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Febeg

STUDY OF THE APPLICATION OF THE SOCIAL TARIFF FOR ELECTRICITY AND GAS

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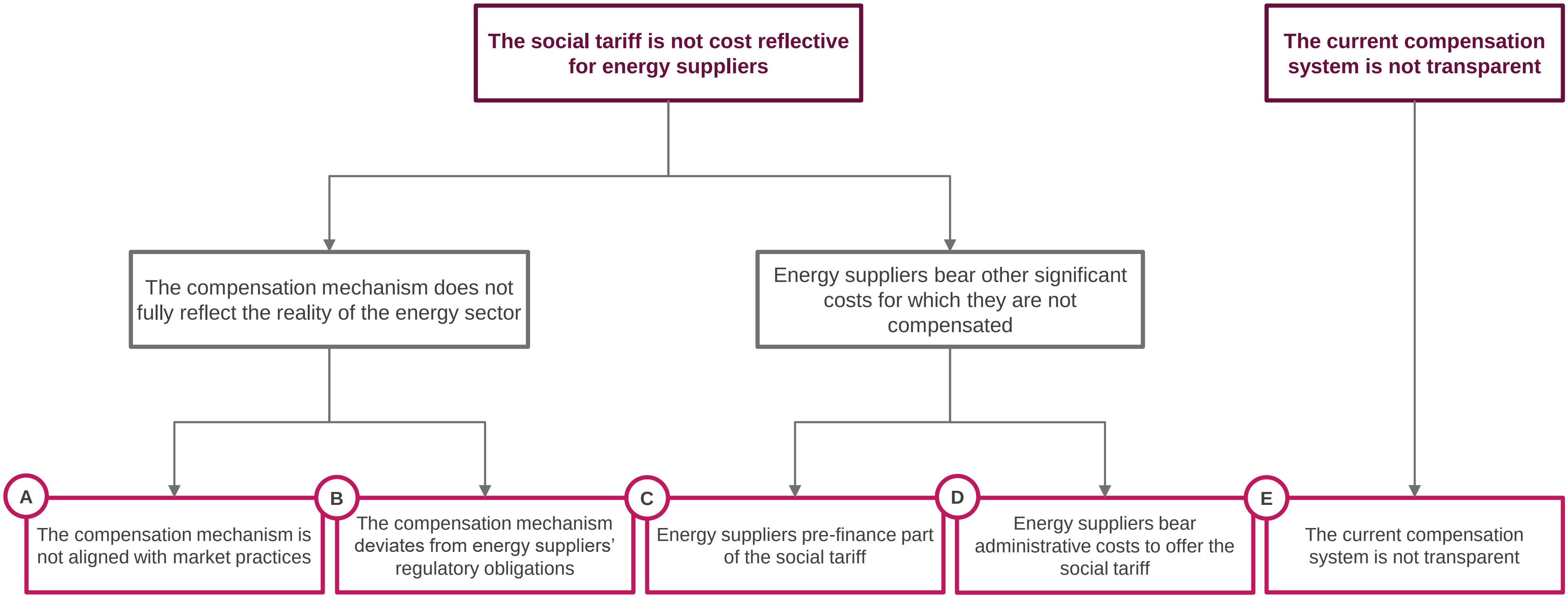
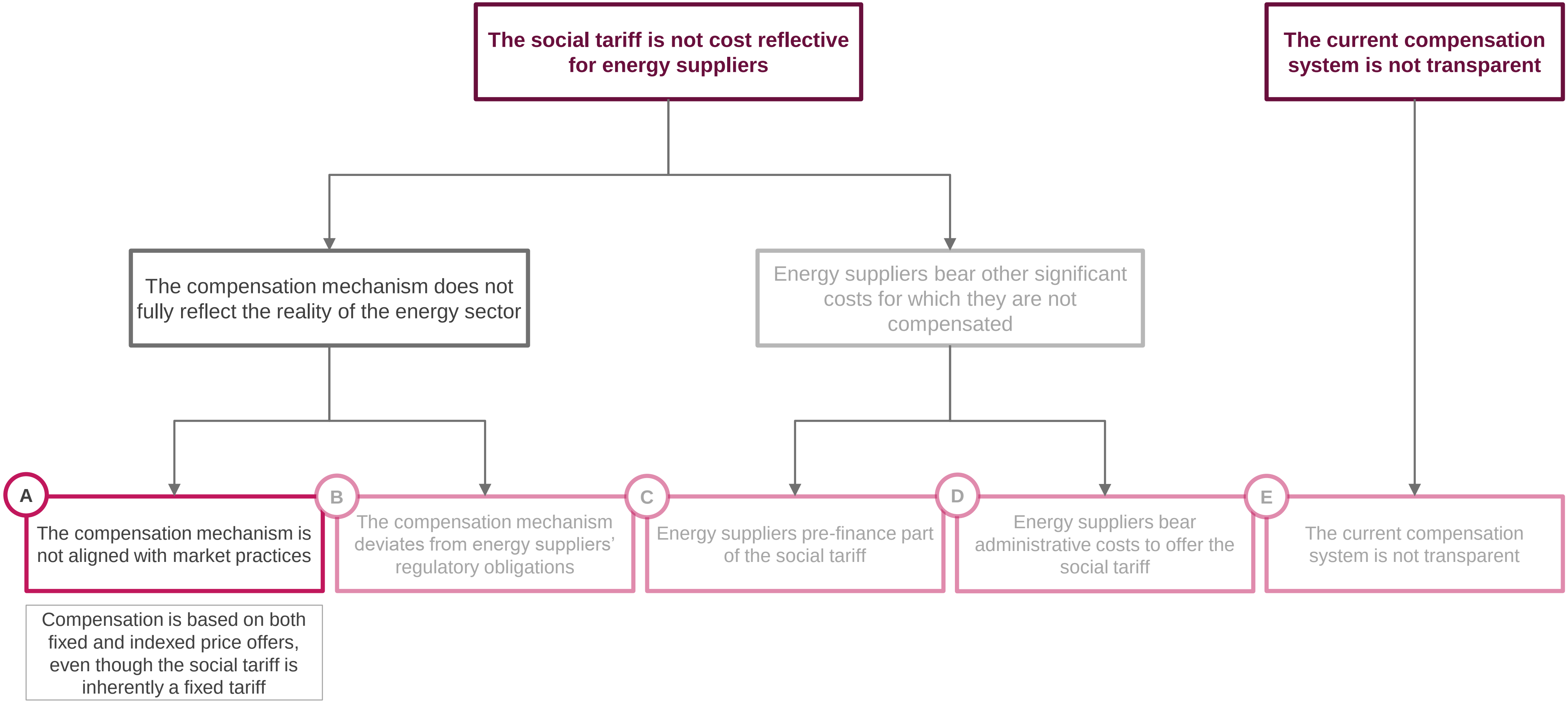


Suppliers are not fully compensated for offering the social tariff



The reference price is fixed for a period of 6 months, but its calculation takes into account both indexed and fixed price offers

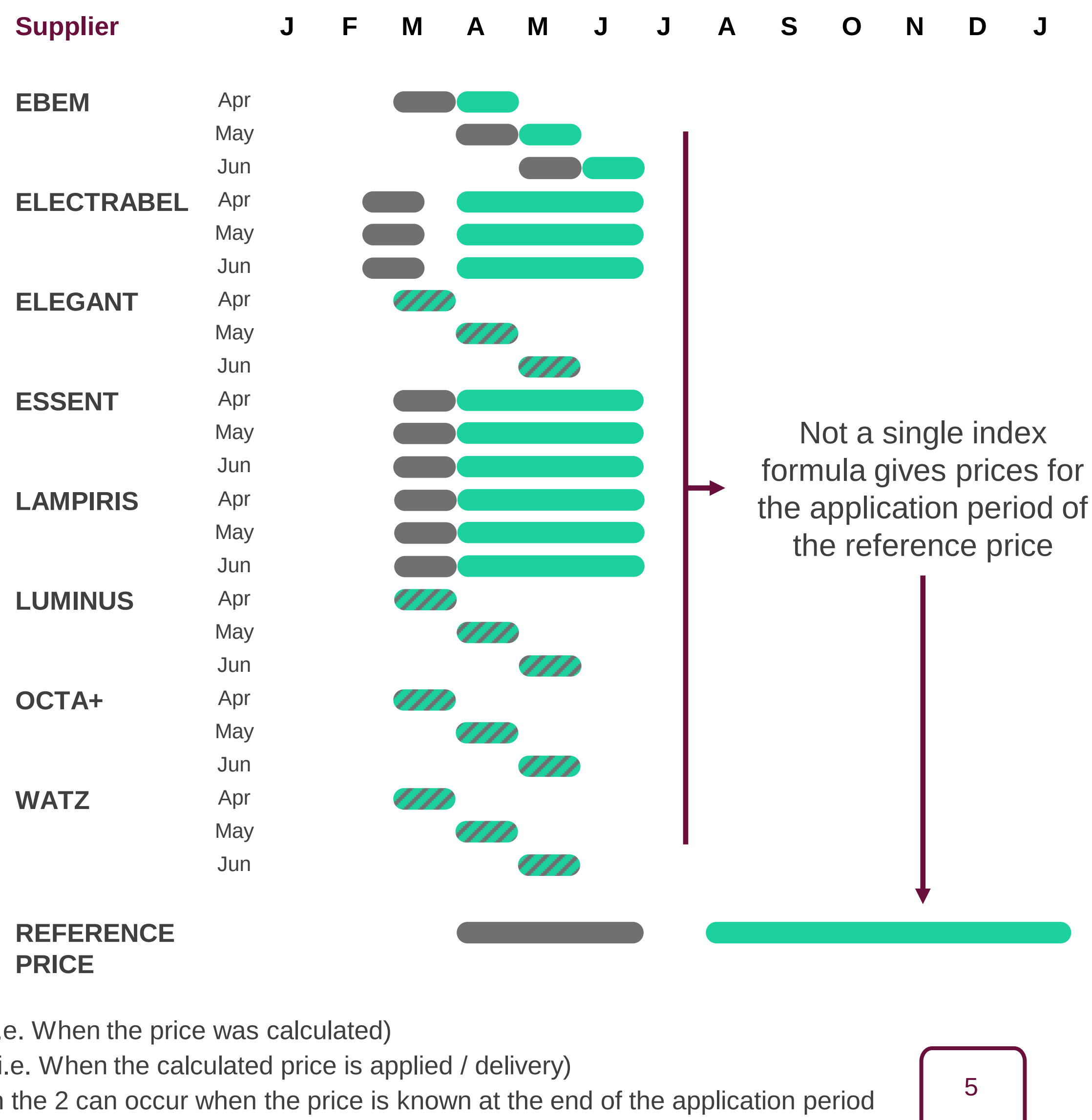
The market prices used to determine the reference price are most of the time variable prices. Hence, the displayed prices are based on past market parameters

It is impossible to hedge the reference price if it is based on values for past delivery periods

Estimated annual cost

9M€ ***11M€***

21 €/SPD ***45 €/SPD***



Suppliers are not fully compensated for offering the social tariff

The social tariff is not cost reflective for energy suppliers

The compensation mechanism does not fully reflect the reality of the energy sector

Energy suppliers bear other significant costs for which they are not compensated

The current compensation system is not transparent

A — The compensation mechanism is not aligned with market practices

B — The compensation mechanism deviates from energy suppliers' regulatory obligations

C — Energy suppliers pre-finance part of the social tariff

D — Energy suppliers bear administrative costs to offer the social tariff

E — The current compensation system is not transparent

Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff

The reference price is usually based on low-service contracts whereas protected customers are entitled to full service

The reference price includes offers with lower service levels than what is actually offered to the social tariff beneficiaries

Cost source

Service costs

Category

REFERENCE PRICE

Relevant vector(s)

Electricity & Gas

The reference price used to compensate suppliers includes low service levels: **e-invoicing, direct debit and internet communication only**

In reality they often offer all three services to social tariff beneficiaries because these are entitled to full service

Direct debit
vs.
Monthly transfer

E-invoicing
vs.
Paper invoicing

Online only
vs.
All channels contact

Estimated annual cost

1,4M€	***2,3M€***
5,4€/SPD	***5,4€/SPD***

*Note: **the cost of call centers** (compared to fully online communication**) was not estimated**. Moreover, depending on the supplier, other service costs exist (e.g. app/website dedicated workflow)*

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Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff

The reference price is usually based on low-service contracts whereas protected customers are entitled to full service

The compensation mechanism is based on equal green energy obligations for all three regions

The reference price is calculated using the lowest green power obligation whereas these obligations vary from one region to the other

Cost source

Quota obligations and GC prices

Category

REFERENCE PRICE

Relevant vector(s)

Electricity

Prices and quotas for Green Certificates (GC) and CHP certificates significantly vary between regions but the compensation for green energy obligations is made **regardless of the actual delivery region** of the social tariff beneficiary

Since the lowest prices are taken, suppliers incur a loss

Example for August – December 2018

Region	Type	Quota	Cert. price	Total
		%	EUR/cert.	**EUR/MWh**
	GC	21.5%	€ 95	**€ 19.5**
	WKK	11.2%	€ 25	**€ 2.8**
	GC	8.5%	€ 110	**€ 8.6**
	GC	35.65%	€ 73	**€ 25.0**

Estimated annual cost

11M€ ***25 €/SPD***

*Note: An additional cost is borne by suppliers who offer **100% green energy** to their protected customers as they need to purchase Guarantees of Origin*

Suppliers are not fully compensated for offering the social tariff

The social tariff is not cost reflective for energy suppliers

- The compensation mechanism does not fully reflect the reality of the energy sector
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    - Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff
    - The reference price is usually based on low-service contracts whereas protected customers are entitled to full service
  - B: The compensation mechanism deviates from energy suppliers' regulatory obligations
    - The compensation mechanism is based on equal green energy obligations for all three regions
    - The compensation mechanism does not take into account the evolving green energy quotas
- Energy suppliers bear other significant costs for which they are not compensated
  - C: Energy suppliers pre-finance part of the social tariff
  - D: Energy suppliers bear administrative costs to offer the social tariff

The current compensation system is not transparent

- E: The current compensation system is not transparent

The reference price is based on quotas at offering time, but quotas (can) increase from year to year

Cost source

Quota obligations

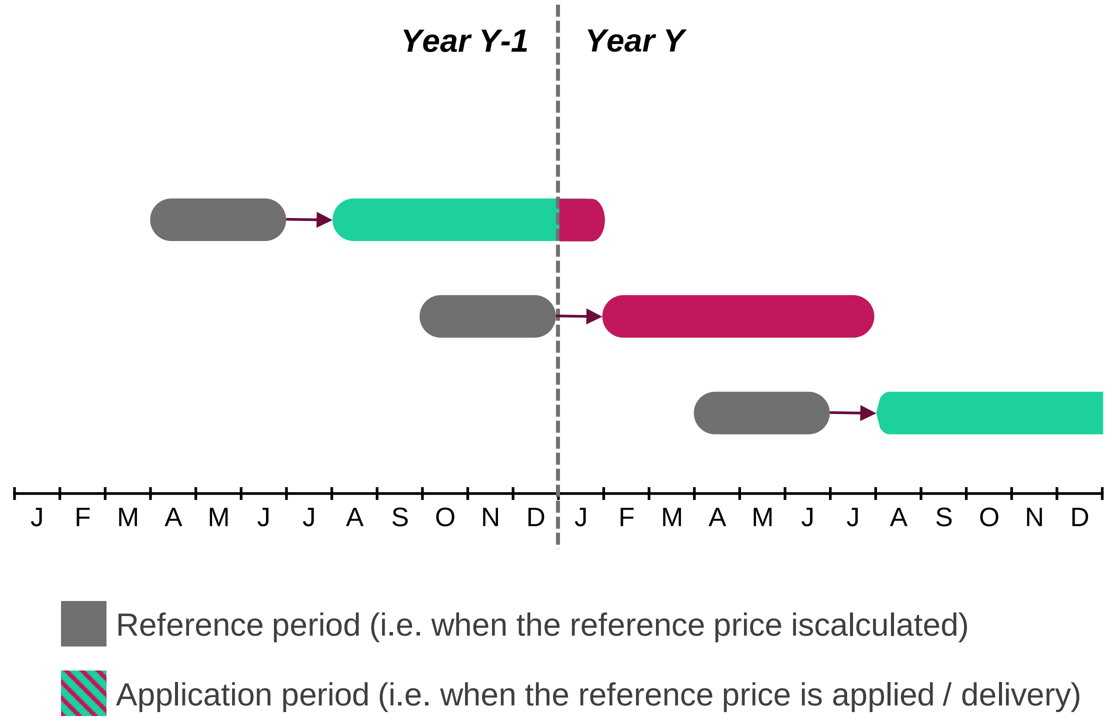
Category

REFERENCE PRICE

Relevant vector(s)

Electricity

Energy suppliers have to comply with quota obligations for the delivery year Y but **for 7 months in the year**, they are compensated based on the quotas of the year before



Estimated annual cost

0,8M€ ***2 €/SPD***

Suppliers are not fully compensated for offering the social tariff

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  - C — Energy suppliers pre-finance part of the social tariff
    - On average, suppliers have to wait 22,5 months before they are reimbursed
  - D — Energy suppliers bear administrative costs to offer the social tariff

The current compensation system is not transparent

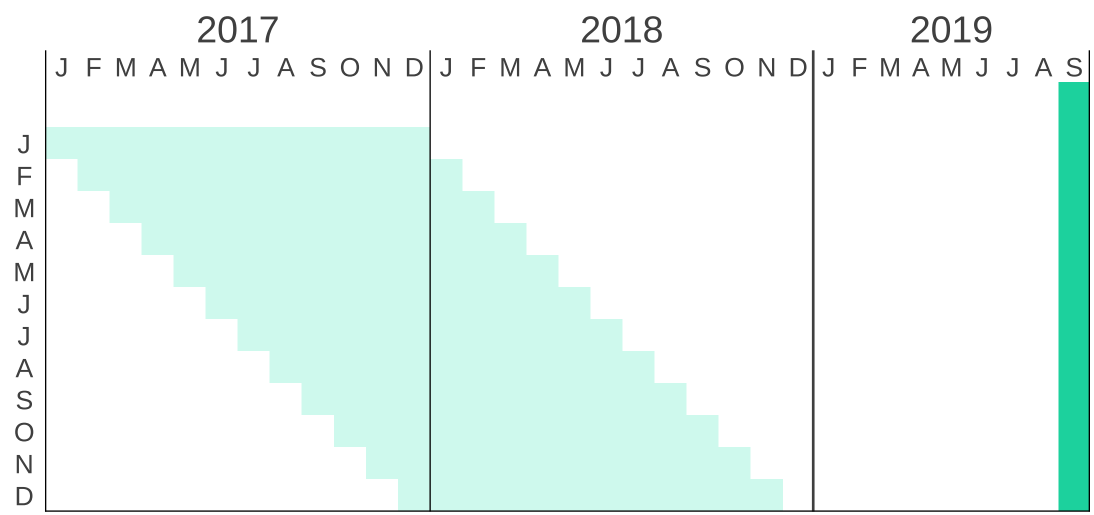
- E — The current compensation system is not transparent

The CREG reimburses the suppliers with a delay due to the verification procedure

Cost source	*Category*	*Relevant vector(s)*
Cost of capital	PRE-FINANCING COSTS	**Electricity & Gas**

Between the payment of advance invoices and reimbursement by CREG, the **suppliers have to pre-finance the difference between the reference price and the social tariff**

The weighted average reimbursement duration is **22.5 months**



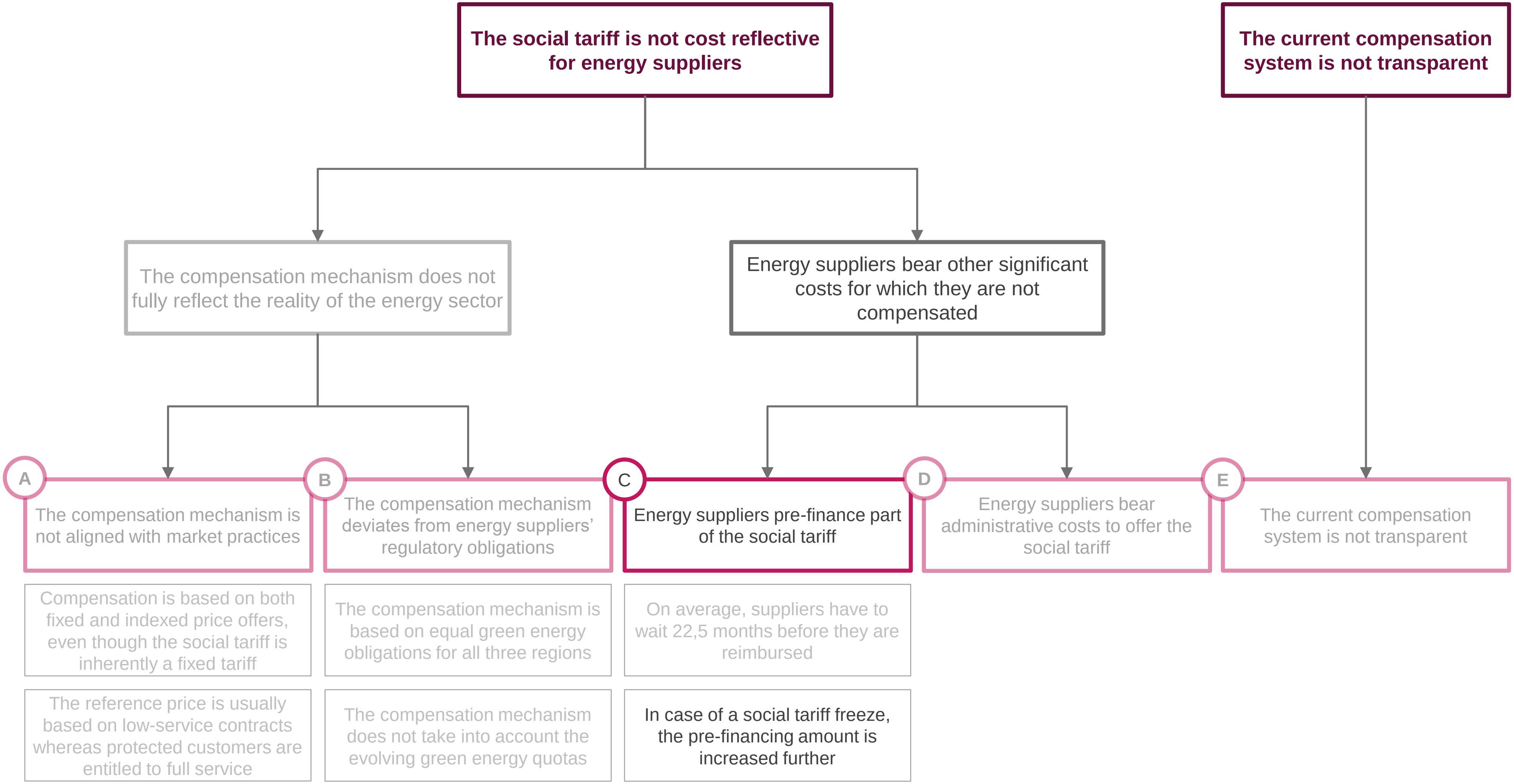
Reimbursement by the CREG in September

Estimated annual cost

6M€ ***6M€***

13 €/SPD ***23 €/SPD***

Suppliers are not fully compensated for offering the social tariff



The freeze of the social tariff increased the pre-financing cost of the delta between the social tariff and the reference price

Cost source

Cost of the social tariff freeze

Category

PRE-FINANCING COSTS

Relevant vector(s)

Electricity & Gas

Due to rapidly increasing energy prices, the **social tariff was frozen** on 1/2/2019

- For 6 months for gas
- For 12 months for power

The gap between the social tariff and the reference price has increased, resulting in an increased pre-financing by the suppliers

Estimated cost of freeze

0,9M€ ***1M€***

2 €/SPD ***4 €/SPD***

Based on the first period Feb '19-July '19

Suppliers are not fully compensated for offering the social tariff

The social tariff is not cost reflective for energy suppliers

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The current compensation system is not transparent

A
The compensation mechanism is not aligned with market practices

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B
The compensation mechanism deviates from energy suppliers' regulatory obligations

- The compensation mechanism is based on equal green energy obligations for all three regions
- The compensation mechanism does not take into account the evolving green energy quotas

C
Energy suppliers pre-finance part of the social tariff

- On average, suppliers have to wait 22,5 months before they are reimbursed
- In case of a social tariff freeze, the pre-financing amount is increased further

D
Energy suppliers bear administrative costs to offer the social tariff

- The social tariff imposes extra administrative obligations on the supplier
- Social tariff beneficiaries require more administration than regular customers

E
The current compensation system is not transparent

Energy suppliers bear extra administrative & operational costs to offer the social tariff

Cost source	*Category*	*Relevant vector(s)*
Administrative costs	ADMINISTRATIVE COSTS	**Electricity & Gas**

Energy suppliers face a number of costs that are specific to the social tariff:

1. Energy suppliers must report to the CREG with regards to the social tariff
2. The social tariff requires adaptations to the invoicing process as well as rectifications
3. The automated granting of social tariffs requires a database reconciliation (with FPS Economy)
4. Attestations of non-automated clients must be treated manually
5. Processes associated to the social tariff generate questions and complaints which suppliers must handle

Conclusion
Suppliers bear additional administrative & operational costs to offer the social tariff, amounting to more than 4 million euros per year. They cannot file a claim for these extra costs

Estimated annual cost

Electricity	Gas
2.6 M€	***1.5 M€***
6 €/SPD	***6 €/SPD***

Suppliers are not fully compensated for offering the social tariff

- **The social tariff is not cost reflective for energy suppliers**
  - The compensation mechanism does not fully reflect the reality of the energy sector
    - A. The compensation mechanism is not aligned with market practices
    - B. The compensation mechanism deviates from energy suppliers' regulatory obligations
  - Energy suppliers bear other significant costs for which they are not compensated
    - C. Energy suppliers pre-finance part of the social tariff
    - D. Energy suppliers bear administrative costs to offer the social tariff
- **The current compensation system is not transparent**
  - E. The current compensation system is not transparent

A	B	C	D	E
The compensation mechanism is not aligned with market practices	The compensation mechanism deviates from energy suppliers' regulatory obligations	Energy suppliers pre-finance part of the social tariff	Energy suppliers bear administrative costs to offer the social tariff	The current compensation system is not transparent
Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff	The compensation mechanism is based on equal green energy obligations for all three regions	On average, suppliers have to wait 22,5 months before they are reimbursed	The social tariff imposes extra administrative obligations on the supplier	The way the reference price is calculated is not transparent
The reference price is usually based on low-service contracts whereas protected customers are entitled to full service	The compensation mechanism does not take into account the evolving green energy quotas	In case of a social tariff freeze, the pre-financing amount is increased further	Social tariff beneficiaries require more administration than regular customers	The cost of the social tariff is not fairly shared between suppliers

Suppliers are not fully compensated for offering the social tariff

Legend

= recurring extra cost

= recurring extra cost (highly dependent on market conditions)

= non-recurring extra cost

The social tariff is not cost reflective for energy suppliers

The compensation mechanism does not fully reflect the reality of the energy sector

Energy suppliers bear other significant costs for which they are not compensated

The current compensation system is not transparent

A The compensation mechanism is not aligned with market practices

- Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff
- The reference price is usually based on low-service contracts whereas protected customers are entitled to full service

B The compensation mechanism deviates from energy suppliers' regulatory obligations

- The compensation mechanism is based on equal green energy obligations for all three regions
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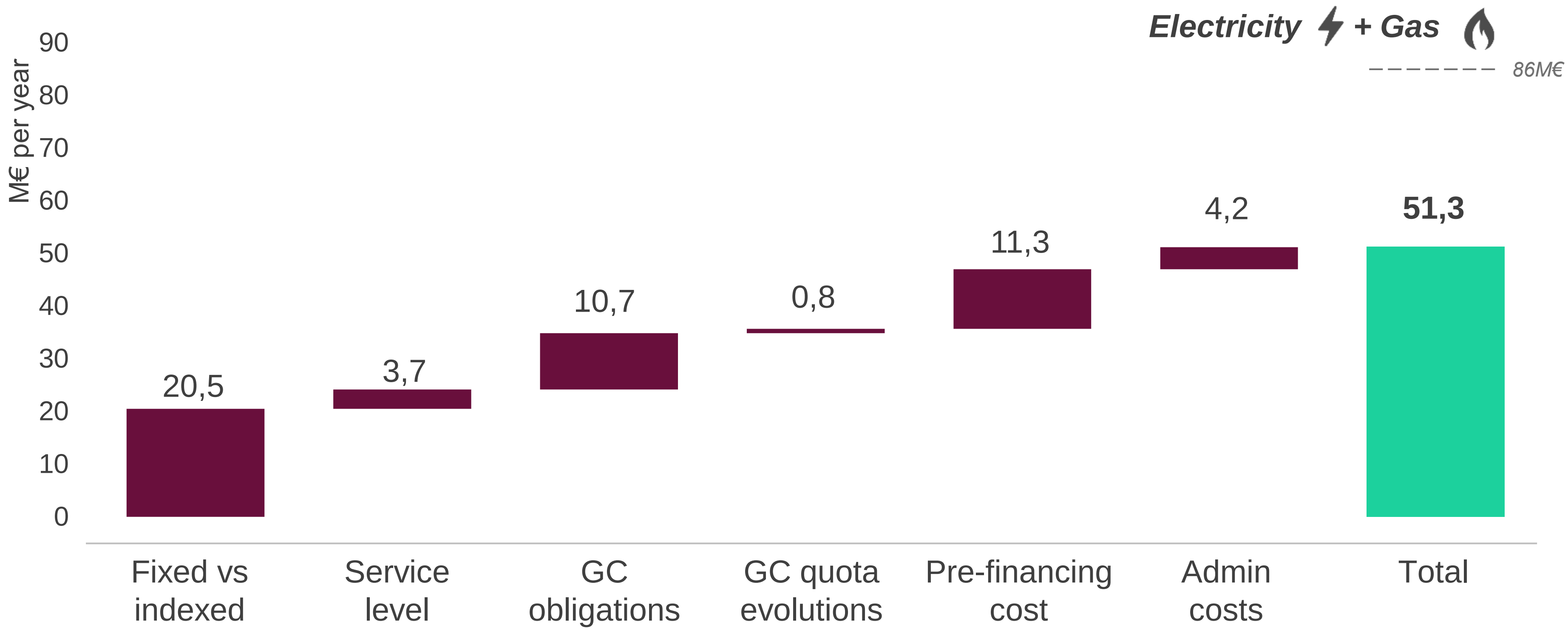
E The current compensation system is not transparent

- The way the reference price is calculated is not transparent
- The cost of the social tariff is not fairly shared between suppliers

The current compensation mechanism induces a 51M€ net annual cost for Belgian energy suppliers



A The compensation mechanism is not aligned with market practices

B The compensation mechanism deviates from energy suppliers' regulatory obligations

C Energy suppliers pre-finance part of the social tariff

D Energy suppliers bear administrative costs to offer the social tariff

The social tariff system which will be implemented as of July 2020 will have little impact on the extra costs present in the current system

As of July 2020, an adaption will be made to the current social tariff system. In short, the social tariff (and the related reference price) will be determined on a quarterly basis and the social tariff will include a (temporary) capping mechanism. The impacts on the current findings are expected to be the following:

FINDINGS		IMPACT OF THE NEW SOCIAL TARIFF SYSTEM
Compensation is based on both fixed and indexed price offers, even though the social tariff is inherently a fixed tariff	● (remains)	The new system does not solve the **fundamental mismatch between the reference period and the delivery period**. It will also increase the gap between the contract duration (e.g. 1 year) foreseen in the price cards and the application period (3 instead of 6 months). The only positive point is that the alignment with market products (quarters) will make the hedging a bit easier.
The reference price is usually based on low-service contracts whereas protected customers are entitled to full service	● (remains)	**No impact** is expected as the methodology remains the same
The compensation mechanism is based on equal green energy obligations for all three regions	● (remains)	**No impact** is expected as the methodology remains the same
The compensation mechanism does not take into account the evolving green energy quotas	● (improved)	The current social tariff system has a 7-month discrepancy in green energy quotas (prices from Y-1 are used as a reference for the period January to July). With the new system, **this discrepancy will be reduced to 3 months**: quotas for quarter 1 (January-March) will be based on price cards (and hence quotas) of December Year-1.
On average, suppliers have to wait 22,5 months before they are reimbursed	● (remains)	**No impact** is expected as the methodology remains the same
In case of a social tariff freeze, the pre-financing amount is increased further	● (worsens)	The new system includes an article on capping the social tariff (on a quarterly and annual bases) to prevent outrageous price increases. This new measure will induce **more social tariff freezes**, for which suppliers bear the **pre-financing cost of a greater gap between the social tariff and the reference price**
Energy suppliers bear extra administrative costs to offer the social tariff	● (worsens)	Although limited, the impact of having **4 different prices instead of 2** (multiplied by the number of meter types and commodities) can only bring an additional complexity to the administrative process
The way the reference price is calculated is not transparent	● (remains)	**No major impact** is expected. Only the use of a single month for the reference period facilitates the calculation of the reference price

● The issue is improved (not solved) by the new system
● The issue remains present in the new system
● The issue worsens in the new system

Two distinct approaches can improve the cost-reflectiveness of the compensation mechanism for energy suppliers

FINDINGS	SCENARIO A: MARK-UP BASED	SCENARIO B: PRICE-CARD BASED
A The compensation mechanism is not aligned with market practices	**Use a formula for determining the reference price: *base cost + mark-up*.** The mark-up should be negotiated with CREG and should cover for the **service cost, risk bricks and other costs**	**Calculate the reference price based on suppliers' published price cards**, but limit to contracts with a **normal service level** (no online products) and a **fixed price for 1 year**
B The compensation mechanism deviates from regulatory obligations	**Reimburse suppliers based on the average of the lowest green certificate (and WKK) costs per region,** taking into account the regional quotas for the delivery period and an inference of the GC prices using the GC costs published on price cards	
C Energy suppliers pre-finance part of the social tariff	**Make advance payments** (e.g. on a quarterly basis), based on an estimation of the supplier's expected compensation. When the delta between reference price and social tariff increases due to capping, increase the advance payments as well	
D Energy suppliers bear extra administrative costs to offer the social tariff	**Reimburse suppliers for their extra administrative costs** based on a fixed amount per point of delivery	
E The current compensation system is not transparent[1]	**Communicate the exact rules for calculating the reference price**, as well as the calculation file itself to the stakeholders	

[1] The issue of the cost of the social tariff not being fairly shared between suppliers is automatically solved if the system is made cost-reflective for suppliers

[2] Both scenarios require changes to the existing Royal Decrees

Disclaimer

Several methodological and scope decisions deserve a brief disclaimer

The presented results are estimated for the year 2018

- Many extra costs for the suppliers estimated in this study are related to market conditions (e.g. wholesale prices). By definition, these are subject to evolutions that are hard to foresee. Other extra costs are linked to regulatory constraints (e.g. green certificate quotas) which may also evolve with time
- In order to present consistent results, Sia Partners focused on the calendar year 2018. At the time of the study, it was the latest occurrence for which data was available for a full year. The extra cost sources which are the most sensitive to idiosyncratic conditions are highlighted in the study
- It is important to note that, although the exact cost estimate might vary up or down depending on the years, the underlying issues and extra cost sources remain relevant

The study does not account for all (extra) impacts of the social tariff on energy suppliers

- Due to time constraints and the operational difficulty to gather the relevant data, some impacts of the social tariff were kept out of the scope of this study. This is the case for instance for suppliers that cover their electricity portfolio of protected customers with guarantees of origin (“100% green”) whereas the reference price only partially takes this into account. There are also extra IT costs – such as creating a dedicated workflow for protected customers in suppliers’ customer zones – which are not studied
- Furthermore, the impact of the social tariff on the churn rate, cross-selling and bad debt was not estimated
- Lastly, upon FEBEG’s request, Sia Partners did not carry out a detailed estimation of the missed revenues associated with offering the social tariff
- The market impacts of these extra costs were not investigated. From a theoretical perspective, they can be passed on the energy prices of other clients, be imputed on suppliers’ profit or affect their investments

Wrap-up

1. Suppliers are not fully compensated for offering the social tariff
2. The current compensation mechanism induces a 51M€ net annual cost for Belgian energy suppliers
3. The social tariff system which will be implemented as of July 2020 will have little impact on the extra costs present in the current system
4. Two distinct approaches can improve the cost-reflectiveness of the compensation mechanism for energy suppliers

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