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Regulatory and Energy Assistance

RE: EU Directive Requirements on Unbundling and Komunalno Brcko Distrikt

Bosnia and Herzegovina is a signatory to the Treaty Establishing the Energy Community, signed on March 22, 2005. The Treaty through the Ministerial Council obliges Bosnia and Herzegovina to implement the Second and Third Liberalisation Packages. With regard to the obligation to unbundle, both the Federation Electricity Law and the Republika Srpska Energy Law prescribe unbundling.

Both the Third Liberalisation Package Electricity Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009¹ and Directive 2003/54/EC of 26 June 2003 (the Second Package)² contain a clear requirement for unbundling of distribution system operators (the distribution network) and unbundling of accounts. The two Directives basically contain the same requirements, but the Third Liberalisation Package has elaborated on the requirements of the Second Package. Therefore, this memorandum discusses the requirements of the most recent Directive.

Requirements of the Third Liberalisation Package

Functional and Legal Unbundling³

The key requirements for unbundling of distribution system operators in Article 26 can be described as follows:

- When the distribution system operator (DSO) is part of a vertically integrated undertaking, it shall be independent at least in terms of its legal form, organization and decisions making from other activities not relating to distribution. With regard to organization and decision making, the following minimum criteria apply:
 - DSO members of management shall not participate in company structures of the integrated electricity undertaking. This includes directly or indirectly the operation of generation, transmission or supply of electricity.
 - The DSO must have effective decision-making rights, independent from the integrated electricity undertaking regarding assets necessary to operate, maintain or develop the network. However, this does not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets of a subsidiary are protected. [We realize that Komunalno Brcko Distrikt is not legally unbundled into a parent company and subsidiaries as of now.]

Accounting Unbundling⁴

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>.

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:176:0037:0055:EN:PDF>.

³ Article 26.

Electricity undertakings shall keep separate accounts in their internal accounting for each of their transmission and distribution activities as if such activities were carried out by separate undertakings, with a view to avoid discrimination, cross-subsidization and distortion of competition. Separate accounts will be kept for supply activities for eligible customers and supply activities for non-eligible customers.

Applicability to Komunalno Brcko Distrikt (KBD)

KBD is a Public Utility, established by the Brcko District Parliament. It is a limited liability company (d.o.o.) and consists of several departments. The management structure is a General Manager and a management team, with three Heads of Departments. Currently, there is one account for the public utility and separate sub-accounts for the departments. The EU Directive provisions for unbundling of the DSO should be considered for implementation by KBD particularly due to the facts that (i) the electricity distribution network and supply are bundled together; and (ii) KBD has common services with the sister departments.

With regard to legal unbundling, the European Commission's Interpretative Note on Unbundling⁵ states that the legal form may be chosen by the vertically integrated undertaking (here, this would be the Supervisory Board) so long as the legal form chosen ensures a sufficient level of independence of the management of the DSO from other parts of the vertically integrated undertaking, namely, the supply function.⁶ This means that the DSO would be a legal entity, legally separate and financially independent from its sister departments. It would report independently on its profit and loss and have a separate balance sheet.

As indicated above, DSO management cannot participate in company structures that are responsible, directly or indirectly, for the day-to-day operation of production, transmission or supply activities. An issue that is involved in this management separation is common services, services that are shared between transmission/distribution [here, there is no transmission involved], supply and possibly other businesses. Such services could relate to personnel and finance, IT services, accommodation and transport.⁷ The KBD Administration Department falls squarely within this description. This is not an unusual situation in integrated utility companies; however, where such services are provided, conditions should be fulfilled to reduce competition concerns and exclude conflict of interest. *In particular, any cross-subsidies being given by the DSO to other parts of the vertically integrated undertaking cannot be accepted. To ensure this, the service must be provided at market conditions and laid down in a contractual arrangement.*⁸

⁴ Article 31.

⁵ Commission Staff Working Paper, Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: The Unbundling Regime, 2010_01_21_the_unbundling_regime.pdf.

⁶ Note on Unbundling, p. 23.

⁷ Note on Unbundling, p. 25.

⁸ *Ibid.*

Finally, SERC's Rule on Tariff Methodology⁹ requires accounting unbundling of regulated activities, in particular supply for eligible and non-eligible customers. Further, the KBD's temporary license conditions require unbundling of licensed activities from other activities. The temporary license expires on February 18, 2013.

To comply with the EU Directives, the SERC Rule on Tariff Methodology and the conditions of the KBD license, KBD should unbundle the DSO and supply functions. In addition, accounting unbundling should be implemented, with particular attention to the Administration Department function. Care should be taken that there is no cross-subsidy given to sister utilities through the Administration Department function; to ensure this, it would be optimal for KBD to contract with the Administration Department.

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⁹ SERC Methodology for Development of Tariffs for Service of Electricity Distribution in Brcko District of Bosnia and Herzegovina, 26 October 2011, Article 9.