



Best Practice Guidelines on the Protection of Vulnerable Household Customers

**Ref: R07-WGC-01-05
28-June-2007**

FINAL VERSION

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1 Summary

Background

The ECRB WG on Customers took over the work produced by the ERGEG TF on South East European Customers, which was approved as working document by the ERGEG Focus Group on Customers (CFG).

In 2005, the ERGEG task force produced this work following a request of the European Commission (EC), since the ECRB by that time had not been established yet. The EC's request included investigating into affordability issues and customer protection and, after a state-of-play analysis¹, drafting guidelines on best practice. The Guidelines set out the principles and indicate the way forward. The ECRB is invited to adopt the Guidelines. The state-of-play report along with its annex remains an ERGEG working document and serves as work of reference for the ECRB.

1. In general, customers are best protected by well-functioning competitive markets. The establishment of competition in energy supply in the Energy Community should therefore be a prime objective. When it comes to transmission and distribution, efficient regulation is needed for the protection of customers and the organisation of a competitive energy market. Even in the best of worlds, there are requirements for customer protection.

2. The Energy Community Signatory Parties are to introduce energy markets based on competition in generation and supply. Network supply activities are regulated monopoly business. In a mature and well functioning competitive market, competitive forces will ensure the right allocation of resources seen from a macroeconomic point of view, and consumer protection is secured by the ability of customers to effectively choose supplier. Regulation of network business is designed to secure the same objectives for these activities.

3. Both for generation/supply and for networks, this market model implies that

- costs of energy companies will be covered and
- a reasonable (market based depending on risk) return on capital must be allowed for.

In principle, energy companies not realizing these two requirements will leave the market – in the case of network owners/operators, however, for security of supply reasons regulators must ensure new owners/operators to take over their businesses.

¹ An interim report provides the state of play of the current situation in the Energy Community and in the seven EU Member States: At, Bg, Hu, Gr, It, Ro and Sl.

4. Some countries traditionally have below cost energy prices reflecting the concept of energy being a public good. The transition to prices covering costs plus a reasonable return on capital will imply a rise in end-user energy prices, which might be not affordable to certain consumer groups. This social problem must be addressed. This process – in the case of small customers – is the focus of this report.

5. The Guidelines suggest the following sequence of questions to regulators from South East Europe:

a. What is the energy price level of the country for household customers at the outset?

Does the price cover costs and a reasonable return on capital?

b. If there is an affirmative answer to question a) the next question to be raised is whether this price level implies an affordability problem to this consumer group.

In a case of a negative answer to question a) the next question to rise, is how market oriented energy prices will be introduced – especially the timetable.

The subsequent question is whether this new price level will imply an affordability problem to this consumer group.

c. If the answers to the questions under b) basically say that there will be no affordability problem to be envisaged, in principle no further specific consumer protection addressing the affordability problem seems necessary.

If the answer to the questions under b), however, suggests that there will be affordability problems for certain consumer groups, these groups must be identified and the solution to the affordability problems must be addressed.

d. Addressing any affordability problem identified under c) implies a choice between

- Tariff based solutions – regulated tariffs for certain well defined consumer groups*
- Non tariff based solutions – typically using the / introducing a social security system*

Non tariff based solutions must be preferred as they do not obstruct market forces. However, tariff based solutions might for various reasons be the only available option – at least for a period of time. The timeframe of the transition period and the criteria defining this period must be carefully set, foreseeing regular assessments of the results achieved and allowing for a review of the steps to be taken to achieve the target – allowing for development of market prices.

e. Tariff based solutions must be designed firstly in order to have the minimum obstructive influence on the market. Secondly it must be envisaged that any below cost (including a reasonable return on capital) solution will require compensation to the energy companies subject to this regulation, and the financing of this (PSO) compensation must be addressed.

2 Introduction - Subject matter and scope

6. Affordable and reliable electricity and gas supplies are central to modern economic and social life. Most EU citizens now take these for granted, but in the case of the Energy Community Contracting Parties, memories of electricity supply disruption are still vivid for different reasons. Whilst the situation has improved over recent years, as the reconstruction of these countries picks up speed, there are still problems to be solved, such as the lack of investment to modernise these countries' damaged and outdated energy infrastructure; this situation itself harms peoples' lives, their health and their economic prospects.

7. The Energy Community endeavours to ensure:

- More reliable electricity and gas supplies;
- Better quality of life and health for citizens;
- Participation in a European Single Energy Market, and
- Improved relations and cooperation between all partners.

8. In particular, the Commission and the donors place great emphasis on payment and tariff reforms, meaning better collection rates and cost-recovery pricing, to create the market conditions for foreign and domestic direct investment in the energy sector. Without this, investment is unlikely.

9. Utmost care must be taken in achieving public support for the process. In a transition period and thereafter, full respect of public service obligations, appropriate for the situation in each of the states concerned, must be ensured.

10. Reform of the energy sector should be accompanied by measures to compensate households for the diminished household budget this would normally entail. At present, there is no standard approach for dealing with this issue in the Energy Community. Income support mechanisms must be developed taking into account local characteristics, including income levels and the extent of the household-price increase brought about by the reform. Key issues, the participants must address, include the establishment of criteria for determining eligibility for support as well as the support mechanism.

11. The strategic targets must observe:

- Reduction of poverty and of social marginalisation;
- Enhancement of the standard of life of the elderly;
- Protection of the elderly and people with disabilities;
- Partnerships with local public administration authorities to develop social services (e.g. financial support for insulation of buildings) equivalent to EU standards.

12. The Internal Energy Market Directives provisions ensure that citizens have access to energy of a specified quality level at reasonable, cost-reflective prices and to the conditions of real competition and free choice. This objective implies intervention due to the fact that some consumer classes are less attractive for the companies (remote consumers, low consumption consumers or low-income consumers). Competent authorities might also develop a policy for fighting fuel poverty in some areas such as: competition in gas and electricity supply, energy efficiency commitment, monitoring supplier social obligations. It could also develop a policy for promoting good practice on debt prevention, by focusing the attention of energy companies on improvements in minimising billing errors, using consumer records to target energy efficiency, demonstrating flexibility in debt recovery, offering sustainable solutions to consumers in extreme hardship, helping consumers who are unable to manage their own affairs.

13. The social dimension should be reflected also at the level of distribution companies or domestic suppliers which shall have to publish Codes of Practice on key areas of their service. These Codes of Practice could cover payment of bills, dealing with customers in difficulty, provisions on energy efficiency advice, services for prepayment meter customers and special help for the elderly, disabled or chronically sick as well as debt prevention strategies. The competent regulatory body should approve the codes, and monitor compliance to ensure that they are effectively implemented.

14. The Best Practice Guidelines on the Protection of Vulnerable Household Customers provide guidance for national action plans to promote secure energy supply to households including vulnerable customers for this region.

15. The scope of the Best Practice Guidelines is electricity, gas and (district) heating (the latter playing a prominent role in the region where temperature fluctuations and geographic differences are substantial). The responsibility lies with the countries of the region to consider each of the principles in a more detailed way – framing national strategies, activities and plans for implementation as well as a legal framework - which takes into account the specificities of the country concerned.

16. While preference has been given to non-tariff-based support mechanisms for vulnerable customers, this document also deals with the so-called “social tariffs”.

17. Article 3 of the Electricity and Gas Directives provides the framework to build on.

Art. 3 (2) of the Electricity and Gas Directives provides that any Public Service obligation shall guarantee, inter alia, equality of access for EU electricity companies to national consumers

Art 3 (5) according to which measures by Member States shall in particular ensure high levels of customer protection and adequate safeguards to protect vulnerable customers. This includes measures to help them avoid disconnection and measures to protect customers in remote areas.

18. In addition, the Energy Community Treaty in its preamble refers to energy market reforms that would deliver energy supplies to all citizens. Continuous energy supply is essential for economic development and social stability.

19. Recognising the importance of providing high quality, accessible and affordable services meeting the needs of citizens and enterprises, the Commission put forward a Memorandum of Understanding on social issues.

20. It is important to make a distinction between electricity supply and transmission and distribution. Generation and supply of electricity can, and shall according to the Directive, be organised applying competition principles, whilst transmission and distribution networks are natural monopolies and therefore they are regulated.

21. The ERGEG Best Practice Propositions on Customer Protection (E05-CFG-03-04; E05-CFG-03-05; E05-CFG-03-06) complement these Best Practice Guidelines and provide good guidance on customer protection in general, customer switching and on making prices transparent.

3 Definitions

22. The definitions of terms used in the present Best Practice Guidelines either stem from the Directives or the ERGEG Definition List which in parts is annexed to the Best practice propositions (see Appendix - Definitions). The Definition used by ERGEG to describe a vulnerable customer relies on national provisions, stating that a “Vulnerable customer” [is] A customer defined by national laws as a person to be protected in his relations with energy suppliers.” (It provides the following non-exhaustive list of examples: “disabled, chronically sick, pensioners, living on low-incomes and living in remote areas”).

23. As a first step, it is recommended to clearly define, on a national level, criteria for vulnerable customers, taking into account national realities and provisions with regard to income (see Point 37 of the Guidelines).

4 State of play in South East Europe

24. The main economic indicators of the Energy Community Contracting Parties generally reveal that citizens have relatively low incomes, on an average basis, which may prevent timely introduction of cost-based market prices of electricity and gas and network related services.

25. Explicitly, there are some characteristic institutional and historical issues, of varying degree², in the Energy Community which have to be taken into account:

- Tariffs do not reflect costs³;
- Cross-subsidisation between large and small consumers;
- Low collection rates, both non-payment and non-invoicing as a result of poor customer data bases ;
- Lack of transparency in data and harmonisation of accounts;
- Insufficient production and transmission/distribution capacity for electricity on a regional level and a major dependence on one gas supplier;
- Lack of competition in wholesale and retail market;
- TSO bundled with dominant (wholesale) supplier/dominant or sole importer;
- DSO bundled with retail;
- Unclear situation on cross-border issues (capacity allocation procedures and balancing regimes);

² Cf. Energy Community Secretariat's Benchmark Reports, at www.energy-community.org

³ The underlying report does not display the current levels of electricity and gas prices in individual countries and UNMIK. The concept of cost as well as the different methodologies for tariffs need to be tackled by the Working Group with a view of possibly harmonising the methodologies across the region.

5 Supply markets

26. Supply prices: in a well-functioning competitive market, supply prices are not regulated. The market function is not disturbed. During a national transition period, however, some regulatory measures or supervision may be justified. Until a competitive market is established and as long as the national or regional market is dominated by very few players, regulatory supervision is required (reference to EU competition law). In the case where no national competition authority exists (yet), enough powers in the field of supervising competition including enforcement powers shall be given to the regulator.

6 Network regulation

27. Where meters are not in place, modern systems such as automatic meter reading should preferably be put in place instead of old technologies, if financially reasonable. Alternatively or in parallel, prepayment meters should be put in place. Donors' attention should be drawn to this issue in order to facilitate its realisation. The replacement of current meters with smart meters needs to be considered.

28. Efficient network regulation is crucial. Regulators' competence to monitor the economic performance of energy undertakings through the network tariff regulation shall be implemented in practice and its enforcement strengthened. The Internal Energy Market Directives provide Regulators with the power to set cost-reflective network tariffs or establish or approve transparent methodologies for tariff calculation.

29. No cross-subsidisation between end-consumer groups, i.e. households and small or large commercial customers or industry, or among groups of household consumers, is possible. Regulators must exclude any cross-subsidisation by primary or secondary legislation.

30. Investment plans need to be evaluated. In the absence of an appropriate regulatory mechanism to provide incentives, major investment plans may be submitted to the Regulator. The Regulator evaluates the economical viability of the project on the basis of the data/business model provided by the transmission and distribution system operators to avoid the unjustified increase of energy tariffs. Regulators must be able to oversee and assess market and regulated infrastructure operations and ensure that investments are made in the public interest. Regulators need to have a balanced view in terms of decision making as regards cross-border investments (national vs. cross-border).

31. Energy efficiency can be improved by attracting network investments. Also, efficiency of heat and electricity generation (degree of efficiency), gas exploration, as well as transmission and distribution (reducing losses) must be ensured.

7 Customer protection

32. The Internal Energy Market Directives provide minimum requirements for customer protection. Applicable mechanisms include transparent information of supply prices and network tariffs, comprehensible bills, transparent and non-discriminatory contracts, effective, inexpensive and timely dispute settlement mechanisms provided either by the regulatory authority or another relevant body, guaranteed quality of supply standards, etc. (see ERGEG's Best Practice Guidelines mentioned in Point 21.). Awareness-raising campaigns are helpful in informing customers about their rights and how to enforce them.

8 Affordability objectives

33. Governments and regulators (and other relevant authorities) have joint responsibilities to ensure that affordability measures are designed, implemented, and monitored. The measures in question have to be economically viable (minimum level of consumption granted at preferential price, range of beneficiaries etc.). Governments have to put the legal and institutional framework in place. Regulators act in accordance with the legal framework by taking necessary regulatory and supervisory measures. The Regulator is responsible for monitoring the functioning of the energy market and for detecting deficiencies in case of market distortions.

34. In order to grant secure energy supply to vulnerable customers, current energy price levels should be brought to a cost reflective level step by step. Targeted support systems for this category of customers are to be established in compliance with Art. 3 of the Electricity and Gas Directives.

35. The affordability issue related to the end-user's costs for network as well as for supply. There are basically **two main concepts**:

A) Non-tariff based support mechanisms

Social allowances are provided from the state budget or from local government's budgets or municipalities, and go directly or indirectly to the beneficiaries without affecting the cost-reflective energy tariff or supply price structure. They usually cover parts of the expenses incurred (e.g. fixed sum per heating period).

To also avoid any discrimination of fuel types (in particular as regards heating) caused by a levy or tax on the grid charge, social allowances are likely to be the best opportunity to let the market forces operate. Non-tariff based systems have the advantage of not disturbing the market function and do not give false incentives to increase the consumption.

B) Tariff based support mechanisms

Social tariffs are normally funded through a levy or tax on the grid charge. Such levy or tax on the grid charge is used to contribute to the costs of vulnerable customers but shall not cover their payments in full, as vulnerable customers are expected to contribute some proportion of the costs themselves. There may be situations which legitimate tariff based systems; however, they may distort the market, if not in line with the prerequisites for free competition.

Non tariff based solutions must be preferred as they do not obstruct market forces.

36. Support systems need to be applied in a **targeted and restricted manner**. Generally, strict criteria are needed to keep the number of support beneficiaries as small as possible, in relation to the general economic growth. The best option seems to be to grant support to those households which income is lower than the average minimum income or people with no income at all.

37. Income-based systems rather than consumption-based systems shall avoid excessive and uneconomic energy use. Any system must cap either consumption granted a preferential price or the threshold of income allowed for applying for support. Any system should avoid indirect rewards for high energy consumption, and should avoid penalising energy savings through taxes or feed in tariffs, etc.

9 Education and information

38. Relevant authorities have to ensure that awareness-raising campaigns are launched to inform people how to switch supplier (if necessary), how to efficiently use energy (such as the use of efficient machines, insulation of apartments and houses, highly efficient heating and cooling systems and other demand side management measures) and must take actions to ensure that efficiency measures are put in place in the residential sector. The campaigns must also include measures specifically addressed to vulnerable customers. Campaigns include providing transparent information on energy consumption (i.e. through applying EU energy efficiency classification) and actual energy costs, with the goal of making consumers change their consumption behaviour, and possibly granting an initial allowance for the implementation of such measures.

39. There is a need for easy access for vulnerable customers to transparent information. Relevant authorities in charge of supporting vulnerable customers need to ensure that application for support is transparent and feasible (e.g. remote customers should not have to travel to the next bigger city to apply, application forms should be made publicly and easily available). Information on how to benefit from support should be transparent and accessible. The fact that the number of illiterates is high in the region must be considered when designing communication and information standards.

10 Billing, Payment of bills, Disconnection

40. Bills should reflect actual consumption rather than estimating the amount of energy used (e.g. in the region it is very common to charge districting heating according to the apartment size).

There must be a wide range of payment methods available regardless the classification of customer (vulnerable or not).

41. Generally, all customers must comply with their obligations set by law and contract. Disconnection as a punitive measure for non-payment of energy bills must be considered as the last means to react to delayed payment. Before disconnecting customers, an adequate notification period must be given. Moreover, the decision to disconnect a customer must be transparent and regulated by law or other general conditions. Other reasonable measures such as payment by instalments, prepayment facilities need to be offered by the service provider. (Confiscating luxury items such as TV sets might be considered as an alternative, see example of Norway.)

11 A step by step approach

42. As the date of full market opening has been set to 2015 for the Energy Community Contracting Parties, a gradual and sensible procedure of market opening is recommended. This is regarded as the best way to prepare for the necessary accompanying measures to protect vulnerable customers. **Three major milestones can be identified:**

- **Definition of vulnerable customers:** Vulnerable customers should be clearly defined at national level.
- **Implementation of acquis:** National implementation of adequate parts of the Electricity and Gas Directives, including a legal framework establishing transparent monitoring and regulated rights for vulnerable customers. As of today, none of the concerned Energy Community Contracting Parties has opened the household market to competition and the retail market is only open to a few medium enterprises. The market opening shall be done in a step by step approach, taking into account the lack of production and insufficient transmission capacities on a regional level and shall encourage investments in the related fields. Where they exist, regulated prices shall be increased year after year in such a way that they reach market price level and that subsidies need not be maintained.
- **Customer awareness:** In parallel with market opening, customers should be addressed with relevant information in order to enable them to make choices and be aware of their rights in the electricity and gas markets.

43. A range of initiatives to help vulnerable households has to be developed. The aim is to find innovative ways to reduce the effect of price increases on these customers as a result of difficult but necessary business decisions.

44. Present Best Practice Guidelines shall provide guidance to the Energy Community Contracting Parties as relates to the protection of vulnerable household customers. They shall contribute to the debate on the protection of vulnerable customers in the Energy Community. Stakeholders' suggestions and views with regards to the Guidelines' principles in a first step help to develop ideas addressed to those in needs without affecting competition. National action plans will concretize these ideas.

45. The implementation of the Guidelines into national jurisdictions will be equally as essential as the subsequent monitoring of the implementation by the ECRB.

12 Appendix - Definitions

Terms extracted from directives 2003/54/EC and 2003/55/EC

Complaint: A charge against a supplier or a transmission/distribution operator.

Consumer protection: Measures ensuring “transparency regarding general contractual terms and conditions, general information and dispute settlement mechanisms” (2003/54/EC and 2003/55/EC art.3).

Contract: Written agreement between the client and the supplier, or between the client and the transmission/distribution operator for the provision of a certain service or product.

Customers: “Wholesale and final customers of energy” (2003/54/EC art.2 §7 and 2003/55/EC art.2 § 24).

Customer protection: Same definition as Consumer protection.

Disconnection: The action of interrupting delivery of energy to a point of supply. This action can be initiated by the supplier, the network operator or the customer.

Dispute: Argument or disagreement between parties (a customer, a supplier and a transmission/distribution operator).

Dispute settlement mechanisms: The mechanisms in place to resolve disputes related to transmission, distribution and supply of energy.

Distribution: The transport of energy through local or regional networks with a view to its delivery to customers, but not including supply (2003/54/EC and 2003/55/EC art.2 §5).

Eligible customers: “Customer[s] who [are] free to purchase energy from the supplier of [their] choice” (2003/54/EC art.2 §12 and 2003/55/EC art.2 § 28). “From 1 July 2004, [...] all non-household customers” (see this definition). “From 1 July 2007, all customers” (see this definition) (2003/54/EC art.21 and 2003/55/EC art.23).

Final Customers: “Customers purchasing energy for their own use” (2003/54/EC art.2 §9 and 2003/55/EC art.2 §27).

Household customers: “Customers purchasing energy for their own household consumption, excluding commercial or professional activities” (2003/54/EC art.2 §10 and 2003/55/EC art.2 §25).

Service provider: A provider of services related to energy supply or distribution/transmission. A Service provider is not necessarily a Supplier (see this definition).

Small enterprises: “Enterprises with fewer than 50 occupied persons and an annual turnover or balance sheet not exceeding EUR 10 million” (2003/54/EC art.3 §3).

Supplier: Seller or reseller of energy to customers (see Supply).

Supplier of last resort: A supplier of last resort is obliged to provide energy to final customers in emergency situations according to national legislation when the chosen supplier does not serve or cannot serve.

Supplier switching: The action through which a customer changes supplier.

Supply: “The sale, including resale, of energy to customers” (2003/54/EC art.2 §19 and 2003/55/EC art.2 §7).

Transparency: Principle of openness, honesty and accountability in public and private transactions. Concerning customer protection, the principle of transparency applies to “contractual terms and conditions, general information and dispute settlement mechanisms” (2003/54/EC art.3 §5 and 2003/55/EC art.3 §3).

Universal service: “Right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices” (2003/54/EC art.3 §3).

Vulnerable customers: Customers defined by national laws as persons to be protected in their relations with energy suppliers (example: disabled, chronically sick, pensioners, living on low-incomes and living in remote areas).

Other relevant terms:

Activation: The action of enabling the delivery of energy to a specific point of supply. Activation and connection might be separately requested by the final customer.

Connection: The action of physically connecting a point of supply to the network. Only new points of supply are concerned by a connection, existing points of supply are considered connected (but not necessarily with an activated meter. Activation (see this definition) must take place following connection if the customer wants to use energy.

Default supplier: The Supplier (see this definition) to which the customer is attributed when he does not choose a supplier.

Disconnection: A point of supply whose meter has been de-activated and no energy can be consumed/supplied.

Incumbent supplier: The historical supplier in a specific geographical area (sometimes with the obligation to supply energy to local customers).

Integrated contract: A contract related to the access to the energy network and the supply of energy. This contract is usually signed by the customer with the supplier (who has its own agreement with the system operator).



Supply contract: A contract exclusively related to the supply of energy to the customer. This contract is signed by the customer with the supplier.