns with broader Energy Union objectives. Similar to what has been proposed for ENSTO-E,<sup>20</sup> the **EU DSO should be required to:**

- (v) **act for the European good and to carry out its tasks independent from individual interests of its member DSOs and of national interests;** and
- (vi) **contribute to the achievement of the climate and energy objectives and targets.**

Such a new obligation will be particularly important to prevent the EU DSO from lobbying for the interests of its DSO members while simultaneously taking a leading role in drafting rules that will affect its other market participants and new entrants such as generators, suppliers, consumers, and aggregators.

### 3.3 Stronger oversight over the establishment of the EU DSO

Under Article 50 of the proposed Electricity Regulation, the DSOs must submit the following documents to ACER when establishing the EU DSO: 1) draft statutes, 2) a list of registered members, 3) draft rules of procedure, and 4) financing rules of the EU DSO. Under the proposed provision, ACER provides an opinion to the Commission, which then provides its own opinion. These opinions would however be non-binding. Given that the EU DSO may be granted rule-setting tasks regarding NCs, the **language in this provision should be strengthened to ensure that the process for establishing the new entity is legitimate and sufficiently monitored**, specifically by enhancing the powers of ACER in three respects:

*First*, there should be a requirement on **ACER to define criteria for the elaboration of the draft statutes, the list of registered members, and the draft rules of procedure** with a view to:

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<sup>20</sup> Proposal for a recast Electricity Directive, supra note 1, at Article 25(2).

- (i) protecting the independence of the EU DSO from its members and conformity with unbundling rules, and;
- (ii) guaranteeing a balanced representation as well as equitable treatment of all member DSOs, including in decision-making.

These criteria should also apply to the appointment and participation of members of executive bodies that are created. ACER should be required to formally consult organisations representing all stakeholders on the development of these criteria.

*Second*, to ensure proper oversight of the establishment of the EU DSO, the adoption of the draft statutes, the list of registered members, the draft rules of procedure, and the financing rules should be **conditional upon the favourable opinion of ACER**. Similarly, the Electricity Regulation should enable ACER to amend, where necessary, the draft statutes, the list of registered members, and the draft rules of procedure and financing rules.

*Third*, the Electricity Regulation should provide the **Commission with explicit decision-making** power to approve the draft statutes, the list of registered members, and the draft rules of procedure and financing rules, taking into account the opinion of ACER.

### 3.4 Ensuring accountability of the EU DSO

Given the EU DSO's potentially privileged position in the elaboration and subsequent monitoring of NCs, **ACER should to be significantly empowered to exercise more robust and close oversight of the entity as it carries out its tasks**. Such changes should be reflected in the Recast Electricity Regulation, with cross-references in the proposed Recast ACER Regulation.<sup>21</sup>

In particular, ACER should have the power to monitor the EU DSO to ensure that it complies with the criteria contained in its governing statute, in particular with criteria for maintaining its independence and adequate representation of all DSOs. ACER should have the authority to **formulate opinions or recommendations for violations of rules designed to maintain the independence of the EU DSO from individuals** and/or DSO members. ACER should also have the power to refer such instances of lack of compliance to the Commission.

In addition, ACER should be granted new powers to **monitor the execution of the tasks assigned to the EU DSO**, thus limiting the risk of bias or an abuse of power. These powers should include:

- (i) authority to obtain information upon request from the EU DSO, and correspondingly from DSOs;
- (ii) authority to require the EU DSO to respond to ACER's recommendations and opinions;
- (iii) power to make binding decisions where ACER finds that EU DSO's activities (e.g. its draft annual programme, or implementation of EU Network Codes) do not comply with IEM and other relevant rules or are inconsistent with EU level objectives.

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<sup>21</sup> Proposal for a Regulation of the European Parliament and of the Council establishing a European Union Agency for the Cooperation of Energy Regulators (recast), Brussels, 30.11.2016, COM (2016) 863 final.

ACER should be required to report annually to the Commission on the execution of tasks performed by the EU DSO, including on the avoidance of conflicts of interest (particularly in areas where DSOs have a commercial interest), and to propose measures to enhance the cooperation between DSOs.

Lastly, the proposed Recast Electricity Regulation should **promote public scrutiny over the activities of the EU DSO** and ensure that timely and accurate disclosure is made on all material matters relating to its decision-making and activities, including of meetings and deliberations (e.g. agendas, minutes, and documents), similar to what is currently proposed for ENTSO-E.<sup>22</sup> Where the EU DSO is required to convene an NCs 'drafting committee', it should also be required to provide agendas, minutes and documents produced by the committee in a timely manner. This is important to ensure that the activities of the EU DSO do not result in agreements, concerted practices, or unilateral behaviours incompatible with the principle of undistorted competition.

## 4 Limiting the mandate of the EU DSO and transferring tasks presenting conflicts of interest to ACER

Even where regulatory safeguards are included in the Commission's proposal (Option 3), the risk of the EU DSO – a private industry membership-based organisation – exerting discriminatory influence on the NCs cannot be entirely eliminated. One of the most effective responses to this issue is to **limit the formal tasks of the EU DSO to strictly consultative and representative functions**. Limiting the mandate of the EU DSO aims most importantly at **reducing the risks of potential anti-competitive behaviour** arising from large DSOs attached to parent utilities.

Under this Option, the **EU DSO's responsibilities that present conflicts of interest** – in particular the responsibility to draft and monitor NCs related to distribution networks – **should be transferred to ACER**, as an independent stakeholder acting in the interest of the public. This would provide an opportunity to strengthen the legitimacy and transparency of the NCs' development process.

### 4.1 A narrowly-defined mandate for the EU DSO

Option 4 requires relatively straightforward amendments to the Commission's proposal to strictly limit and define the duties, powers, and obligations of the EU DSO.

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<sup>22</sup> ENTSO- E is required to publish the minutes of its Assembly, Board and Committees meetings and provide the public with regular information on its decision-making and activities. See Proposal for a recast Electricity Regulation, supra note 1, at Article 27(3).

In particular, the mandate of the EU DSO should not include any legislation-setting tasks. Importantly, the EU DSO should not be the main stakeholder responsible for the actual drafting of NCs that relate to distribution issues. Similarly, it should not be required to convene a 'drafting committee' to support the elaboration of NCs and should not have a leading role in monitoring the implementation of NCs. Limiting the EU DSO's mandate would make it less likely that its members would try to exert discriminatory influence (e.g. against demand response and self-consumption) or to transfer risks to other stakeholders within the distribution network.

The EU DSO could still be **granted a formal advisory role** to provide expert input to the Commission, ACER, and ENTSO-E in specific instances, for instance by participating in the NCs' 'drafting committees' as a formal participant (see section 4.2). The EU DSO could also be empowered, at the request of ACER, ENTSO-E, or the Commission, or on its own initiative, to examine problems arising from the implementation of relevant NCs, and to **formulate recommendations** related to the operation of the distribution system.

Under this option, the EU DSO would still be mandated to cooperate with ENTSO-E on necessary planning and operation tasks. It would also be empowered to work and develop best practices to ensure a common direction of travel for DSOs regarding the operation of the distribution network, the integration of renewables, and the development of demand response and smart grids, data management, cyber security, and data protection.

## 4.2 Transferring tasks concerning the development and monitoring of NCs to ACER

As mentioned above, one of the key features of Option 4 is to **transfer tasks concerning the development and monitoring of NCs to ACER**. As such, this option is based on the assumption that it would not be appropriate for the EU DSO and ENTSO-E to have primary responsibility for drafting and monitoring of NCs given the potential for conflicts of interest and self-regulation.

The following **changes to ACER's remit** should be reflected in both the proposed Recast Electricity and ACER Regulations:

- (i) ACER should be ascribed the responsibility to draft and propose any NCs or guidance on issues related to the operation of the distribution system;<sup>23</sup>
- (ii) ACER should be required to convene the NCs' 'drafting committees' mentioned in the proposed Recast Electricity Regulation;
- (iii) There should be clarification that ACER and/or national regulators will monitor the implementation of NCs on issues related to the operation of the distribution system and ensure compliance with their requirements;

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<sup>23</sup> The Commission would have the final say and decision-making power on the NCs given that it assumes the responsibility of translating the proposed NCs into draft legislation. Hence, transferring the tasks of developing and monitoring NCs to ACER would not contravene the Meroni doctrine, which stipulates that it is not possible to delegate power involving a wide margin of discretion, since it transfers responsibility by replacing the choices of the delegator for those of the entity to whom power was delegated. However, it is worth noting that transferring these new tasks to ACER may face political opposition due to Member States' dislike of EU agencies. See Meroni & Co., *Industrie Metallurgiche, SpA v High Authority of the European and Steel Community* (Cases C-9/56 and C-10/56) ECR I-1958 (Meroni), paras 150-152.

- (iv) In order to provide effective oversight of NCs' implementation, ACER should have authority to obtain information upon request from market players.

**Allocating new responsibilities to ACER provides an opportunity to improve the governance of the NCs' development process.** Stronger arrangements should be required for **more participative and transparent governance of the NCs' development process.** Specifically, the following arrangements on stakeholder engagement and transparency should be clarified and improved:

#### **1. Promoting enhanced stakeholder participation in public consultations**

- (i) Provisions on public consultations should be enhanced to require far more robust and broadly-based stakeholder participation – beyond regulatory and large industry representation – and strengthen the traction of independent scrutiny;
- (ii) To reinforce this requirement, ACER should also be required to explain how it takes comments into account, including comments submitted by the EU DSO.

#### **2. Turning the NCs' 'drafting committees' into 'stakeholder committees'**

- (i) Under the current Commission's proposal, the NCs' 'drafting committees' include representatives from ENTSO-E, ACER, the EU DSO, nominated electricity market operators, and "a limited number of the main affected stakeholders". The **conditions or criteria for participation and adequate representation** of a range of "main affected stakeholders" in **drafting committees should be clarified** to ensure that all relevant stakeholders, particularly smaller less-resourced ones, can support the NCs' development process. Such clarification is necessary in order to ensure that the process is not captured by large industry stakeholders;
- (ii) In addition, these **drafting committees should be renamed 'stakeholder committees'** to prevent any misinterpretation regarding their role (i.e. the committees should have a consultative, supporting role but should not 'hold the pen' in the drafting of NCs).

## 5 Summary of key findings

The proposal for an EU DSO could be improved in a number of ways. However, the options of ‘scrapping the Commission’s proposal’ or ‘turning the new entity into a Consultation Forum’ (Options 1 and 2) may not satisfy the need to enhance the institutional framework for DSOs and improve co-operation and communication between DSOs and other stakeholders. Furthermore, the analysis in this paper makes clear that – if created – the EU DSO will need to be properly designed to ensure that it acts impartially, that it contributes to the completion of the IEM and broader EU-level objectives, and that it does not abuse its position of influence. In particular, key regulatory safeguards will need to be incorporated into the Commission’s proposal to strengthen the governance of the new entity (Option 3). The most appropriate response to eliminate the risks of self-regulation and potential conflicts of interest will be to limit the formal tasks of the EU DSO to strictly consultative and representative functions (Option 4). If combined, Options 3 and 4 are most desirable, both in terms of ensuring more formalised coordination between DSOs and with other stakeholders and of limiting the risks of discriminatory practices.

### Key recommendations

Having considered the four options laid out above, we identify **several key principles that should shape the design of the EU DSO**:

1. **Regulatory safeguards should be in place** to ensure equitable treatment of all member DSOs. Most importantly, the EU DSO's status and rules of procedure should ensure that **smaller or independent DSOs are adequately represented**, including in decision-making;
2. Provisions should be inserted in the proposed Recast Electricity Regulation to ensure the **independence of the EU DSO and to require that it acts for the European good and in pursuance of EU climate and energy objectives**;
3. The formal tasks of the EU DSO should be limited to strictly consultative and representative functions. **Tasks carried out by the EU DSO that present conflicts of interest** (i.e. any NCs or guidelines developed on DSO issues) **should be transferred to ACER** in order to prevent DSOs from embedding bias and/or vested interests into NCs’ development;
4. **Governance of the NCs needs to be sufficiently robust** (for instance through enhanced engagement of stakeholders and higher levels of transparency in NCs’ ‘drafting committees’ and consultations) to prevent DSOs from advancing their commercial interests;
5. **ACER should have strong powers to oversee the new EU DSO** to limit the risk of bias or abuse of power. Similarly, there should be a requirement on ACER to report to the Commission on the execution of tasks performed by the EU DSO, including on the avoidance of conflicts of interest.

June 2017

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ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

ClientEarth is funded by the generous support of philanthropic foundations, institutional donors and engaged individuals.

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