

## **COMPLIANCE NOTE**

*by the Energy Community Secretariat*

**on assessment of compliance with the unbundling requirements of the Electricity Directive by the Albanian DSO**

CN 02/2021 / 22 November 2021

## COMPLIANCE NOTE No 02/21

### Albania – compliance with DSO unbundling requirements

In this Compliance Note, the Energy Community Secretariat verifies compliance by the Albanian DSO with the unbundling requirements of the Electricity Directive 2009/72/EC. It takes into account the European Commission’s Interpretative Note on the Unbundling Regime from 2010, the Secretariat’s toolbox and guidelines, as well as checklist of functional unbundling of DSOs. Besides reviewing the main legislative framework, the Secretariat relied on information submitted by the distribution system operator (“DSO”), *OSSH (Operatorii Shpërndarjes)*, as well as by monitoring consultant OMNIA (“consultants”). The consultant’s conclusions have been documented in a report on the status of unbundling in March 2021 (“consultants’ report”), updated with comments to the Secretariat’s questions in May 2021 and followed up by exchange on the facts via emails in the following months.

Unbundling of the DSO remains work in process and should be monitored continuously by the Energy Regulatory Entity (“ERE”). The Secretariat’s assessment does not aim at replacing such monitoring and is without prejudice to ERE’s assessment and measures that it might take. This report reflects the status of DSO’s unbundling in November 2021, and outlines some areas where further improvements are necessary or recommended, always under close monitoring by ERE.

### 1. Background factual information

The electricity sector in Albania is governed by Law No. 43/2015 on Power Sector (“Power Sector Law”). It entered into force in June 2015 (amended in 2018 and 2020<sup>1</sup>) and transposes the Third Energy Package in electricity. The Power Sector Law regulates the generation, transmission, distribution and supply of electricity in Albania.<sup>2</sup> ERE, which was established in 1995, is the regulatory institution for the electricity and the natural gas sector in Albania. Article 72 of the Power Sector Law, as amended in 2020, provides the legal basis for unbundling of the DSO.

“OPERATORI I SHPËRNDARJES SË ENERGJISË ELEKTRIKE” SH.A (*OSHEE SH.A*). *OSHEE*, is a 100% state-owned company controlled by the Ministry of Infrastructure and Energy. Until recently, *OSHEE* acted as the country’s only DSO, free supplier, universal service supplier (“USS”), and last resort supplier (“SoLR”) based on licenses issued by ERE. In the last years,<sup>3</sup> three companies have been established as subsidiaries of *OSHEE*: A free market trader - *FTL (Furnizuesii Treguttë Lirë)*;<sup>4</sup> a DSO – *OSSH*,<sup>5</sup> and a Universal Service Supplier - *FSHU*

<sup>1</sup> 15 days after publication in the Official Gazette of Albania No 87/2015 of 28 May 2015 (ref Article 109 PSL) as amended with Law No. 7/2018 and by Law 61/2020 dated 14.05.2020.

<sup>2</sup> Article 2 of the Power Sector Law.

<sup>3</sup> Order No. 157, dated 12.02.2021, “On the establishment of three companies controlled by the Electricity Distribution Operator JSC of the General Assembly of the Company, in accordance with article 207, of law no. 9901, dated 14.04.2008, “on enterprises”, with the aim of dividing the distribution activity, the universal supply service and the sales activity in the market of electricity, three controlled companies have been established: Free Trade Supplier Company (FTL JSC), Universal Service Supplier Company (FSHU JSC), Distribution System Operator Company (OSSH SH. A).

<sup>4</sup> License No. 422, series T18, issued on 03.09.2018 valid for five years until 03.09.2023. Under ERE decisions No. 264 of 20.12.2018 and No. 211 of 18.12. 2019, *OSHEE* had an obligation to transfer its licenses of Universal Service Supplier and Distribution System Operator to respective companies until 31.12.2019. See: ERE Decision 264 of 20.12.2018 available at: [https://www.ere.gov.al/doc/VENDIM\\_NR.264\\_2018\\_opt.pdf](https://www.ere.gov.al/doc/VENDIM_NR.264_2018_opt.pdf) and ERE Decision 211 of 18.12.2019 available at: [https://ere.gov.al/doc/VENDIM\\_NR.211\\_2019.pdf](https://ere.gov.al/doc/VENDIM_NR.211_2019.pdf)

<sup>5</sup> Decision no. 216 dated 11.10.2018 «On the transfer of the license for the operation in the electricity distribution system of the DSO (*OSHEE S.A*), no. 250, series p14sh, approved with the decision of ERE no. 96, dated 27.10.2014, valid until 27.10.2044 to the company “Distribution System Operator S.A” (*OSSH SH.A*), valid until 27.10.2044», available at [http://www.ere.gov.al/doc/VENDIM\\_NR.216\\_2018.pdf](http://www.ere.gov.al/doc/VENDIM_NR.216_2018.pdf)

(*Furnizuesii Shërbimit Universal*).<sup>6</sup> These three companies became operational on 1 January 2020.<sup>7</sup> OSHEE owns 100% of shares of OSSH, FSHU and FTL.

OSSH operates the distribution network, which consists of substations of 110/20 kV, a distribution network of 35/20/10/6 kV and transformers of 110/35/20/10/6 kV, still as the only DSO in Albania.<sup>8</sup>

## 2. Energy Community Law

Articles 26, 30 and 31 of Electricity Directive 2009/72/EC<sup>9</sup> define key requirements for unbundling of DSOs aimed at ensuring their independence in a vertically integrated undertaking (“VIU”) from the supply branch and to prevent market distortion through cross-subsidization and discrimination of other supply companies. Ministerial Council Decision 2011/02/MC-EnC<sup>10</sup> required implementation of the legal provisions by 1 January 2015.

Based on the requirements of the Energy Community law, the DSOs of the Contracting Parties, including OSSH, have to comply with the requirements of:

- legal unbundling;
- functional unbundling and
- accounting unbundling.

The rules stated in the Directive are minimum requirements; national legislation may define stricter requirements, depending on the organisation of the sector. To create a level playing field at retail level, the activities of distribution system operators should therefore be monitored so that they are prevented from taking advantage of their vertical integration as regards their competitive position on the market, in particular in relation to household and small non-household customers.<sup>11</sup>

On 16 January 2018, the Energy Community Secretariat initiated a dispute settlement proceeding in Case ECS-4/17 taking the preliminary view that Albania by failing to transpose and by failing to take national measures to implement legal and functional unbundling, Albania failed to fulfill its obligations under the Energy Community Treaty.

## 3. Assessment of compliance

While the Power Sector Law from 2015 transposed the necessary legal provisions for unbundling in Albania, the implementation has been delayed for years. In the following, the Secretariat assesses the implementation of the requirements for legal, accounting and functional unbundling.

### 3.1. Legal unbundling

DSOs must operate under a **separate legal form**. Article 26(1) of the Electricity Directive stipulates: “[*Where the distribution system operator is part of a VIU, it shall be independent at*

<sup>6</sup> License No. 251, Series P14FPP, initially issued to the OSHEE, but transferred to the FSHU by ERE Decision No. 215 of 11.10.2018. See: ERE Decision 215 of 11.10.2018 available at: [https://www.ere.gov.al/doc/VENDIM\\_NR.215\\_2018.pdf](https://www.ere.gov.al/doc/VENDIM_NR.215_2018.pdf). The license was renewed under ERE Decision No. 164 of 04.11.2019 and it is currently valid for 5 years, starting of 21.12.2019. See: ERE Decision 164 of 04.11.2019. available at: [https://ere.gov.al/doc/VENDIM\\_NR.164\\_2019.pdf](https://ere.gov.al/doc/VENDIM_NR.164_2019.pdf)

<sup>7</sup> <http://oshee.al/cilet-jemi/>

<sup>8</sup> The distribution network of 35/20/10/6 kV covers a length of 15.600 km. See: <http://oshee.al/en/distribution-network/>

<sup>9</sup> OJ L 211 of 14.8.2009, p 55 et seq.

<sup>10</sup> Including the Third Energy Package in the Energy Community

<sup>11</sup> Electricity Directive 2009/72/EC, recital 26 and Gas Directive 2009/73/EC, recital 25.

least in terms of its legal form, organisation and decision making from other activities not relating to distribution. Those rules shall not create an obligation to separate the ownership of assets of the distribution system operator from the vertically integrated undertaking.”<sup>12</sup> Article 26 of Directive 2009/72/EC requires that distribution is performed by a separate ‘network’ company. The obligation to create a separate company only concerns network activities. Other activities such as supply and production can be carried on within a single company. The vertically integrated undertaking is in principle free to choose the legal form of the DSO, provided that this legal form ensures a sufficient level of independence of the management of the DSO from other parts of the vertically integrated undertaking in order to fulfill the requirements of functional unbundling.

An **exception** exists for DSOs serving less than 100.000 customers or closed distribution systems.<sup>13</sup> The threshold of 100.000 customers is not limited to a single legal entity of a vertically integrated undertaking but must refer to the whole customer base of the integrated undertaking. The exemption is not applicable to *OSSH* as it has more than 100.000 customers connected.<sup>14</sup>

No generation and supply undertakings (*FSHU*, *FTL*, or any other non-related companies) have direct control (ownership, participation or significant influence) over the DSO, nor does the DSO have any interest in generation and supply undertakings. The relationship of the DSO with the mother company is defined by Article 25 of the Statute of the DSO as explained below.

The corporate governance of the company comprises the General Assembly, the Board of Directors and the Administrator. The responsibilities of the governing bodies are stipulated by the Law on Enterprises<sup>15</sup> and the statute of the DSO.<sup>16</sup>

*OSSH* is a holder of a DSO license issued by ERE, valid until 2044.<sup>17</sup>

All employees working within *OSHEE* on distribution activities have been transferred to *OSSH*.<sup>18</sup> At the end of November 2020, *OSSH* had 5371 staff members, including financial, legal, HR, IT experts. In addition, the consultants have reviewed the inventories of all three companies of the *OSHEE* group (of the DSO – *OSSH*, and of the two suppliers – *FSHU* and *FTL*) and have found in their report that assets necessary to operate their distribution activity have been adequately separated and allow *OSSH* to dispose over the necessary means to operate their distribution business. The transfer of the identified assets is ongoing. In any event, the assets identified for the DSO activity are transferred to the DSO and disclosed and accounted for as DSO assets in the *OSSH* financial statements for 2020. ERE should monitor and verify if further transfers of assets has an impact on the DSO.

Based on the available information, the Secretariat considers that Albania complies with the requirements for legal unbundling of the DSO.

### 3.2. Functional unbundling

When the DSO is part of a VIU as in the case of *OSSH*, it must comply with requirements related to functional unbundling. As elaborated in the European Commission’s Interpretative note on Unbundling Regime, functional unbundling must include:

- management separation;
- independence and effective decision making right of a DSO;
- separate identity in communication and branding;

<sup>12</sup> Article 26(1) Electricity and Gas Directives.

<sup>13</sup> Articles 26(4) and 28 of the Electricity and Gas Directives.

<sup>14</sup> *OSSH* has 1.2 mil customers connected.

<sup>15</sup> Article 134 of the Law on Enterprises.

<sup>16</sup> Article 11 of the Statute of the DSO.

<sup>17</sup> Supra note 5.

<sup>18</sup> Employees have been moved to, and have signed employment contracts with *OSSH*. The mother company, *OSHEE*, has approx. 200 employees and they are only based in the headquarters in Tirana.

- preservation of confidentiality of commercially sensitive information by DSO (non-disclosure in discriminatory manner).

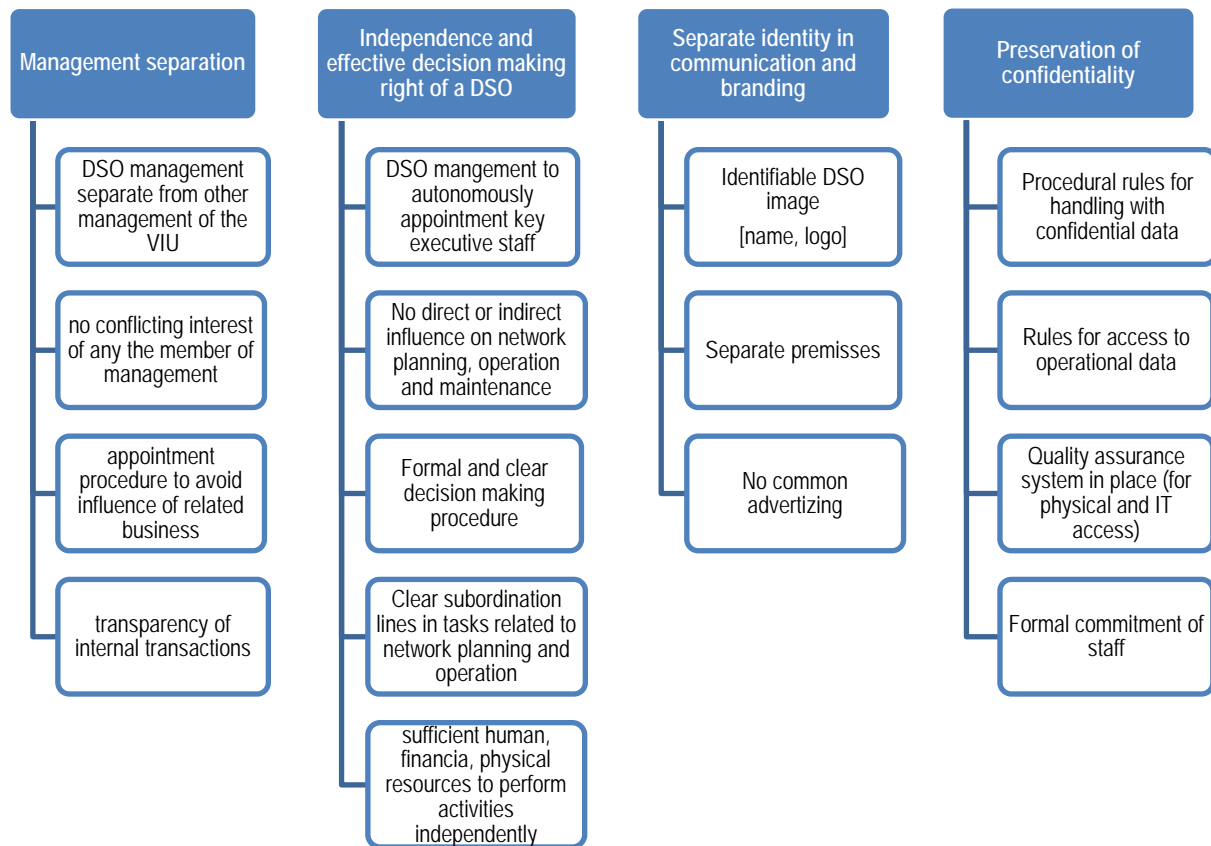


Figure 1

### 3.2.1. Management separation

Under the Electricity Directive, the management staff of the DSO may not participate in corporate structures of the VIU or of its any subsidiary responsible, directly or indirectly, for the day-to-day operation of the production, distribution and/or supply of natural gas.

In this regard, members of the Management Board, the General Manager, as well as operational management (*i.e.* heads of units) of the DSO may not be employed by the parent company or its subsidiaries engaged in generation/production and/or supply and may not be appointed as members of any corporate body of these companies, including supervisory and management boards. The Interpretative Note explains that a manager of the DSO cannot at the same time be a director of the related transmission, supply or production company, or vice versa. Whether and to what extent a manager of the DSO can work at the same time for the holding company of the vertically integrated undertaking if the holding company is not at the same time directly involved in production or supply, because legally separate entities exist for these activities, must be decided on a case-by-case basis. In any event, such a combination of functions can only be permissible if the holding company does not take any day-to-day management decisions concerning the supply, production or network activity.

In the case of *OSSH*, one of its members of the Board of Directors is an employee of *OSHEE*. The current composition of *OSSH* Board of Directors consists of one *OSSH* employee, one *OSHEE* employee and one external person. However, based on information available to the Secretariat, the mother company is not taking day-to-day management decisions concerning the supply, production or network activity. Based on the explanations from *OSSH*, in accordance with Article 156 of the Law on Enterprises, the members of the Board of Directors can be elected from the ranks of shareholders and employees of the company, as well as from the ranks of other

individuals outside the company. There are no detailed provisions and the shareholders are allowed to select directors if they fulfil the requirements of the law (i.e. the person has to have knowledge about the business of the company and bring the required expertise). There is no need or legal obligation to develop more detailed criteria or to select board members in a competitive procedure.

**It is in principle up to ERE to ensure that there is no conflict of interest inherent in the position that the member of the DSO's Board of Directors holds in the mother company.**

**The Secretariat considers that the statute has to be amended to include an explicit prohibition for executive officials of the mother company to be appointed in the Board of Directors of the DSO. The notion of seniority should be defined in the Statute. Additionally, this kind of restrictions should extend not only to the mother company, but also to the related undertakings.**

In order to ensure management separation:

- *the DSO management shall be separate from other management of the VIU;*
- *there shall be no conflicting interest of any member of the DSO management;*
- *appointment procedure should avoid influence of related business;*
- *there shall be transparency of internal transactions.*

In accordance with the Law on Enterprises<sup>19</sup> and Article 15 of the DSO Statute, the Board of Directors consists of 3 (three) members who are appointed and dismissed by decision of the General Assembly (in practice OSHEE as sole shareholder). The mandate of the members of the Board of Directors is three years with a right of reappointment. The Board of Directors appoints the Administrator of the DSO<sup>20</sup> and determines his/her salary. This appointment is also for 3 (three) years with a right to be appointed again.

The Statute of the DSO also contains a provision that the General Assembly decides on the dismissal of the members of the Board of Directors, if they do not fulfill the obligations in accordance with the law and the statute.<sup>21</sup> This provision has been inserted to limit the discretionary influence by OSHEE by removing the possibility to dismiss the DSO management without justified reasons.<sup>22</sup>

The consultants assessed the staff lists of the different companies forming part of the OSHEE group and found that there was no overlap between positions of employees or of management held in the different companies.<sup>23</sup> Concretely, the management boards of the FTL and FSHU have been changed as there were members holding at the same time positions in OSSH Board of Directors and also in the Board of Directors of other subsidiaries.<sup>24</sup> The case of a person

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<sup>19</sup> Law on Enterprise Nr.9901, dated 14.4.2008 as amended by Law Nr.10 475, dated 27.10.2011 and law Nr. 129/2014, dated 2.10.2014.

<sup>20</sup> Article 16.1(f) of the Statute of OSSH.

<sup>21</sup> Article 12.2 of the Statute of OSSH.

<sup>22</sup> See Interpretative Note, p.24: Decisions of the parent company to replace one or more members of the management of the DSO may also undermine the independence of the DSO in certain circumstances, notably if the reasons for replacement of members of the management have not been established beforehand in the charter of the DSO.

<sup>23</sup> Employees and operational management of OSSH do not overlap with employees and managers of other companies. There is also no overlap between board of directors of OSSH with any of the daughter companies after they have changed the composition of the board of directors end of last year for the unbundling purposes. Composition now is as follows:

- OSSH: Perparim Nebiaj (OSHEE) Ceno Klosi (External), Dorian Baba (OSSH).
- FSHU: Artur Lama(OSHEE) Florenc Rama (FSHU), Blerta Isa (OSHEE).
- FTL: Irakli Qiriako (FTL), Bibjana Terolli, Artur Lama (OSHEE).

<sup>24</sup> OSHEE: Decisions: Nr. 550, dated 05/07/2018, Nr. 156 dated 02/04/2019, Nr. 242, dated 12/06/2019, Nr. 355, dated 04/10/2019, decision dated 27/01/2020 and Nr. 215, dated 02/06/2021. FTL: Decision Nr. 1, dated 28/03/2018 and decision Nr. 16, dated 12/11/2020. FSHU: Nr. 17, dated 12/11/2020. OSSH: decision from 20/12/2019 (Nr. of decision not entirely readable in document).

employed in the mother company *OSHEE* as a member of the Board of Directors of *OSSH* was assessed above.

According to the Commission's Interpretative Note,<sup>25</sup> appropriate measures must be taken to ensure independence of the management staff of the DSO and to secure its professional interests in performing assigned functions related to day-to-day DSO-related activities. In particular, the following minimum measures must be applied:

- the salary of the General Manager of the DSO shall not be based on the performance of the parent company and shall be established on the basis of pre-fixed elements related to the performance of the Network Company.<sup>26</sup> Similarly, the remuneration of DSO management (Board of Directors or Administrator) must not depend on the performance of the other parts of VIU, but solely on the performance of the DSO and any reward system should be preferably defined in advance and clearly communicated.

The compliance program of the DSO contains a provision that the persons managing the DSO *"will not receive financial compensation or other material or financial benefit from other companies and will not have salaries related to the level of performance of other companies within the integrated company."* The Secretariat has inquired about the appointment and selection process and the exact criteria for selection of management of the DSO, as well as for defining their salary. *OSSH* has submitted that the General Assembly appoints the Board of Directors without specifying any further detail, and that the compensation of employees is approved by Council of Ministers Decision No 574 of 2016 without any further explanation. This means that no competitive procedure is in place, and *OSHEE* as sole shareholder (the Administrator of *OSHEE* on its behalf) appoints the Board of Directors of the DSO. **The Secretariat considers it appropriate to amend the Statute of the DSO, and to include provisions related to the competences and procedures of appointment of each level of management and executive staff in the mother company and subsidiaries, in particular the DSO, to exclude conflicting interest.**

- employees shall be subject only to the authority of the management of the DSO and promotions and sanctions can be decided only by the management of the network company.<sup>27</sup>

In the case of *OSSH*, neither the hiring of employees, nor the disciplining, sanctioning, training, promoting etc. are foreseen as competences of the General Assembly or the Board of Directors. The consultants considered that those are nonetheless within the competences of *OSSH*'s general management and *OSSH*'s Administrator. Article 18(3)a of the Statute entitles *OSSH*'s Administrator to perform all actions for administration of the commercial activity of the company. Since nothing to the contrary is stated in the Statute, the consultants concluded that these rights/tasks are exercised by *OSSH*. **Without any information to the contrary, the Secretariat would agree that *OSSH* can exercise such tasks. It might be appropriate however to define explicitly the competence of the relevant executive officials, namely the Administrator, including the competence and responsibility to decide on the organizational, operational and working arrangement, to employ necessary staff including definition of the requirements for any position and be responsible that senior and all staff members meet the conditions required for their position and corresponding legal requirements.**

- the reasons justifying a replacement of a member of the Management Board, or of the Administrator of the DSO at the initiative of the VIU shall be clearly spelled out in the

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<sup>25</sup> See also: EXERGIA A.E., Final Report on Technical assistance to efficiently implement, monitor and report the functional unbundling of network operators, June 2019.

<sup>26</sup> ERGEG, Guidelines of Good Practice on Functional and Informational Unbundling for DSOs, Ref: C06-CUB-12-4b (15.7.2008).

<sup>27</sup> *Ibid.*

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Statute of the Network Company and correspond to the responsibilities of the respective VIU body<sup>28</sup>;

In the Statute there is no provision governing the reasons for dismissal of the Administrator, whereas for the Board of Directors can be dismissed only if the members do not comply with law and statute. The Secretariat has inquired whether criteria for dismissing the Administrator are defined elsewhere. *OSSH* has submitted information that based on Article 18 of the Statute of the DSO, the Administrator is appointed (for a term of 3 years, with the right of re-election) and dismissed by the Board of Directors, and that any individual not barred by the restrictions provided in Article 13/1 and 158/2 of the Company Law could be elected as Administrator. **The Secretariat considers that it is important to stipulate clear criteria for dismissal of the Administrator, as applicable to the Board of Directors, in the Statute or other company document.**

- transfer of management staff of the network company to the parent company or its any subsidiaries engaged in the generation/production and/or supply and *vice versa* shall be made subject to transparent conditions clearly included in the Statute of the DSO, including that any of such transfers shall not be predetermined from the outset<sup>29</sup>;

**no such procedure exists now. The Secretariat considers that this issue should be addressed and such provisions should be included in the company's documents, in particular cooling periods for participation in management structure and transfer of senior executive staff from distribution to a competitive operator and vice versa.**

- the DSO shall not be allowed to hold shares of the parent company or its any subsidiaries engaged in generation/production and/or supply;

no explicit statement prohibiting holding shares is in place, and was not considered relevant by the consultants, given the current ownership structure of the parent company and the subsidiaries. *OSSH* also submitted that the DSO does not hold shares in the parent company or any of the subsidiary companies now because based on the decision establishing the three companies, *OSHEE* as a parent company owns 100% of the shares of *FTL*, *FSHU* and *OSSH*. The controlled companies were planned to be companies with one level of administration and the functions of the shareholder's representative of *OSHEE* in the controlled companies is exercised by the Administrator of *OSHEE*. **While the Secretariat understands that currently the DSO does not own shares in the mother company or any other generation and supply companies, ERE should continue monitoring this in the future, unless such possibility is not excluded or prohibited explicitly.**

- shareholding interests of the General Manager and/or other management staff of the DSO in the parent company or its any subsidiary engaged in generation/production and/or supply shall be clearly limited so as to ensure independence of the DSO's management staff and to prevent any potential conflict of interest<sup>30</sup>.

The consultants considered that this is subsumed under article 4 of the compliance program and also the written statements that are obligatory to be signed by *OSSH* management. Based on information submitted by *OSSH*, the requirement that the working conditions of the management of the DSO can actually ensure independence, including remuneration to management and senior managing staff, has been done through the employment contract and the list of competences of the Board of Directors and the Administrator, defined in the Law of enterprises and the Statute of DSO.

The Senior Directors have signed declarations stipulating that they have no conflict of interest in accordance with Article 4 of the DSO's compliance program,<sup>31</sup> and for violations they can be

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<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

<sup>31</sup> Article 4(1) of the DSO's compliance program: "...when the Distribution System Operator is part of a vertically



subject to disciplinary procedure.<sup>32</sup> OSSH submitted the staff list and the legally binding declarations proving that the persons responsible for management of the DSO do not participate in any company structure vertically integrated company directly or indirectly. Based on that, the persons responsible for the DSO (management and senior executives) certify that they are professionally independent from other parts of the VIU and are allowed to act independently.

The Commission has considered in its Interpretative Note that when shaping the rules on independence of the staff and the management of the DSO, the detailed provisions on independence of the staff and the management of the ITO as laid down in Article 19 Electricity and Gas Directives may serve as a point of reference, where appropriate. One such requirement is the cooling-off period provided for in Article 19(3) of the Electricity Directive, according to which the management of the DSO cannot exercise any professional position or responsibility, interest or business relationship, directly or indirectly, with any part of the VIU, or with its controlling shareholders, other than the DSO, for a period of three years before its appointment and four years after the termination of its term.

There is no separate procedure for transfer of senior staff of the DSO to the OSHEE group. According to the consultants' argumentation, a cool-off period in the Albanian legal system has to come with monetary compensation equal to the duration of the cool-off period and would therefore be very costly. By consequence, such obligation does not exist and the management can be transferred from the DSO to the mother company or any of its other subsidiaries and vice versa without limitation. **Recalling that restrictions are related solely to the position of senior executive officials and their transfer between competitive and regulated business, the Secretariat considers that such restriction, if explicitly stipulated in the appointment procedure and reflected in the management / work contract may be implemented at no costs. It would be useful to include a restriction when DSO managing staff is transferred to the mother company, requiring that he/she would not take up a managing or high executive position where reward depends on the performance of supply or generation. In addition, it is necessary that a requirement is stipulated in the compliance program for the compliance officer to monitor continuously any such transfer and to ensure that confidentiality of information is preserved. Finally, it is necessary that the monitoring report and findings are reported to ERE and are published.**

### *3.2.2. Independence and effective decision making rights*

Decision-making rights of the DSO do not preclude the mother company exercising its economic and management rights in respect of return on assets in the DSO. According to Article 26(2)(c) of the Electricity Directive, the mother company may approve the annual financial plan, or any equivalent instrument, of the DSO and set global limits on the levels of its indebtedness. However, the mother company in no manner whatsoever is permitted to give instructions regarding day-to-day DSO-related activities. Furthermore, within the scope of the approved financial plan, the DSO must enjoy complete independence.

Article 72 of the Power Sector Law, as amended in 2020, transposes these requirements.

**The following requirements need to be implemented in the Statute of the DSO:**

- *DSO management shall autonomously appoint key executive staff;*

There is no explicit provision granting this right, but also no right of interference granted to organs outside of DSO management. Based on the general provisions from the Law on Enterprises, and

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*integrated company, in order to be independent in terms of organization and decision-making from other activities not related to distribution of electricity, inter alia, must meet the following conditions:*

...  
d) *Persons responsible for the management of the Distribution System Operator shall sign a declaration of independence reflecting points (i) to (iii) above.*"

<sup>32</sup> See Article 11 (3) of the DSO's compliance program.

the DSO's statute based on which the Administrator has the right to perform all the actions of administration of the commercial activity of the company, this right seems ensured.

- *there shall be no direct or indirect influence on network planning, operation and maintenance;*

In order to comply with the requirement to ensure that there is no direct or indirect influence on network planning, operation and maintenance, while the Administrator is obliged to obtain prior approval from the General Assembly and / or the Board of Directors before taking and / or implementing any decision regarding the specific issues provided in Article 12.2<sup>33</sup> and Article 16.1 h / i / j<sup>34</sup> of the Statute, the Statute has been amended in order to reflect the obligation that such approval by the General Assembly should be done in compliance with the obligation for unbundling.<sup>35</sup> Article 25 of Statute of the DSO reads:

*“25.1. The DSO operates independently for the day-to-day operational activity of the distribution system and makes independent decisions regarding the implementation of the network development plan, construction or reconstruction of distribution lines, the investment value of which is within the levels of the financial plans of the distribution system approved by..., or the values defined in the company's statute or the legislation in force. In the conditions of independence of the DSO from other activities not related to the distribution of electricity, the parent (controlling) company, in accordance with the legislation in force, enjoys rights related to economic, managerial and decision-making supervision, only for issues, which are within its competence.*

*25.2 The controlling company has the right of economic and managerial supervision through its bodies defined in the statute, as well as through the approval of decisions in the capacity of owner, regarding the return of capital, approval of the economic financial plan or any other equivalent instrument of Distribution System Operator and set general limits on the debt levels of this company.”*

- *formal and clear decision making procedure of the DSO should be ensured;*

In order to ensure that formal and clear decision making procedure of the DSO are in place, the decision making by the governing bodies of OSSH is governed by the Law on Companies and the Statute of the company. This is relevant for decisions related to the DSO's activity independent of the decision making procedures of the mother company. Namely, the General Assembly's ordinary decisions are valid if shareholders who own more than 30% of the voting shares are present or represented. Decisions requiring a qualified majority require that shareholders holding more than 50% of the voting shares are present or represented. The decisions are adopted by majority of the shareholders participating in the voting and by  $\frac{3}{4}$  the votes of the shareholders participating (for change the statute, increase or decrease the capital, distribution of profits, reorganization and dissolution of the company).<sup>36</sup> **While ERE is not directly involved or its approval is not necessary for reorganization of the DSO, based on Article 19 of the Power Sector Law, it is supposed to perform monitoring of the licensed entities including the DSO.** The Statute stipulates that the meeting of the Board of Directors is considered valid in case more than half of its members participate (quorum), and the decisions are taken by a majority of the members present. When there is a tie, the chairman's vote is decisive.<sup>37</sup>

- *clear subordination lines in tasks related to network planning and operation should be in place;*

<sup>33</sup> Specifying all competences of the General Assembly.

<sup>34</sup> Competences of the Administrator related to cooperation with other companies of the group or changes related to expenses of the DSO.

<sup>35</sup> Article 18.3.(f) of the Statute of the DSO.

<sup>36</sup> Article 14 of the Statute of the DSO.

<sup>37</sup> Article 17 of the Statute of the DSO.

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- *the DSO shall have sufficient human, financial, physical resources to perform activities independently.*

According to Article 26(2)(c) of the Electricity Directive, the DSO shall have sufficient human, financial, physical resources to perform activities independently which requires that the DSO shall have enough resources to prepare decisions, to evaluate alternatives and to be assisted by external consultants. The DSO may choose to benefit from general services performed by the parent company if it demonstrates that this choice results in lower costs and it does not imply any undue dependence. Such services shall be provided under precisely defined contracts, which are to be kept at the disposal of the regulator. Certain services, especially strategic ones such as the legal, regulatory and controlling services, have to be established in the network company.<sup>38</sup>

As elaborated and assessed below, Service Level Agreements (“SLA”) between the OSHEE Group and the DSO as a daughter company have been signed and implemented since December 2020, after being approved by ERE. The decision to conclude SLA has not been based on an analysis whether it results in lower costs in comparison to such services being procured on the market. Instead, it has been decided that the mother company should provide such services to all its three daughter companies (the DSO and the two suppliers), avoiding to develop any of those services within the network company itself. No obligation for the DSO to develop any of those services in-house has been established.

With reference to the requirement that the DSO must have the power to raise money on the capital market sufficient to maintain and develop its infrastructure, OSSH made a reference to Article 5 of the Statute. Article 5 refers to the activity of the company, but does not provide power to raise money on capital market. Since there is nothing in the Statute that would remove this capacity from OSSH, the consultants consider that this is required to perform DSO’s activities according to Article 5, and thus allowed.

The Statute or an equivalent act should contain an explicit provision allowing OSSH to raise funds in the capital market under certain conditions, primarily if the current equity capital is not sufficient to ensure viable financing of the DSO operation and network development and maintaining the level of indebtedness defined in the approved financial plan. OSSH has informed that the Statute or equivalent act on establishment has to oblige the mother company (as a sole shareholder) to make available sufficient means to the DSO in order to finance its operation and development. Otherwise, when the shareholders’ equity is not sufficient and/or lending options are not cost effective, or not sufficient to finance needed investments needs, DSO should be able to raise money in the capital market, including by issuing shares. The main source of funding of DSO are the revenues from its operations. Additional source of financing for the company are commercial banks from which currently the company has received several OVD limits that were used to cover working capital needs. **Currently there is no explicit possibility for the DSO to be able to raise money on capital market and the Secretariat considers it necessary that Article 10 of the Statute is amended to reflect this possibility.**

As regards ensuring sufficient human, financial, physical resources, according to the Consultant’s report and decisions on allocation of assets, liabilities and staff, there is further need to identify the nature and scope of services to be provided by mother company. In particular, as Consultant noted that OSSH has at disposal qualified staff including financial, legal, HR, IT experts. Hence, there is a need to investigate and justify the services procured from mother company extending to financial, human resources and IT.

### *3.2.3. Separate identity in communication and branding*

Ensuring that the identity of the DSO is separate and does not risk confusion with the mother company, or the companies of the same group, at least the following should be ensured:

- *DSO should have identifiable image [name, logo];*

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<sup>38</sup> ERGEG Report, *supra note*.

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- *DSO should be based on separate premises;*
  - *There should be no common advertising.*

Moreover, physical separation that restricts access to facilities and geographical separation including separate buildings are necessary.<sup>39</sup>

In their report in March 2021, the consultants found that there was no fully-fledged website yet and the go-live of such a website still needs to take place in 2021. Moreover, in their assessment, not all employees had separate email addresses. In addition, *OSHEE* and its daughter companies do share the headquarters building in Tirana, but separation of office space also needs to be made more visible in the entrance hall of the building, mirroring more a business center that hosts different companies. The consultants have therefore concluded that requirement for separate communication and branding strategy has not been fully achieved and that the following points remain outstanding:

- design of a separate logo for *OSSH*;
- develop roadmap to implement rebranding for all offices and DSO affiliated building, cars etc. throughout Albania;
- implementation of such roadmap;
- whereas the full implementation of separate communication and branding can be a more time-consuming process, a clear vision to achieve that is required in the near future.

In the course of the last several months, progress was reported in relation to the separation of identity in communication and branding. Namely, the website of the DSO online, but the logo is the same as that of *OSSHE*. Email addresses have been fully separated and communication exclusively takes place *via OSSH* addresses. Based on information from the IT of *OSSH*, within Microsoft exchange they created separate active directories. As there are only virtual servers, no physical separation of servers is possible, but virtually this is ensured by having four different virtual machines running the servers (one per company).

The visible separation in the entrance hall has been installed. On the different floors, measures were also taken to ensure data protection. For example, in the case of printing on the different company floors, it is only possible to do so with the key cards of that company, so unauthorized personnel would not be able to access printer and print other documents.

However, in addition to the lack of separate logo, the consultants raised the issue that there are no separate access gates on the different floors. Instead, there is only one main gate at the entrance on the ground floor. However, how rebranding was implemented in the field offices dealing with customers is not investigated by the consultants and no clear guidance is provided in the Statute, code of conduct, or compliance program.

ERE should oblige the DSO to rebrand and redefine the communication according to the unbundling requirements in order to properly inform consumers on offers since the logos are often the first information and marker that a client will have regarding a company.<sup>40</sup> **The Secretariat considers that this has to be reflected in the license issued by ERE and should be monitored by the regulator based on the competences stipulated in the Power Sector Law. The compliance program has to contain explicit provision obliging the DSO to ensure that in the daily contact with customers (contact centers and field office) there is no preference to any undertaking performing competitive activity of generation or supply. When the DSO provides list of suppliers, this list has to be exhibited in a neutral and impartial manner with the same level of detail for relevant information. Furthermore, the Secretariat considers that it is not sufficient only review and monitoring of separation of offices/ floors in the headquarters, but it is important to develop a plan (a roadmap) envisaging a**

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<sup>39</sup> *Supra note.*

<sup>40</sup> CEER, Status Review: Implementation of TSO and DSO Unbundling Provisions, Ref: C18-LAC-02-08, 14.06.2019, p.31.

**concrete timeline for rebranding of all branches and local offices, as well as publicly displayed material and equipment. Concrete actions should be stipulated for the whole territory of the country, as well as reporting to ERE of when full unbundling will be achieved so that field offices of DSO would not share premises with any supply entity and all signs of the mother company (on premises, on cars, uniforms of staff etc) would not be visible in the DSO.**

#### *3.2.4. Preservation of confidentiality of commercially sensitive information by DSO*

Having in mind that the main reason for unbundling of the distribution network operation from activities of generation and supply is to prevent discrimination, Article 27 of the Electricity Directive requires that data related to distribution system operation must be confidential and may not be shared with the related undertakings.<sup>41</sup> For that reason it is necessary that the DSO puts in place:

- *procedural rules for handling with confidential data;*
- *rules for access to operational data;*
- *quality assurance system in place (for physical and IT access);*
- *formal commitment of staff.*

Article 74 of the Power Sector Law contains a general provision on obligation of the DSO to preserve the confidentiality of commercially sensitive information provided during the exercise of the activity and shall prevent discriminatory disclosure of information on its activities, used to gain a commercial advantage on another party. Furthermore, Article 9 of the compliance program contains a provision obliging the DSO to ensure that the collection and processing of data by it, is in accordance with the legislation on personal data protection, while maintaining the confidentiality of the information received, as well as an obligation for the DSO to maintain the confidentiality of commercially sensitive information, except when required by the competent authorities, in accordance with their functions, as defined by applicable law. This provision obliges the DSO to establish internal procedures ensuring that commercially sensitive information may not be accessed by persons having any connection to the integrated company or its subsidiaries or any other company and defines what shall be part of such procedure.<sup>42</sup> However, such procedures and detailed rules on ensuring confidentiality have not been developed yet. Moreover, there are no rules in place for access to operational data and no quality assurance system has been put in place (for physical and IT access). The compliance program does not define the details of what confidential information is, and what the internal procedures ensuring that commercially sensitive information is protected should contain. Specifically bearing in mind that, according to the draft agreement on SLA, IT services will be outsourced from the mother company, there is a serious concern related to access to information of DSO by competitive operators within VIU. **The Secretariat considers it necessary that such rules are developed, and their implementation is monitored by the compliance officer and ERE.**

#### *3.2.5. Compliance Program*

To ensure that functional unbundling takes place and is maintained in a permanent and systematic manner, the DSOs must **develop a compliance program and appoint a compliance**

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<sup>41</sup> Confidential information may include among others: Financial and technical conditions of grid access (individual grid access contracts); Financial and other conditions of energy supply Metering data, load profiles of consumers Inactive and planned new connections to the grid Customer contact details, billing records, bank data. See EXERGIA Report, *supra note*.

<sup>42</sup> Article 9 of the compliance program of OSSH stipulates that the DSO shall:

- (i) put in place mechanisms and rules to safe-guard commercially-sensitive information and particularly ensure that companies affiliated to the DSOs do not have discriminatorily advantageous access to information;
- (ii) treat in a confidential manner any information shared by a market participant unless otherwise marked as non-confidential information by such market participants;
- (iii) Give confidential treatment to any financial information affecting the operations of the market participant or information related to the cost of its energy supply;
- (iv) Provide non-discriminatory access to any relevant public data and, in doing so, adhere to applicable procedures in a consistent manner.

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officer.<sup>43</sup>

The regulatory authority or other national body must have the right and duty to monitor functional unbundling and compliance program in particular. The compliance officer is the key person responsible for *permanent and continuous* monitoring the application and effectiveness of the compliance program, for evaluation of the effectiveness of the applied policies, procedures and measures, and for regular reporting to the regulatory authority. This report must contain explanation of the measures taken and their effectiveness as well as any risk for non-compliance. The report must be published. To fulfill the task, the compliance officer must be fully independent and must have access to all the necessary information, not only of the DSO but of any affiliated undertaking.

The scope of the compliance program will depend on the complexity of integrated undertakings, their legal form and the already established management and supervisory system. The Interpretative Note explains that the compliance program shall set out measures taken to ensure that discriminatory conduct is excluded and to ensure that conduct of DSO staff in this aspect is adequately monitored. It is a formal framework for ensuring that the entire network activities as well as individual employees and the management of the DSO comply with the principle of non-discrimination. The compliance program shall explicitly define policies and procedures to be observed by management and staff. Such policies may consist, inter alia, of the following elements:

- active, regular and visible support of the management for the program;
- written commitment of staff to the program by signing up to the compliance program;
- indication to disciplinary action which will be taken against staff violating the compliance rules;
- training on compliance on a regular basis and notably as part of the induction program for new staff.

Article 72 of the Power Sector Law, as amended in 2020, transposed the obligation from the Electricity Directive related to the appointment of a compliance officer and the adoption of a compliance program by the DSO. While a compliance program has been adopted by the OSSH,<sup>44</sup> a compliance officer has not been appointed.

The compliance program stipulates that the compliance officer shall be appointed by ERE's decision and such officer shall be responsible for ensuring compliance, as well as submitting the compliance report to the regulator. The compliance officer shall monitor compliance with the legal obligations of the compliance program, as well as for necessary changes or revisions of this program with the approval of the ERE. In case of concerns related to compliance, the compliance officer shall first inform the management of a non-compliance or disputable matter and propose a remedial measure. In case the issues are not resolved timely, the officer shall report persisting non-compliance to ERE. The compliance officer will neither directly nor indirectly hold any other professional position or interest in the VIU and shall report cases where OSSH staff are identified to be simultaneously working in more than one company or are otherwise conflicted. Article 3 of the compliance program stipulates clear obligation of the employees to comply with and be bound by the compliance program, and Article 4 underlines the requirement as to ensuring independence of the DSO's management. Article 5 of the compliance program contains requirements as to ensuring legal and functional unbundling. This article contains a prohibition for interference from other persons with respect to the day-to-day operations of the DSO. According to this article, all decisions regarding the management, maintenance and development of the distribution system are direct functions of the persons in charge of the management of the DSO in a non-discriminatory manner and without exerting any influence on other market participants or the VIU. The compliance program further contains provisions on right to information and confidentiality, as well as on provision of joint services.

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<sup>43</sup> Article 26(2)d of the Directive 2009/72/EC.

<sup>44</sup> The compliance program has been approved by the Board of Directors of OSSH and by ERE.

The consultants assessed that the compliance program is broadly drafted and can be regarded as an all-encompassing document establishing an obligation to supervise compliance with the unbundling requirements and report on any shortcomings. **The Secretariat agrees with this finding.**

The Secretariat, however, observes that a compliance officer has not yet been appointed. **This is not in line with the Directive.** OSSH submitted that the employment contract of the compliance officer will also include an overview of the requirements and standard to be fulfilled by this person, as well as explicit and exhaustive list of ground for dismissal. The company deems that the lack of detailed criteria in compliance program is to be done by the employment contract or the publishing of the vacancy. **However, the Secretariat considers that independence and integrity of the compliance officer is crucial for effective performance of the tasks. Therefore, personal and professional capacity and requirement for the position must be clearly stipulated in advance in the post description, preferably in consultations with ERE. In addition, reasons for dismissal from the assignment before the end of term must be clearly stipulated beforehand. Both criteria for appointment and reasons for dismissal should be included in the compliance program and not only for *ad hoc* appointments in term sheets when publishing a concrete position.**

### 3.3. Accounting unbundling

The provisions of the Directives are very strict<sup>45</sup> as regards the need for the DSOs to be unbundled in terms of accounting. The DSOs have to draw up, submit to audit and publish their annual accounts. The accounts and financial report must be audited. The scope of audit may be subject to specific regulatory requirements with the aim to ensure that there is no cross-subsidization between activities. In this case an audit has to examine the way costs have been allocated, especially for activities that concern shared services.

Article 31 of the Electricity Directive explicitly requires that annual accounts are disclosed in accordance with the rules of national legislation concerning annual accounts of limited liability companies adopted pursuant to the Fourth Council Directive 78/660/EEC<sup>46</sup>. This provision, as explained in the Interpretative Note, for accounting unbundling requires accurate application of accounting principles.<sup>47</sup>

Standards defining segment reporting and related party disclosures are crucial in this exercise. Accounting policies have to ensure that transactions with related undertakings and internally procured or provided goods and services are recognized at fair value.<sup>48</sup>

An audit will have to confirm if accounting policies are in place to ensure fair presentation of the financial position of the DSOs and its transactions with related undertakings. The audit of financial statements shall confirm that inter-segment prices are fairly established, in accordance with sound accounting policies and that goods and services procured from related parties are charged at fair value. Measuring the fair value of these goods in this respect shall be based on the

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<sup>45</sup> Article 31 of the Gas and Electricity Directives.

<sup>46</sup> The Council Decision lists provisions concerning the presentation and content of annual accounts and annual reports, the valuation methods used and their publication in respect of all companies with limited liability.

<sup>47</sup> In the EU and all Contracting Parties International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) are used as accounting principles. Basic principles defined in these standards related to fair presentation of the financial position, assets and liabilities, income, changes in capital and statement of cash flow, must be followed by DSOs with different operating segments and all its related undertaking. This refers to treatment of property, plant and equipment, including revaluation, impairment of assets, leases, borrowing costs, inventories, provisions and contingencies etc.

<sup>48</sup> In accordance with IAS 14 Segment reporting and IFRS 8 Operating segment, the basis for inter-segment pricing must be defined and disclosed. In case of related undertakings, IAS 24 must be applied, including the disclosure of nature and amount of transactions, nature of relationship where control exists, such as from parent – subsidiary relationships, entities under common control, associates, individuals who, through ownership, have a significant influence over the enterprise and close members of their families, and key management personnel. In case of associated undertakings, IFRS 8 (Associates and joint ventures) and IAS 28 (Investment in associates) must be applied.

accounting policies of the undertakings, respecting the accounting principles and standards.

*OSSH* has submitted information that the DSO is under the auditing process by external auditors assigned by the General Assembly, in accordance with the Law on Enterprises. The consultants obtained the audited group account of 2019, the audited opening book values of all daughter companies for 2020 and also separate balance sheets for the daughter companies. The consultants reviewed the auditor's report for 2019,<sup>49</sup> prepared in line with ISRS 4400,<sup>50</sup> and concluded that the accounts between *OSHEE* mother company and the three daughter companies have been separated and also *OSSH* and its management disposes over separate accounts. However, at that time, *OSSH* did not receive any of the net trade receivables in the separation process. All those receivables were allocated to *FSHU* with the justification that only *FSHU*, given its supply function, can be entitled to those receivables and collect the connected payments. Those receivables also entail a distribution component for the use of the distribution network and this part should have been allocated to *OSSH*. From the consultants' explanation, it was shown that the new DSO gave up its share of receivables as of the date of separation. However, all due liabilities related to DSO operation are assumable neatly transferred to DSO. The reason for such approach was not presented, but it seriously affected DSO's financial leverage and level of indebtedness.

This has been improved. In the beginning of 2020, separate bank accounts had been created and invoices were sent in the name of the three separate companies. The invoicing process is separated as the DSO currently is a separate legal entity so it invoices directly suppliers and customers. While the DSO has a choice on whether to issue invoices directly or the supplier to do the billing of the all charges including network charges, while DSO would charge suppliers respectively, it is crucial that the supplier has no access to information of the reading and billing data of DSO. The 2020 payments for DSO charges/services all went to DSO. Also, collection rate of the supplier does not have an influence on payment of DSO charges, as this is completely separate process. The financial statements of 2020 have been completed and the DSO receivables of 2020 were fully collected by DSO.

*OSSH* informed also that the old debts (from before unbundling) were allocated in proportion with the assets' allocation. The DSO took over also receivables that were related to its activity of new connections. Regarding the distribution fee, no receivables from the period prior to unbundling was allocated. But since the balance sheet was created, additional receivables allocation would have meant also additional debt allocation for DSO.

However, the consultants raised the following remaining issues:

- the mandate of the auditor did not include an assessment for potential cross-subsidization although this is explicitly required by article 35(3) Power Sector Law;
- definite statements on content are not made, as also pointed out in the disclaimers given by the auditors, but a focus was on procedures and checking for cases of misrepresentation;
- the auditor refer to non-completed transfer of ownership title on the assets;
- the auditor questioned viability of company to the loss that was made.

The auditor's opinion indicates that the allocation of assets and liabilities is affecting the company's viability, which need to be investigated and amended.

*OSSH* explained that the auditors' questioning of financial viability is related to the negative equity

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<sup>49</sup> As per decision from 14 and 15/12/2020 and 22/02/2021 separate auditors for *OSHEE*, *FTL*, *FSHU* and *OSSH* were appointed. *OSHEE*: Fatime Alliu; Diana Ylli, Gerta Avrami, Vullnetre Cela, Nezat Maze → (On 30.04.2021 the auditor Gerta Avrami was substituted by Nuriana Berdica.) *FTL*: Leteri Kushta, Rezar Llukacej. *FSHU*: Bendis Husi, Gerta Avrami *OSSH*: Ilija Cece;Berti PASHKO

<sup>50</sup> The objective of this standard and an audit done in accordance with this standard is to assess whether an agreed upon procedure was upheld and to report on the factual findings of such a procedure, but not to provide any explicit references to potential issues of cross-subsidization. The report merely assesses the chosen methodology of separation of assets and liabilities and concludes that the chosen methodology is a reasonable and fair one.



of the DSO inherited from the legal unbundling. They challenged the recovery of the negative equity while the company in its first year of activity materialised financial losses, thus making impossible the offsetting of negative equity. Based on the above, the DSO has requested to ERE increase of the access tariff as its main source of revenue, in order to put the company into a financially viable path. The application is currently under review by the regulator. Aspects of cross-subsidization also relate to the competences of ERE. The regulator is the only party mandated by law to take measures to prevent cross-subsidization according to Article 19 of the Power Sector Law. The DSO license also refers to ERE for the assessment of cross subsidization. In making their decision related to the allowed revenues and distribution tariffs, the regulator needs to ensure that there are no cross-subsidies borne by the DSO which provide the affiliated companies a competitive advantage compared to other suppliers. According to *OSSH*, the auditors are not entitled to make assessment on cross-subsidies but they are required to focus on financial compliance (with national tax laws and/or IFRS standards, where applicable). Even if they gave an opinion on cross-subsidization *OSSH* would still have to provide evidence to ERE that the costs recovered through the DSO tariffs strictly relate to the DSO business.

It is the responsibility of the DSO to make sure that terms of reference of the audit includes audit of the transactions with related undertakings and assessment if these are made in an arms' length basis. **The Secretariat considers that based on Article 31(4) of the Directive 2009/72/EC, the auditor shall be tasked with assessing whether there are cross-subsidies in place.**

### 3.3.1. Service Level Agreements

Services of general and administrative nature may also be provided from related parties, be it special service center for this purpose or a segment in another undertaking. The network company could choose to benefit from general services performed by the parent company if it demonstrates that this choice results in lower costs and it does not imply any undue dependence and such services shall be provided under precisely defined contracts, which are to be kept at the disposal of the regulator.<sup>51</sup> Shared services between DSOs and the VIU are limited and accepted under the condition that effective competition is ensured and conflicts of interest are excluded. Such services concern all the different categories of services from personnel to finance, IT, accommodation, transport and call centres.<sup>52</sup>

Sound policies would require establishing a service agreement to measure the scope and quality of provided services. Keys for allocation of respective costs of service must be determined in a transparent manner. These keys are also subject to audit, in accordance with Article 31 of the Directives.

SLA between *OSHEE* and the DSO as a subsidiary have been signed and implemented since December 2020. The SLA have been concluded for 2 (two) years period, with a possibility to renew them based on an explicit request by the DSO and can be terminated from any of the contracting parties within a 1 (one) year notice before the effective date of the termination. While two years as a period of validity could be considered temporary, one year notice for termination (i.e. half of the validity period) is not usual as it is very long and it is very probable that a decision for termination would not be made within one year that would lead to prolongation of the SLA after the two years. **It is thus recommended that for some services there should be a clear phase out, approved by ERE in advance (for ex. in three to five years the DSO should be obliged to develop its own IT and other service sand based on clear criteria, achieving the objective should be monitored by ERE).**

*OSSH* has informed that most of the procurement processes of the DSO are performed by its organizational structures, and a small number of them, are performed under SLA between *OSHEE* Group and DSO as a daughter company signed and implemented. Namely, the SLA have been signed for services related to human resources, legal services, media services,

<sup>51</sup>ERREG, Guidelines of Good Practice on Functional and Informational Unbundling for DSOs, Ref: C06-CUB-12-4b (15.7.2008).

<sup>52</sup> CEER Status Review, *supra*, p.37.

support services, IT services, economic services and business development services.

The SLA define the OSHEE Group as a company that “*masters knowledge, skills, capacity, extensive experience in the electricity sector, as one of the most important operators in the electricity market.*” This explains that the mother company is in fact an important electricity market player and appears quite inappropriate to provide administrative and supportive service subject to the SLA, except those related with electricity market itself. On the other hand, electricity market related transactions must be based on competitive procurement procedure and outsourcing can only be done for the administrative services. As submitted by OSSH, the sole purpose of the OSHEE mother company is to provide services to its daughter companies. The consultants noted that the companies did not go for a structure where they mirrored departments from the OSHEE also in the daughter companies, as this would defeat the purpose of the shared services. Within the DSO in the technical units, there are also skilled people in the areas of the SLA which are preparing the work and deliver the content input to the mother company for consolidation.

The SLA contains general provisions stipulating that the “*support of OSHEE is limited to administrative and supportive functions*” whereas “*actual decisions, day to day operations of the OSSH and management issues will not be affected.*” The agreement also underlines the prevalence of the compliance program of the DSO over the SLA and the regulatory oversight of the ERE over the implementation of the SLAs. One example relates to the HR process, where the services of OSHEE are actually very much the same of a third party/recruitment agency. OSSH develops the requirement profile and states what they are looking for, OSHEE Group publishes the ad and collects CVs, forwards this to OSSH who then assess the CVs and at the end of the process OSSH decides which staff to hire. However, the consultants noted that in other areas, it is not as clear whether the limitation to supportive and administrative functions as stated in the SLA is always respected. **The Secretariat considers that this should be monitored and verified by ERE.**

Moreover, and having in mind that such SLA will be signed with all subsidiaries (the DSO, as well as with the two suppliers), which entails a potential conflict and raises questions as to the separation and confidentiality of those services provided by the mother to the DSO. The SLA thus contains provisions prohibiting OSHEE to share confidential information related to OSSH with other affiliated licensees who may also be recipients of services from OSHEE. **The Secretariat considers it appropriate to have an act of DSO defining a procurement procedure for internally procured / shared services within the VIU. Future outsourcing at least cost should be done based on a prior analysis of the costs. Currently there is no obligation that the DSO should regularly check provision of services on the market, compare with provision of services by the mother company and report to ERE. The Secretariat considers that ERE should require such a procedure by the DSO, including a plan for phasing out some of the SLA over time.**

In relation to the concrete services, stock management that initially was intended to be provided by the holding company, was removed and will be procured on the market. Provision of IT services is subject to the internal procedures on data confidentiality established in accordance with the compliance program, and for legal service an exception to avoid possible conflicts of interest was included. However, effective implementation questionable due to the fact that data protection rules are not yet developed.

Despite the general principles limiting the scope of the SLA in scope and duration, the specific solutions detailed in the SLA actually extend the scope in a way that might contravene the independence of the DSO. In particular, in addition to the IT service and confidentiality concerns, the services identified as business development or support services are not defined in nature, raising the question of both independence and cost allocation. Except for accounting service, all services are actually paid as lump sum and not provided or paid based on the actual scope of service and service request. Nothing in the SLA agreement confirms that this contract is transitory in nature. **In addition to the task of ERE to check the scope and price of the services provided by the mother company and set the criteria for recognition of only reasonable cost for tariff setting, the Secretariat recommends that ERE establishes milestones and**

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**criteria to be met in order to extend the provision of any of the services stipulated in the current SLA.**