

## Energy regulators highlight “fuzzy” distribution separation, default suppliers and suppliers of last resort

- Scope to empower customers through supplier of last resort or default supplier
- Time to end the fuzzy separation of distribution from supply

Today the European Regulators Group for Electricity and Gas (EREG<sup>1</sup>) published two Status Reviews which seek to better protect energy customers and promote retail market competition to the benefit of Europe’s energy customer. Both reports will be presented at the Citizens’ Energy Forum<sup>2</sup> this month.

The first report<sup>3</sup> reviews customer protection support systems in place. It finds that there is no consistency of approach across Europe in defining “vulnerable customers”, “default suppliers” and “supplier of last resort”, and recommends ways to promote competition.

The second report<sup>4</sup> monitors the status of unbundling the Distribution System Operator (DSO) of vertically integrated firms in terms of its management and information flows.

### **Scope to empower customers through supplier of last resort or default supplier**

An important way of protecting customers is to have a “*default supplier*”<sup>5</sup> and/or “*supplier of last resort*”<sup>6</sup> or some other system which protects those customers who might be unable to obtain energy. EREG finds that *supplier of last resort* and *default supplier* are understood in many different ways. It is usually the incumbent energy supplier who acts as both, and the service is normally not time-limited. This is a barrier to new entrants.

In an effort to promote competition, EREG recommends a tendering procedure for appointing a default supplier/supplier of last resort, and also time-limiting these services<sup>7</sup>.

EREG Chair, Lord Mogg explains “*This would serve the dual purpose of encouraging new suppliers to enter the market, and the time-limitation would promote activity by customers away from the default supplier/supplier of last resort*”.

While EREG has found that only few countries use the term “*vulnerable customers*”, different support systems do exist for customers who are financially weak or have certain needs (disabled, etc)<sup>8</sup>. Thanks to the new 3<sup>rd</sup> Package of energy laws, customer rights, and those of the vulnerable customer in particular, are set to improve<sup>9</sup>.

### **Time to end the fuzzy separation of distribution from supply**

The core idea of liberalisation is to maintain the monopoly for the distribution network but to open the market for the supply business, thus introducing competition. The 2003 Directives thus require the DSO to be both legally and functionally separated from the competitive parts (supply and generation) of the vertically integrated energy firm by July 2007<sup>10</sup>.

EREG’s status review on DSO unbundling finds that consumers do not know yet about different separated roles of distribution and supply; consumers find identical branding for what should be separated parts of the businesses; and the separation of information is a big problem not least because the DSO and supply businesses share the same staff.

Lord Mogg pointed out “*DSO unbundling is key for getting retail market competition started. Retail competition needs a market facilitator, providing non-discriminatory services to all energy suppliers. Fuzziness about the separation of the DSO from the supply arm can not only create consumer confusion but moreover can undermine consumer’s trust to change supplier. A lot of work still needs to be done. Management salaries are still tied to the performance of the integrated company and not to the DSO performance, staff are shared and the Compliance Officer is often not independent. It is time to end the fuzziness of roles and responsibilities and build market confidence.*”

Brussels, 18 September 2009

**Ends (see Note for Editors on next page)**

**Notes for Editors:**

1. The Council of European Energy Regulators (CEER) is the body through which Europe's national energy regulators voluntarily cooperate. The European Regulators Group for Electricity and Gas (EREGG) is the European Commission's formal advisory group of energy regulators on internal energy market issues in Europe. See [www.energy-regulators.eu](http://www.energy-regulators.eu).
2. The European Commission established the Citizen's Energy Forum, or so called "London Forum", in October 2008. The 2<sup>nd</sup> (annual meeting) of the Forum takes place 29-30 September 2009. The participants to the Citizens' Energy Forum are national energy regulators, Member States, the European Commission, some MEPs, consumer organisations, and industry (energy industry and industrial consumers). It is co-chaired by ERGEG and the European Commission. Responsibility for energy consumer issues within the European Commission is shared between DG TREN and DG SANCO. The Citizens' Energy Forum is akin to the Florence Forum in electricity or the Madrid Forum in gas, but has a focus specifically on consumer and retail energy market issues.
3. ERGEG Status Review of the definitions of vulnerable customer, default supplier and supplier of last resort (E09-CEM-26-04), July 2009, presents the findings of a questionnaire completed by the regulators of 27 countries (25 Member States, plus Croatia and Norway) in electricity, and 25 Member States in gas.
4. ERGEG Status Review of DSO Unbundling with Reference to Guidelines of Good Practice on Functional and Information Unbundling for Distribution System Operators (E09-URB-20-05), September 2009, presents the findings of a questionnaire completed by the regulators of 21 countries in electricity, and 19 in gas. The questionnaire (comprising 75 questions) deals with different elements of (a) functional and (b) information unbundling including whether legal unbundling provisions have been transposed into national law; whether the DSO is required to be physically separated from the competitive parts of the business; whether the DSO can "share services" with the vertically integrated utility; and whether there is separate branding and communication strategies for the network business and the other competitive aspects of the mother company.
5. The term "default supplier" does not exist in the 2003 Electricity (2003/54/EC) and Gas (2003/55/EC) Directives and ERGEG finds that a majority of the countries do not define this term - 16 out of 27 respondents for electricity and 17 out of 25 respondents for gas do not have a definition of "default supplier". Where it is defined, it is most common that the default supplier is activated when the customer is inactive and does not choose a supplier or when the customer cannot find a supplier on the market.
6. On the contrary, the term supplier of last resort appears in Article 3 in the 2003 Directives but no definition is given. ERGEG's study finds that a supplier of last resort is not the same as a default supplier (but some countries do not separate or distinguish between the terms). 20 respondents for electricity, and 16 for gas have a definition of supplier of last resort. In most cases it is appointed when a supplier goes bankrupt or when a customer cannot find a supplier on the market.
7. It is almost always the case that the default supplier is in fact the same as the incumbent supplier, and in half of the responding countries the role of supplier of last resort falls on the incumbent supplier. To choose incumbent suppliers to act as default supplier and supplier of last resort is, from a competition perspective, not the best solution. A market-oriented solution for appointing a default supplier/supplier of last resort could be to have a tendering procedure to facilitate competition between suppliers. This would help new suppliers to enter the market, especially in countries where competition is not yet very well developed. Furthermore in most countries there is no maximum time limit for the length of the service provided by default suppliers and suppliers of last resort. From a competition perspective, this is not an ideal situation in markets where

customers do not choose their supplier. Time limits promote activity among the customers. If there is no time limit, the customers are more likely to remain with the default supplier/supplier of last resort than if the service is time limited. Such a limit would empower the customers to make a choice between available suppliers and strengthen competition. A time limit of course requires that the customers are given sufficient and adequate information about what will happen when the time limit is reached and what they need to do in order to make an active choice of supplier

8. The Status Review of the definitions of vulnerable customer, default supplier and supplier of last resort (E09-CEM-26-04), shows that few countries (8 out of 27 respondents) actually use the term “vulnerable customer” but there are (different) ways of supporting weak energy customers in most countries. Almost all countries have support systems *not* specific to the energy sector, for financially weak customers. These support systems consist of financial support - mainly social allowances. A majority of countries also have non-economic support systems, such as protection against disconnection (60% of countries), or special services such as bill reads in Braille. Of the 10 countries in electricity and 9 in gas which have economic support systems within the energy sector, some countries still use regulated supply prices for certain groups of customers. ERGEG is a strong advocate that regulated prices distort the functioning of the market and should be abolished, or where appropriate, brought into line with market conditions. Support systems should not hinder competition but rather should allow customers to shop around for the best deal and actively participate in the market.

**Figure 1 – What does your economic support system within the energy sector consist of? (electricity and gas)**

	Supply: specific regulated prices for certain consumer groups	Supply: specific prices for certain consumer groups	Network: a specific tariff for certain consumer groups	Other
<b>ELECTRICITY</b>	Belgium, France, Romania, Slovenia, Spain	Great Britain	Italy, Spain	Bulgaria, Great Britain, Greece, Ireland
<b>GAS</b>	Belgium, Estonia	France, Great Britain		Austria, Bulgaria, Great Britain, Hungary, Ireland, Italy, Romania

9. Consumer rights must be well defined and defended. While the 2003 Electricity (2003/54/EC) and Gas (2003/55/EC) Directives provided for Member States to “ensure that there were adequate safeguards to protect vulnerable customer”, it did not define “vulnerable customers”. The new (2009) 3<sup>rd</sup> Package of energy legislation (Article 3 of the Directive) obliges Member States to provide a definition of “vulnerable customers” which may refer to energy poverty and, inter alia, to the prohibition of disconnection of such customers in critical times. Member States shall ensure that rights and obligations linked to vulnerable customers are applied. In particular, they shall take measures to protect final customers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is in fact able easily to switch to a new supplier. Member States shall take appropriate measures, such as National Energy Action Plans, benefits in social security systems for ensuring the necessary electricity supply to vulnerable customers or support for energy efficiency improvements, to address energy poverty where identified, including in the broader

context of poverty. Such measures shall not impede the effective opening of the market or market functioning and shall be notified to the European Commission.

10. The 1st July 2007 was the deadline for “legal and functional” unbundling of Distribution System Operators (DSOs). Thus whilst Member States could delay the obligation to legally unbundle (i.e. to create a separate “legal” company) large DSOs (above 100,000 customers) until 1 July 2007, such an exemption did not exist with regard to the obligation to unbundle in “functional” terms. It is mainly the “functional unbundling” that is heavily disputed by major EU companies. Unbundling of functions implies the management of the network company shall not be involved in any competitive business (i.e. generation, production of supply) of the vertically integrated company. The 3<sup>rd</sup> Package of legislation targets those integrated DSOs who seek to take advantage of its vertical integration to distort competition. According to Art 26 of the revised Electricity/Gas Directives “distribution system operators of vertically integrated companies shall not, in their communication and branding, create confusion in respect of the separate identity of the supply branch of the vertically integrated undertaking”. Under the Directives of the 3rd Package, Member State are obliged define the roles and responsibilities of relevant market participants.
11. For retail markets to function properly, the distribution network must be a neutral place for retail competition. This requires DSOs of vertically integrated companies to make significant structural changes to the day-to-day running of their business to ensure functional and informational unbundling, including continuous and consistent information for consumers on the role of the DSO and the provisions to guarantee fair treatment. The DSO should also act in full independence of any commercial interests in the market to avoid any conflict of interest, and also effectively monitor and enforce unbundling. ERGEG’s Status Review of DSO Unbundling (September 2009) shows that consumers still find identical branding by the DSO and the rest of the integrated company; consumers still expect “integrated behaviour” i.e. one person responsible for supply and distribution; and only in 5 countries do consumers complain. ERGEG also found that network users/competitors do not trust the neutrality of integrated DSOs. The separation of information remains the biggest problem. Non-discrimination requires well-trained staff on the DSO side, which tends to be in place. However, very often the distribution and supply businesses employ the same persons - ERGEG considers informational unbundling cannot be guaranteed in such circumstances. ERGEG further considers that compliance programmes, which are widely in place, are important tools.