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Regulatory and Energy Assistance

Supplier of Last Resort Default Supplier

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What we mean by Supplier of Last Resort (SOLR) and Default Supplier (DS)

- **For today's seminar:**
 - SOLR means:
 - Short-term emergency supply when regular supplier fails
 - DS means:
 - Long-term supply if customers do not choose or supplier unavailable in market
 - Includes vulnerable and remote customers
- But note, standard definitions do not exist



EU Electricity Directive

- SOLR and DS fall under customer protection provisions – universal service and continuity of supply at reasonable prices
- Goal is to address tension between two objectives:
 - (1) Ensuring **universal service** for citizens
 - with safe and continuous supply
 - (2) In as **competitive** an environment as possible
 - with level playing field for all suppliers, domestic and foreign



The Electricity Directive, Article 3 (3):*

*“Member States shall ensure that all **household customers**, and, where Member States deem it appropriate, **small enterprises** . . . enjoy **universal service**, that is **the right to be supplied** with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent **and non-discriminatory** prices.”*

- * *3rd EU Directive effective March 2011 added “and non-discriminatory”*



The Directive, Article 3 (3) *(continued)*:

*“To ensure the provision of **universal service**, Member States **may** appoint a supplier of last resort.”*

*SOLR “shall be implemented in a **transparent and non-discriminatory way** and shall **not impede the opening of the market**”*



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GUIDING PRINCIPLES UNDER THE EU FRAMEWORK

The Directive, Article 3 (4):*

*“When **financial compensation**, other forms of compensation and exclusive rights which a Member State grants for the fulfillment of obligations ... are provided, this shall be done in a **non-discriminatory and transparent way.**”*

* 3rd Directive Art. 3(6)



The Directive, Article 3 (5):*

- *“Member States shall take appropriate measures to protect final customers, and shall, in particular, ensure that there are **adequate safeguards** to protect **vulnerable customers**”*
- **Current Directive:** *“In this context, Member States **may** take measures to protect final customers in **remote** areas.”*
- **New Directive:** *“In this context, each Member State **shall define** the concept of vulnerable customers.... In particular, they **shall** take measures to protect final customers in **remote** areas.”*
 - *Interpretative. Note: “it is not the intention that energy policy should in any way substitute for the protection of vulnerable customers through social policy”*

* 3rd Directive Art. 3(7)



What does this framework mean?

- Universal service is mandatory for household and small enterprise customers
- SOLR and DS are permitted, not mandated
- Are accepted mechanisms by which universal service can be met, including service to vulnerable and remote customers
- SOLR and DS safeguards cannot impede development of borderless competitive market
- Compensation and rights of SOLR and DS service providers must be assigned in “non-discriminatory and transparent way”



EU Directives Do Not Define SOLR or DS

EU typically uses narrow concept of SOLR:

- SOLR only provides service in temporary and exceptional circumstances, such as emergencies – when supplier goes bankrupt or otherwise abruptly stops service
 - But some ambiguity remains – ERGEG study notes SOLR and DS “understood in many different ways” and, in half of countries surveyed, roles are filled by same entity (the incumbent)
- *See 2009 ERGEG Paper, “Status Review of definitions of vulnerable customer, default supplier, and supplier of last resort”*



Definitions in BiH

- Definitions in Entity Eligible Customer rules are similar to each other:
 - FERC rule: *“Supplier of Last Resort’ shall mean a supplier that takes over the responsibility of electricity supply for eligible customer, under the conditions prescribed within this rule, **in the case when supplier with which eligible customer has signed the contract terminates its operation.**”*



Definitions in BiH

- *RSERC rule: “Supplier of Last Resort’ shall mean the supplier that is appointed to assume responsibility for electricity supply of the eligible customer, under the terms and conditions prescribed by this Rule Book, **when the supplier of eligible customers that the eligible customer has the contract on supply concluded with, stops supply the electricity.”***



Definitions in BiH

- No specific definitions for default supplier, but each envisions post-transitional period rule with a DS-type concept:
 - RSERC: Definition of entitlement of end user to universal service (and SOLR)
 - FERC: Definition of conditions under which customer may be supplied at regulated prices (and SOLR)



- Any definition of SOLR and DS should clearly address supply for:
 - **Eligible Customers Without Market Supplier** - Customers who never choose or cannot find competitive supplier
 - **Vulnerable Customers** who suppliers do not want to serve without security of regulated compensation
 - **Remote Customers** who are not cost-effective to serve without subsidy, and
 - **Abandoned Customers** - Eligible Customers who choose, but something happens to their Suppliers, e.g., – Bankruptcy



Role of SOLR

- Have stand-by supply in place, ready to serve eligible customers when need arises
 - Note challenge of assuring contingent supply for a single very large customer
- Available staff to support the customers to settle past accounts and switch back to an energy trader (competitive energy trader or DS) when SOLR role ends



Role of DS

- Provide regulated energy service to retail consumers as directed by energy regulator
- Obtain customer account information
- Obtain open access for supply
- Obtain load shape data for small consumers
- Arrange for meter reading and billing



Who may serve as SOLR and DS?

- Both SOLR and DS could be any energy trader/ supplier with the proper credentials
- Typically, the unbundled distribution company's retail arm serves as SOLR and DS



Who decides and how?

- Both SOLR and DS usually designated by regulator
- Selection alternatives:
 - Tender
 - Commonly used in competitive markets
 - Bids – short or long terms; geographic areas
 - Imposition – supply license condition
 - Appointed through negotiated, non-tender process



Possible Methods:

- **Alternative #1:** Tender process preferred if one general SOLR or DS chosen per utility territory



- **Alternative #2:** Amend supply licenses to include separate tariff for each of SOLR and DS supply, at regulated price or some variant thereof
 - Can be difficult if imposed on multiple suppliers serving market



- **Alternative #3:** If SOLR can be competitively priced, time period is short and market generally competitive, Regulator may select SOLR in transparent, non-tender process
 - Not applicable for DS, which has regulated price



Benefits and risks of legacy providers

BENEFITS

- Customers and distribution companies know each other and their processes
- Distribution company has all customer information, infrastructure and data
- Potentially smoother transition

RISKS

- Incumbents usually do not want to lose customers to competition, so may not support competition
- May be reluctant to share customer information and data with energy traders
- Could discourage market entrants



BiH Context

- Strong incumbent suppliers – 3 EPs
- Incumbent supplier only viable DS initially
 - Bid process of limited use initially
 - Use license condition, but with flexibility for change of DS when future competition
- Need strong regulation and controls to protect against anti-competitive behavior
- Others could be SOLR



What interested suppliers need to show to become SOLR and DS

- Financial viability
 - Must be economically sound, with customer, employee, contract and revenue base
 - Extent of requirements depends on the regulator
- Capability to provide service
 - May be measured by volume: see, e.g., Romania, where a company may bid to serve as SOLR [or DS] for class of customers in more than one service area only if annual transaction volume ratio for that class is greater than 5%
 - May be measured by record of service: see, e.g., Romania, where supplier must have provided licensed services for 12 months prior



- Access arrangements
 - Network access arrangements need to be contracted or quickly obtainable
- Requisite staff
 - Time and resource intensive so neither SOLR nor DS can be small business, tightly run, or have extensive/burdensome procurement requirements



- For SOLR and DS, understanding and resources to notify customers of transfer, advise of transfer rights
 - For SOLR only, responsible to send notices to customers of what has happened and what will happen, including price increase
- May come from regulator
 - But this places high burden on regulatory resources



- Regulator may require SOLR to notify customers of transfer, advise of transfer rights
 - But regulator needs to maintain active role to avoid abuse
 - In England and Wales, SOLR responsible (within 2 days of SOLR appointment) to send notices to customers of what has happened and what will happen; regulator approves model notices



SOLR and DS General Tariff Considerations

- SOLR pricing can be market-based or regulated
- Regulated tariffs for DS
- Wholesale price pass-through mechanisms
- Underscores metering precondition



SOLR Tariff Treatment in BiH

- **RSERC rule:**
 - Large and medium-sized customers, to receive SOLR service, must conclude SOLR contract in advance with supply licensee of tariff customers, and price contains “fair recovery” of the SOLR costs
 - Small customers’ SOLR is supply licensee of tariff customers, and regulator approves calculation of supply price
- **FERC rule:**
 - Eligible customers may separately contract for SOLR of their choice. If not, they have the right to contract with SOLR having public service obligation
 - Price for customers above 0.4 kV equals cost of supplied electricity, supervised by FERC
 - Small customers (0.4 kV) is approved by FERC based on SOLR application



SOLR Tariff Considerations

- SOLR incurs stand-by, switching and supply costs
 - SOLR includes stand-by cost in its pricing
 - Switching cost can be passed through or absorbed by SOLR
 - Supply costs passed through
 - Approved by regulator
 - May be differentiated by customer class



SOLR and DS rates impact market development

- If too high

- Will encourage customer choice because customers will sign up for lower prices, but
- Vulnerable and remote customers who do not have a competitive retail supplier will pay higher prices than other customers – incidence of nonpayment will increase
- Drag on overall economy

- If too low

- No independent supplier will be able to compete and no market will develop
- Different kind of subsidy



SOLR Fixed prices vs. variable prices

- Fixed
 - Customers who need the service know the price for the pricing period
 - May not get suppliers to provide the SOLR if risks are perceived to be too great
- Variable (pass-through of wholesale costs)
 - Allows the SOLR to recover costs
 - May cause wide variations for customers



Issues in Pricing of SOLR and DS

- Retail suppliers' business practices
 - Retail suppliers operate by taking a small margin on every unit of electricity sold and relying on large volume of transactions. They will market to the most profitable customers (e.g., large customers)
 - Unregulated suppliers may abandon undesirable customers to SOLR
 - SOLR may become a company that has only remote, vulnerable customers, customers with poor credit, or customers with peculiar usage needs



Issues in Pricing of SOLR and DS

Customer class price differences

- There could be a different SOLR for each class of service (e.g., residential, small non-residential, large non-residential)
- There also could be separate prices for each class of service



Guidelines

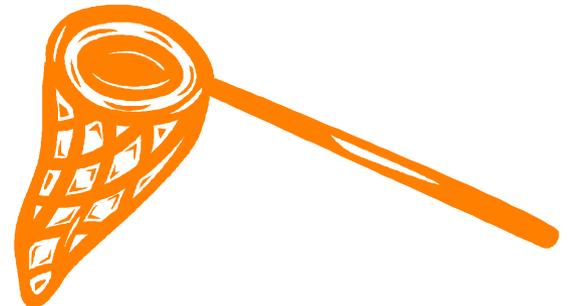
- Ability to change suppliers *quickly* and *easily* is essential condition in open market
 - Challenges suppliers to offer better service, lower prices
- Need for clear, straightforward process that ensures continuation of supply
 - Contact customers
 - Read meters and settle final bill in timely fashion (England and Wales – 14 days)
 - Determine if customer can switch before existing contract term ends

– See *ERGEG 2008 Paper “Obstacles to supplier switch in electricity retail markets: Guidelines of Good Practice and Status Review”*



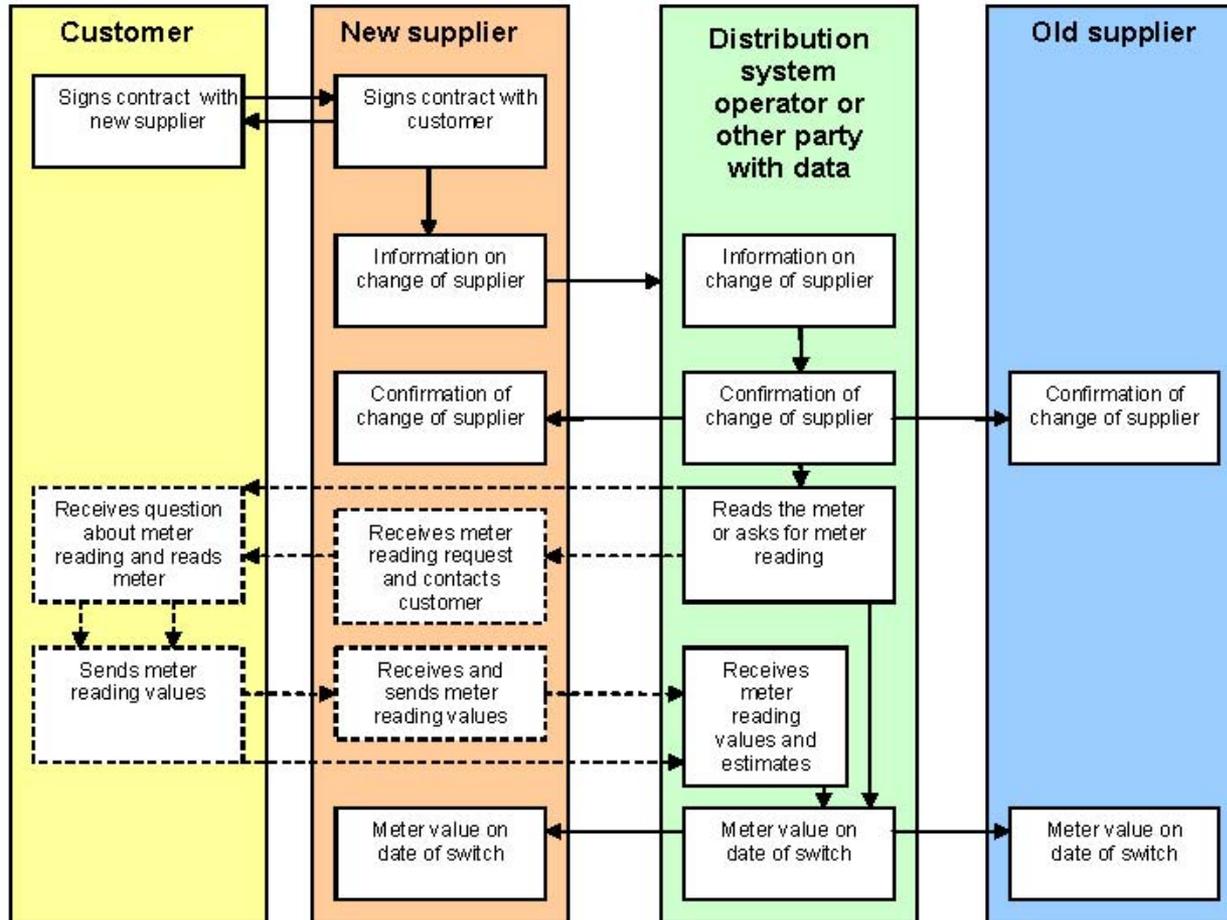
Guidelines

- Should be a minimum/maximum term to purchase from SOLR and DS
 - SOLR meant to be a “safety net” and short-term
 - DS meant to be longer
- Determine whether customers can, at will, switch back and forth between a retail supplier and the DS and whether applies to all classes of customers
 - Difficult to price service if customers are continuously switching





Switching Process



– See *EREG 2006 Paper*
“Supplier Switching Process
- Best Practice Proposition”



Slovenia

- SOLR defined in primary law, no definition of DS
- SOLR designated by DSO
- Currently DSO is SOLR and functions as DS
- SOLR covers both supplier bankruptcy and situations where customer cannot find supplier
- Defined maximum period for SOLR service is 60 days



Romania

- DS and SOLR defined in primary laws
- Both designated by regulator
- SOLR is for supplier bankruptcy and is activated by the regulator when supplier about to lose license
- DS is for customers who do not choose
- To be SOLR for household and small enterprise customers, must be DS as well
- To be SOLR for large customers, must have defined minimum market share
- Current SOLR is incumbent supplier



Romania

- SOLR selected by auction
 - Regulator establishes auction committee
 - Selection occurs before emergency event
 - Regulator maintains list of potential SOLRs, arranged by service area and class
 - Bids evaluated on price only
 - If no award, regulator makes direct assignment



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Hvala!

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