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**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**

**RETAIL MARKETS**

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## RETAIL MARKETS

### 1. INTRODUCTION

Extensive amendments have been made to the provisions of Article 3 and Annex I of both the Electricity<sup>1</sup> and Gas Directives<sup>2</sup> with regard to consumer protection. In addition, Articles 36 and 37 of the Electricity Directive and Articles 40 and 41 of the Gas Directive assign new objectives, duties and powers to national regulatory authorities and Articles 40 and 41 respectively of the Electricity and Gas Directives introduce new rules on the functioning of the retail market.

This note provides further information to guide the implementation of measures in the new Electricity and Gas Directives relating to retail market issues. It outlines the new consumer protection measures that are included in the legislation; describes the new roles and duties of regulators; provides direction for the long-term assessment of the cost-benefit analyses that may be carried out on the implementation of intelligent metering systems (smart meters); and provides guidance on closed distribution systems.

The note sheds light on the Commission's services understanding of how the provisions of the Electricity and Gas Directives are to be interpreted. It aims to enhance legal certainty but does not create any new legislative rules. In any event, giving binding interpretation of European Union law is ultimately the role of the European Court of Justice. For the purpose of this note, the terms consumer and customer are used interchangeably. The present note is not legally binding.

### 2. RETAIL MARKETS

Member States must ensure that the roles and responsibilities of energy undertakings, for example distribution system operators and suppliers, are defined with respect to contractual arrangements, commitment to customers, data exchange and settlement rules, data ownership and meter responsibility (Article 41 of the Electricity Directive, Article 45 of the Gas Directive). These rules should specify which entity has responsibility for the roll-out of smart meters and address issues such as confidentiality of consumer data. The rules should be defined so as to facilitate consumers' understanding of the retail market and the entry of new suppliers. The rules must be subject to review by national regulatory authorities and other relevant national authorities. Given the national regulatory authorities' general objective of promoting competitive, secure and environmentally sustainable internal energy markets, their review of the rules would be essential. Other relevant national authorities may also be consulted. Ultimately, in a single market, roles and responsibilities should converge across Member States.

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<sup>1</sup> Directive 2009/72/EC of the European Parliament and the Council of 13 July concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 55).

<sup>2</sup> Directive 2009/73/EC of the European Parliament and the Council of 13 July concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (OJ L 221, 14.8.2009, p. 94).

Given the national regulatory authorities' new roles and objectives with regard to protecting consumers and promoting competition, it is reasonable to assume that their review is central to producing rules that satisfy the requirements of the Directives (Articles 36 and 37 of the Electricity Directive, Articles 40 and 41 of the Gas Directive).

### **3. NATIONAL REGULATORY AUTHORITIES**

National regulatory authorities have been given the considerably enhanced role of ensuring that customers benefit from the efficient functioning of their national market, promoting effective competition and helping to ensure consumer protection (Article 36(g) of the Electricity Directive, Article 40(g) of the Gas Directive). This provision requires working closely with other national organisations responsible for the protection of consumers, such as consumer bodies and competition authorities, to ensure that consumer protection measures, including those outlined in Annex I to the Electricity and Gas Directives, are effective. The Commission's services consider that this interaction should, as a minimum, take the form of open and transparent public consultation between the relevant bodies and provide for the capacity to share information. Interaction between the organisations should be reinforced by legislation, where appropriate, in order to facilitate the sharing of confidential information and market investigations.

In fulfilling their enhanced role, national regulatory authorities will have a duty to monitor the effectiveness of market opening and competition at the retail level (Article 37(1)(j) of the Electricity Directive, Article 41(1)(j) of the Gas Directive). This should take place across a range of indicators that will promote the active monitoring of retail markets by national regulatory authorities. If the national regulatory authority does not have competence for the enforcement of competition law, it will have to work in close cooperation with the relevant competition authorities and financial regulators.

Part of the monitoring work that will have to be carried out by the national regulatory authority is in relation to its examination of supply prices to determine whether or not they are consistent with Article 3 of the Electricity and Gas Directives, i.e. whether they are the minimum necessary to protect consumers, vulnerable or otherwise, while not inhibiting effective competition in the market (Article 37(1)(o) of the Electricity Directive, Article 41(1)(o) of the Gas Directive). Where supply prices are clearly anti-competitive, for example because they deter market entry by negatively affecting the ability of entrants to acquire a viable customer base, it should be reported to the appropriate national authority for remedial action. As part of this examination, it will be for the regulator to determine whether prices are reasonable, easily and clearly comparable, transparent and non-discriminatory. In this context, such prices should be consistent with a competitive market outcome.

Collectively, the duties and powers of national regulatory authorities broaden the role of the regulators to include additional monitoring and regulation of the operation of the internal energy market.

## **4. CONSUMER PROTECTION**

### **4.1. Licensing and authorisation regimes**

In line with Article 56 of the Treaty on the Functioning of the European Union on the freedom to provide services, consumers in one Member State have the right to be supplied with energy by a supplier who is registered in another Member State (Article 3(4) of the Electricity Directive, Article 3(5) of the Gas Directive) as long as the supplier follows the applicable trading and balancing rules for electricity and gas, and the security of supply requirements for gas. With regard to those Member States that do not have formal licensing regimes, the provisions also apply to other authorisation procedures that allow undertakings to supply energy. These provisions should encourage Member States to have due regard to licensing, authorisation and registration systems in other Member States in an attempt to avoid restrictions on trade and assist in the harmonisation of retail markets in line with the Regional Initiatives, which were established as an interim step towards creating a single electricity and gas market. The Agency for the Cooperation of Energy Regulators should report on progress on these matters as part of its obligations under Article 11 of Regulation (EC) No 713/2009<sup>3</sup>.

### **4.2. Access to consumer information**

As a means of improving customers' ability to switch supplier, customers are entitled to receive all consumption data in an easily understandable harmonised format (Article 3(5) of the Electricity Directive, Article 3(6) of the Gas Directive). The data that should be considered to be relevant for the purposes of this Article include all information that a consumer would need either to assess his or her own consumption pattern or compare his or her consumption costs with offers provided by other suppliers. This does not imply that customers must receive the data, they are entitled to receive the data in a non-discriminatory manner as regards costs, effort or time if they choose to request it.

Annex I to both the Electricity and Gas Directives further elaborates on this provision of information to consumers. In addition to consumers being entitled to receive their consumption data from electricity and gas undertakings, they are also permitted to allow any registered supply undertaking to have access to their consumption data (Annex I(h) of the Electricity Directive, Annex I(h) of the Gas Directive). This service is to be provided free of charge for consumers. The term 'registered supply undertaking' should be interpreted as an undertaking licensed or otherwise authorised to supply energy. It is the task of the national regulatory authority to provide an easily understandable harmonised format for the consumption data (Article 37(p) of the Electricity Directive, Article 41(q) of the Gas Directive).

Taken together, these new provisions of Article 3 and Annex I are designed to make it easier for consumers to understand their own consumption, use this information either to compare it with offers from other energy suppliers, or to allow other suppliers to have access to their consumption data so as to provide them with a new offer of supply.

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<sup>3</sup> Regulation (EC) No 713/2009 of the European Parliament and the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators (OJ L 211, 14.8.2009, p. 1).

### **4.3. Billing information and obligations relating to switching processes**

Annex I(1)(i) states that consumers must be properly informed of actual electricity/gas consumption and costs frequently enough to enable them to regulate their own electricity/gas consumption. The Commission services note that the introduction of appropriate smart meters would greatly assist the fulfilment of this obligation. Annex I also points out that consumers must be offered a wide choice of payment methods, which do not unduly discriminate between customers. Furthermore, prepayment systems must be fair and adequately reflect likely consumption. These provisions are intended to ensure that consumers do not pay an excessive amount as part of a regular payment system and that consumers have access to a range of methods for payment. It is reasonable to assume that consumers should have access to systems that are paid in arrears or in advance and are accessible to all consumers, including those without bank accounts or access to the internet.

In addition to a consumer having the right to switch supplier within three weeks, while respecting contractual conditions (Article 3(5)(a) of the Electricity Directive, Article 3(6)(a) of the Gas Directive), consumers must receive a final closure account following any change of electricity or gas supplier no later than six weeks after the change of supplier has taken place (Annex I(1)(j) of the Electricity Directive, Annex I(1)(j) of the Gas Directive).

### **4.4. Vulnerable customers**

There is an obligation on Member States to define the concept of vulnerable customers (Article 3(7) of the Electricity Directive, Article 3(3) of the Gas Directive). To fulfil this requirement, Member States must define the categories of consumer that will qualify as vulnerable customers. It is anticipated that the actual number of consumers that fall within the category of vulnerable customers will be quite low. It would be reasonable to assume that disabled or elderly consumers could qualify as being vulnerable but not all consumers within these groups should be considered vulnerable, for example those with high incomes.

The protection of vulnerable customers may refer to a prohibition of disconnection at critical times. For example, elderly consumers on an extremely low income may be considered to be vulnerable during a severe winter if they use electricity to heat their home. The prohibition may take the form of a licence condition or obligation.

Article 3 notes that social policy and energy policy, including energy efficiency measures, can interact to protect vulnerable customers. However, it is not the intention that energy policy should in any way substitute for the protection of vulnerable customers through social policy. Crucially, any measures taken to protect consumers through the energy market must not interfere with either market opening or the functioning of the market. Any measures taken must be notified to the Commission.

### **4.5. Single points of contact, complaints and dispute settlement**

In order to build confidence among consumers so that they will actively participate in the internal energy market, it is vital that their concerns and complaints are dealt with in a transparent, effective and non-discriminatory manner. To this end, Member States must ensure that there is an independent mechanism, such as an energy ombudsman or consumer body, to deal efficiently with complaints and facilitate out-of-court dispute settlements (Article 3(13) of the Electricity Directive, Article 3(9) of the Gas Directive).

Under Annex I(1)(f), consumers must benefit from transparent, simple and inexpensive procedures for dealing with their complaints. This should include a good standard of complaint handling by their energy service providers. Out-of-court dispute settlements should be completed within three months. Member States must ensure that suppliers effectively communicate to consumers their rights, including information on alternative dispute settlement procedures. Member States should have regard to best practices in complaint handling, in particular in relation to those systems that are available free of charge.

To avoid consumers becoming confused when dealing with the various agents involved in the supply of energy, Member States must ensure that there are single points of contact to provide consumers with all necessary information on their rights and how they can have access to the relevant dispute settlement procedure (Article 3(12) of the Electricity Directive, Article 3(9) of the Gas Directive).

#### **4.6. European Energy Consumer Checklist**

As a means of providing consumers with practical information relating to energy consumer rights, Member States are to ensure that the European Energy Consumer Checklist as prepared by the Commission is effectively communicated to all consumers (Article 3(16) of the Electricity Directive, Article 3(12) of the Gas Directive). The Checklist has been discussed at the Citizens' Energy Forum in London<sup>4</sup>. The Checklist responses that are prepared by Member States should answer all practical questions that a consumer might have in relation to their local retail energy market. So that the responses are meaningful, Member States should ensure that they are clear, concise and comprehensible. Although there is no legal duty to notify the Checklist answers to the Commission, the implementation of the Checklist will be reviewed in the context of the Citizens' Energy Forum.

#### **4.7. Implementation of intelligent metering systems**

An intelligent metering system or 'smart meter' is an electronic device that can measure the consumption of energy, adding more information than a conventional meter, and can transmit data using a form of electronic communication. A key feature of a smart meter is the ability to provide bi-directional communication between the consumer and supplier/operator. It should also promote services that facilitate energy efficiency within the home. The move from old, isolated and static metering devices towards new smart/active devices is an important issue for competition in energy markets. The implementation of smart meters is an essential first step towards the implementation of smart grids<sup>4</sup>.

It has been noted in the Commission's Benchmarking Reports<sup>5</sup> on the internal market for electricity and gas that switching levels are relatively low, even in some of the more established markets. This indicates that there may still be barriers to consumers' effective participation in the market. There is evidence that consumers are willing to switch when given access to sufficient, accurate and timely information on the benefits of their participation. Therefore, the current perceived transaction cost of switching needs to be addressed. An

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<sup>4</sup> See section 4.8 below.

<sup>5</sup> The Commission's Benchmarking Reports can be found at:  
[http://ec.europa.eu/energy/gas\\_electricity/benchmarking\\_reports\\_en.htm](http://ec.europa.eu/energy/gas_electricity/benchmarking_reports_en.htm).



appropriate solution would be the widespread roll-out of smart meters as a means of facilitating consumers' participation in the retail market.

Under the Electricity and Gas Directives, Member States must ensure the implementation of intelligent metering systems that help consumers to participate actively in the electricity and gas supply markets (Annex I(2) of the Electricity and Gas Directives). Therefore, the technology chosen must facilitate the consumer's active participation in the electricity and gas supply market. As such, the ownership of the meter is a key consideration and must not inhibit the development of retail market competition. The implementation of such metering systems may be subject to an economic assessment of all the long-term costs and benefits to the market and the individual consumer or of which form of intelligent metering is economically reasonable and cost-effective and which timeframe is feasible for their distribution. This assessment must be completed by 3 September 2012.

For consumers and the operation of the retail market, there are a number of benefits associated with the roll-out of smart meters that the Commission considers should be covered by the economic analysis, including:

- improved retail competition;
- energy efficiency and energy savings;
- lower bills due to better customer feedback;
- new services for consumers, including vulnerable consumers;
- improved tariff innovation with time of use tariffs;
- accurate billing;
- reduced costs and increased convenience for pre-pay;
- less environmental pollution due to reduced carbon emissions; and
- the facilitation of microgeneration, including renewable generation.

This is not an exhaustive list of potential benefits. Smart metering would also bring benefits to the energy companies in the form of reduced management costs in terms of manual meter reading and less significant debt handling costs; more efficient network operation and management; and reduced levels of fraud. With regard to the frequency of meter reading, it should be noted that consumers must be properly informed of actual energy consumption and costs frequently enough to enable them to regulate their own consumption (Annex I(1)(i) of the Electricity and Gas Directives). The Commission's services consider that receiving information on a monthly basis would be sufficient to allow a consumer to regulate his consumption. When carrying out an economic assessment, Member States should have regard to appropriate pilot programmes that have already implemented smart meters.

Where an economic assessment of the long-term costs and benefits has been made, at least 80% of those consumers who have been assessed positively, have to be equipped with intelligent metering systems for electricity by 2020. In reply to a request for clarification on

the scope of the 80% target for smart meters in Annex I to the Electricity Directive, the Commission issued a Declaration<sup>6</sup> to the effect that it is understood that where no economic assessment of the long-term costs and benefits is made, at least 80% of all consumers have to be equipped with intelligent metering systems by 2020 (Annex I(2) of the Electricity Directive).

With regard to gas, although there is no specific target date for the implementation of smart metering, it should be achieved within a reasonable period of time (Annex I(2) of the Gas Directive).

Member States must have regard to the interoperability of smart meters in their jurisdiction when implementing these provisions. They must also apply appropriate standards and best practices and have due regard to the importance of developing the internal market for energy. When considering issues relating to the implementation of smart meters, Member States should have due regard to the confidentiality of consumer information as provided for in Article 16 of the Treaty of the Functioning of the European Union.

#### **4.8. Smart grids**

The Commission's services consider that the implementation of more active transmission and distribution systems in the form of smart grids is central to the development of the internal market for energy. The development of technology to deliver more efficient management of networks is more commonly known as smart grids. The new systems will improve efficiency, reliability, flexibility and accessibility and are the key next steps in the evolution of the internal market in energy. Member States are encouraged to modernise distribution networks, for example through the introduction of smart grids, which should be built in a way that encourages decentralised generation and energy efficiency.

In order to promote energy efficiency, Member States or, where a Member State has so provided, the regulatory authority must strongly recommend that electricity and gas undertakings optimise the use of energy, for example by providing energy management services, developing innovative pricing formulas, or introducing intelligent metering systems or smart grids, where appropriate (Article 3(11) of the Electricity Directive, Article 3(8) of the Gas Directive).

Such encouragement is reinforced by the revised objectives and duties of national regulatory authorities, who are responsible for promoting a competitive, secure and environmentally sustainable internal market in electricity/gas within the European Union and effective market opening for all customers and suppliers in the European Union, and for ensuring appropriate conditions for the effective and reliable operation of electricity/gas networks, taking into account long-term objectives (Article 36(a) of the Electricity Directive, Article 40(a) of the Gas Directive). Relevant long-term objectives are European targets for the share of energy from renewable sources in final energy consumption, energy efficiency improvements and greenhouse gas emission reductions.

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<sup>6</sup> Council document 10814/09 ADD 1 REV 1.

When considering issues relating to the implementation of Smart Grids, Member States should have due regard to the confidentiality of consumer information as provided for in Article 16 of the Treaty of the Functioning of the European Union.

## **5. CLOSED DISTRIBUTION SYSTEMS**

### **5.1. Background**

Following the judgment of the European Court of Justice in *Citiworks* (Case C-439/06) there was concern that undifferentiated application of rules relating to the obligations of distribution system operators (DSOs) could result in unnecessary administrative burdens where the nature of the relationship between the distribution system operator and the users of the system was very different to that which prevails on the ‘public’ grid.

In recognition of these concerns, Article 28 of the Electricity and Gas Directives allow Member States to permit competent authorities to classify individual distribution systems as closed distribution systems when certain conditions are met. The decision as to whether it is necessary to do so remains a matter for each Member State, taking into account local circumstances.

Where such a classification is provided for, the national regulatory authority may modify the regulatory regime applying to the DSO in a number of ways. These are discussed below.

### **5.2. What can constitute a closed distribution system?**

As noted, the rationale for modifying the regulatory regime applying to closed distribution systems has to do with the particular relationship between the DSO and the system users. This requires clear criteria to be applied to establish whether such a relationship exists before a system is classified as a closed distribution system. These criteria are set out in Article 28(1) of the Electricity and Gas Directives.

The first point is that the closed distribution system must be located on a geographically confined site. This distinguishes it from the general public network. It also means that it would not be possible, in general, for users located outside the site to be connected to the closed distribution system.

Secondly, the site should be an industrial, commercial or shared services site. In recitals 30 of the Electricity Directive and 28 of the Gas Directive a number of possible examples of such sites are given, including hospitals and chemical industry sites. It is not necessary for the site to have a commercial function — as indicated by the inclusion of hospitals among the examples — but the site cannot be for supplying household customers.

Incidental use by a household is covered in Article 28(4). Only incidental use of the closed distribution system by households having an employment or similar relationship with the owner of the site is compatible with the classification of the system as a closed distribution system. In particular, the total number of households must be small. The definition of what constitutes a relationship similar to an employment relationship depends on the precise circumstances, in particular the historical relationship between the owner and the users of the

system, for example where a company which has developed a distribution system solely for its own operations later splits into several separate companies.

Finally, the site must meet one of two further criteria set out in Article 28(1) to be classified as a closed distribution system. These are either

- (1) for specific technical or safety reasons, the operations or the production process of the users of the system are integrated; or
- (2) the system distributes electricity primarily to the owner or operator of the system or their related undertakings.

Criterion (1) captures situations where several companies jointly use a distribution system which optimises an integrated energy supply, or requires specific technical, safety or operational standards. This is particularly common in industrial sites where, for example, heat from electricity generation is used in the production process of other users of the system. Another reason could be where it is necessary for the users of the site to operate to different reliability standards than those applying on the public grid, for example in relation to frequency.

The interrelationship between the operations of the users of such systems means that it should be possible for them to reach an agreement to ensure that externalities associated with their operations are properly taken into account. It is for Member States to define precisely the circumstances where this criterion would be met.

Criterion (2) allows a modified regulatory regime to be put in place where an undertaking has allowed users to connect to a system which was developed for the undertaking's own use. Generally, this should be understood as excluding, for example, commercial property developments such as office blocks or shopping centres which are not primarily used by the owner or operator of the distribution system (insofar as they can be considered as constituting a distribution system).

### **5.3. Not a separate category of systems**

An important point to note is that closed distribution systems are distribution systems and do not constitute a new and separate category of systems. Therefore the general obligations that apply to DSOs also cover closed DSOs. In particular, the obligation to grant third-party access to the system also applies to closed DSOs.

By creating a sub-category of closed DSOs, the Electricity and Gas Directives recognise that the circumstances prevailing for such systems may differ from those pertaining to 'public' grids. It follows that where there is an obligation on Member States to develop rules applying to DSOs they may design targeted and proportionate rules for closed DSOs that take into account their particular circumstances.

This is particularly important as the precise nature of many obligations on system operators is set by Member States and not directly laid down in the Electricity or Gas Directives.

For example, Article 5 of the Electricity Directive requires Member States or national regulatory authorities to ensure that technical safety criteria are defined and that technical rules establishing the minimum technical design and operational requirements for the connection to the system are developed. Closed distribution systems may require that such provisions are targeted to account for their particular circumstances, for example in relation to the interoperability requirements between a closed distribution system and DSOs or TSOs.

Similarly, the considerations of efficiency and economic balance in relation to the designation of DSOs in Article 24 of the Electricity Directive may differ between closed DSOs and other systems. With the aim of facilitating customers' and suppliers' access to networks, and ensuring effective third-party access to closed distribution systems, it may also be necessary for Member States to clearly define particular roles and responsibilities in relation to closed distribution systems when implementing Article 41 of the Electricity Directive and Article 45 Gas Directive.

Due to the fact that they operate on confined geographic sites serving only non-household customers, closed DSOs will not have more than 100 000 customers. It will therefore be open to Member States to apply the provisions of Article 26(4) of the Electricity and Gas Directives, which allow Member States not to require that such DSOs be unbundled.

#### **5.4. Specific exemptions**

Where a Member State has provided for the classification of a closed distribution system, it may also allow the national regulatory authority to exempt the closed DSO from specific provisions of the Directive.

The most important of these, applying to both electricity and gas, is the provision in Article 28(2) allowing exemption from the requirement that tariffs, or the methodologies underlying their calculation, are approved prior to their entry into force.

This is an extremely important exemption as it allows the users and the owners or operators of closed distribution systems to reflect the particular nature of their relationship and take account of the impact of interdependencies in their operations.

In relation to electricity, Article 28(2)(a) of the Electricity Directive allows the national regulatory authority to exempt the closed DSO from the obligations of Article 32(1) of the Electricity Directive to procure the energy it uses to cover energy losses and reserve capacity in its system according to transparent, non-discriminatory and market-based procedures.

#### **5.5. Review procedure for negotiated tariffs**

Access to an independent review of tariffs is essential if the normal regulated third-party access scheme is modified. This allows users to be confident that they will be fairly treated, and avoids the delays and uncertainty associated with legal proceedings. Such a review mechanism is provided for in Article 28(3). Regulators must have the appropriate range of powers and duties, and the associated expertise necessary to carry out this task efficiently and effectively.

Article 28(3) requires that, upon request by a user of the closed distribution system, national regulatory authorities must review tariffs in line with their powers and duties set out in Article 37 of the Electricity Directive and Article 41 Gas Directive. This ensures that the interests of all parties, including the closed DSO, are properly taken into consideration when reviewing the closed DSO's tariffs. This provides important safeguards both for the user of the closed distribution system and for the system operator.

Without prejudice to the general requirement that the national regulatory authority take into account the specific facts of any dispute brought before it, it should be possible for national regulatory authorities to establish a general framework to apply when requested to review tariffs of closed DSOs. This could reduce what might otherwise become an onerous requirement on national regulatory authorities as it is possible that there will be a significant number of closed distribution systems in Member States.