



A. Introduction

1. On 15 April 2009, Ofgem published a document containing its 'final proposals' for addressing undue discrimination in the domestic energy supply market. This document contained the draft legal texts for two new standard conditions that the Authority says it is minded to introduce into gas and electricity supply licences.
2. One of the conditions ('the payment methods condition') is intended to require any difference in the terms and conditions offered by energy suppliers in respect of different payment methods for domestic customers to be cost-reflective. The other one ('the undue discrimination condition') is intended to prohibit undue discrimination in any of the terms and conditions offered by suppliers to domestic customers.
3. The draft texts, as presented in the April document, raise some concerns about the quality controls applied to Ofgem's legal outputs. This paper looks at the drafting, suggests that in its current form it is not fit for purpose from the viewpoint of users, and recommends alternative drafting. It also examines a legal issue that appears to be raised by Ofgem's proposal that compensation would be payable to customers under the process envisaged for enforcing the undue discrimination condition.
4. For convenience, this paper deals only with the drafting for electricity. However, its comments and recommended revisions are equally applicable to gas.

B. The payment methods condition

5. This licence drafting is proposed by Ofgem in order to 'better reflect' the contents of Annex A (Measures on consumer protection) of EC Directive 2003/54 ('the market liberalisation directive'). The drafting is presented as a direct copyout of the text currently to be found at paragraph (d) of Annex A. There are a number of problems with this approach.

- Ofgem does not explain why a copyout is the chosen method for securing the reflection of Annex A(d) that it seeks.
- The copyout method is inconsistent with both the general and the detailed approach to supply licence drafting adopted as a consequence of the Supply Licence Review completed some 18 months ago. This is because:

General: the text copied out from Annex A is simply declaratory as to the terms and conditions of payment methods. By contrast, the standard conditions of the supply licence proceed, from start to finish, by imposing specific enforceable obligations on a licensee.

Detailed: the copyout method, as applied by Ofgem here, fails to respect the formal decision under the Supply Licence Review to use 'must' instead of the increasingly archaic 'shall' in order to avoid confusion or any ambiguity when imposing imperative requirements.

- Every part of a published EC Directive is to be treated legally as an integral part of the legislative act. Annex A(d) is thus as much a part of the legal text of the market liberalisation directive as are the preambles, recitals, and constituent articles, and requires to be interpreted with as much care as would be applied to those other elements.

The new drafting would sit in standard licence condition 27 alongside that condition's existing references to payment methods. However, the text of Annex A(d) makes a useful distinction between the 'payment methods' and 'payment systems' of suppliers. As a consequence, Ofgem's reliance on the copyout method, while at the same time treating these two different concepts as interchangeable (see paragraph 3.4 of its document), not only obscures the policy objective of Annex A(d), but also breaks one of the golden rules of legal drafting:

Never change your language unless you need to change your meaning and always change your language if you need to change your meaning.

6. All the above problems are unnecessary and easily avoided. They result directly from the decision to simply copy a piece of text from an EC Directive into an existing standard licence condition without adapting it to its new environment. The proper course is to draft a new provision, in conformity with the current style and format of the supply licence, that will give accurate expression to the policy objective of the EC text, and then to insert it at the appropriate place in standard condition 27.

7. In addition to the problems arising from the copyout issue, a further problem arises from Ofgem's policy decision that infringements of both new licence conditions will be assessed against a materiality threshold (paragraph 3.28 of its document). While this decision is embedded in the legal text of the undue discrimination condition, no drafting provision is made for it in the payment methods condition. This omission will need to be corrected.

C. The undue discrimination condition

8. Ofgem's drafting of this condition is characterised by a complete omission of any provision for the all-important matters of guidance, compliance, and enforcement, to which so much of Ofgem's document is addressed. While this is also true of the drafting of the payment methods condition, the omission is even more inappropriate in the case of the undue discrimination condition, because of Ofgem's decision to operate a special escalation process for enforcing compliance with it.

9. The special nature of the guidance envisaged by Ofgem is relevant here. It will be condition-specific, rather than generic, dealing with issues that are both sensitive and contentious in public and political terms, and with intellectual concepts – cost reflective pricing and the meaning of undue discrimination – that are notoriously complex. It will contain advice on the interpretation and application not only of two separate licence conditions and their requirements, but also on inter-relationships between them, while also providing in the case of one of those conditions for a new enforcement process overlaid on Ofgem's existing enforcement guidelines. And while the guidance will not be binding on the licensee, equally it does not bind the Authority either: indeed, Ofgem's document expressly reserves the Authority's right to depart from the guidance (paragraph 3.9).

10. Against that background, it is legally desirable for *at least* the following matters in relation to guidance, compliance, and enforcement to be provided for, in respect of both new standard conditions, by way of direct validation on the face of the licence:

- The expectation that the Authority will issue guidance in connection with the two new conditions.
- The scope and contents of the guidance (in broadest outline) in terms of the matters to which most of its contents are most likely to be directed.
- The procedural and consultative requirements to be satisfied in relation to the issuing and any revising of the guidance.
- The status and effect of the guidance in relation to the enforcement of the licensee's compliance in cases of apparent infringement.

D. Compensation to customers

11. Ofgem's explanation of a new escalation process for enforcement action relating to the undue discrimination condition envisages, at Stage 2 of the process, that the supplier may in some cases be expected to pay compensation to customers to forestall any formal exercise of Ofgem's enforcement powers.

12. The legal validity of this approach is questionable. When Ofgem refrains from formally exercising its enforcement powers under Stage 2, it is effectively relying on the provisions of section 25(5A) of the Electricity Act 1989. These state, among other things, that Ofgem need not take formal enforcement action in respect of a breach of a licence condition where the licensee has agreed to take and is taking all such steps as the Authority thinks are appropriate 'for the purpose of securing or facilitating compliance with the condition'.

13. As a matter of law, it is not clear that paying compensation to customers would ever be a step that Ofgem could reasonably consider appropriate for the purpose of 'securing or facilitating compliance' with the undue discrimination condition. The position would be different if this condition contained provisions requiring licensees to compensate customers in specified circumstances, because, in the event of any failure to make such payments, Ofgem's enforcement powers could then be used to order the licensee to make them. But that is not the case here.

14. The creation of a freestanding enforcement remedy outside the statute would not be within section 25(3)(b) of the Act. So Ofgem's proposal about compensation at Stage 2 of the escalation process, and the related proposal to treat a failure to pay such compensation as an exacerbating factor in considering any possible financial penalty under Stage 3, may need to be reconsidered in the light of this analysis.

E. Conclusions and recommendation

15. Ofgem's licence drafting for its final proposals could be significantly improved from both a legal and a user viewpoint. Appendices 1 and 2 set out revised drafts for the proposed new licence conditions, in each case consistent with the overall drafting style of the supply licence. Appendix 3 shows how a wholly new condition 30 could avoid duplication in providing for guidance that is proposed to straddle two separate but inter-related conditions. Ofgem is recommended to adopt these (or similar) drafts as the right way forward to minimise the risk of blocking.

Appendix 1

RECOMMENDED NEW DRAFTING FOR SLC 27

The text below is consistent with the comments in the main paper and shows how EDF Energy's revised drafting (at paragraphs 27.2 to 27.5) to give effect to Ofgem's policy intentions would sit beneath and relate back to the existing first paragraph of standard licence condition 27.

Condition 27. Payments, Security Deposits and Disconnections

Payment methods under Domestic Supply Contract

- 27.1 Where the licensee offers to supply electricity to a Domestic Customer under a Domestic Supply Contract under paragraph 2 of standard condition 22 (Duty to offer and supply under Domestic Supply Contract), it must offer the customer a wide choice of payment methods for paying Charges for the Supply of Electricity and those methods must include (in each case, for the duration of the contract):
- (a) payment by cash:
 - (i) to a person and at a place that is reasonable in all the circumstances of the case; and
 - (ii) fortnightly or more regularly; and
 - (b) payment in advance through a prepayment meter.
- 27.2 Subject to paragraph 27.4, the licensee must ensure that any differences in the terms and conditions on which it offers Domestic Customers payment methods for paying Charges for the Supply of Electricity properly reflect differences in the costs incurred by the licensee in providing and maintaining the systems necessary to enable it to offer those methods to Domestic Customers (for this condition only, 'the requirement for cost-reflectivity').
- 27.3 In paragraph 27.2, 'terms' means all the terms (including terms as to price) on which the supply of electricity is offered or provided that could significantly affect a Domestic Customer's evaluation of the Domestic Supply Contract under which electricity is or may be supplied to his premises.
- 27.4 The licensee is only in breach of the requirement for cost-reflectivity if and to the extent that the impact of the breach on any Domestic Customers is material in any respect.
- 27.5 Standard condition 30 (Guidance for the licensee) provides for the Authority to issue guidance concerning paragraphs 27.2 to 27.4.
- 27.6 [existing paragraph 27.2 et seq]

Appendix 2

RECOMMENDED NEW DRAFTING FOR SLC 29

The text below sets out revised drafting, consistent with the comments in the main paper, for Ofgem's new standard licence condition 29.

Condition 29. No undue discrimination in supply

- 29.1 This condition applies in relation to the supply of electricity by the licensee under a Domestic Supply Contract or a Deemed Contract for the supply of electricity to Domestic Premises.

Prohibition of undue discrimination

- 29.2 Subject to paragraph 29.3, the licensee must ensure that, in supplying or offering to supply electricity, the Principal Terms on which it does so do not discriminate without objective justification between one group of Domestic Customers and any other such group (for this condition only, 'the requirement for objective justification').
- 29.3 The licensee is only in breach of the requirement for objective justification if and to the extent that the nature of the discriminatory terms offered or relied upon or their impact on any group of Domestic Customers is material in any respect.

Guidance concerning this condition

- 29.4 Standard condition 30 (Guidance for the licensee) provides for the Authority to issue guidance concerning this condition.

Termination of condition

- 29.5 This condition will cease to have effect on [d/m] 2012.

Appendix 3

RECOMMENDED DRAFTING FOR A PROPOSED SLC 30

The text below sets out EDF Energy's proposal, consistent with the comments in the main paper, for a new standard licence condition 30.

Condition 30. Guidance for the licensee

30.1 The Authority may issue guidance for the purposes of:

- (a) paragraphs 2 to 4 of standard condition 27 (Payments, Security Deposits and Disconnections); and
- (b) standard condition 29 (No undue discrimination in supply).

Contents of guidance

30.2 The guidance may, in particular, include provision for removing or reducing inconsistencies between Electricity Suppliers in their interpretation and application of:

- (a) the requirement for cost-reflectivity referred to in standard condition 27; and
- (b) the requirement for objective justification referred to in standard condition 29.

30.3 The guidance may also include provision about how the Authority intends to monitor, assess, and enforce compliance by Electricity Suppliers with those requirements.

Procedure for issuing guidance

30.4 Before issuing guidance under paragraph 30.1, the Authority must give Notice that it proposes to do so to:

- (a) all Electricity Suppliers in whose licences Section B of the standard conditions is effective;
- (b) the National Consumer Council; and
- (c) such other persons as the Authority considers it appropriate to consult in relation to the proposal.

30.5 A Notice given by the Authority under paragraph 30.4 must:

- (a) state that the Authority proposes to issue the guidance and specify the date on which it intends that this should take effect;
- (b) set out the text of the guidance and the Authority's reasons for proposing to issue it; and
- (c) specify the time (which must not be less than a period of 28 days from the date of the Notice) within which representations or objections with respect to the proposal may be made.

- 30.6 The requirements of paragraphs 30.4 and 30.5 may be satisfied by action taken by the Authority in accordance with those requirements before, as well as after, the date on which this condition has effect in this licence.
- 30.7 In paragraph 30.4, ‘issuing guidance’ includes issuing any revision of it.

Effect of guidance

- 30.8 For purposes relating to enforcement, paragraph 30.9 applies where any question (for this condition only, an ‘enforcement question’) arises about the licensee’s compliance with:
- (a) the requirement for cost-reflectivity;
 - (b) the requirement for objective justification; or
 - (c) both requirements taken together.
- 30.9 Where:
- (a) any provision of any guidance issued under this condition is relevant to an enforcement question; and
 - (b) the licensee has acted in accordance with that provision,
- the Authority must take both those matters into account in determining the enforcement question.