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Dear Ljuban Milicevic

Classification of premises for the purposes of the standard conditions of the gas supply licence

Thank you for the opportunity to respond to the open letter of the 14th of December. The Association of Residential Managing Agents (ARMA) fully supports that a review of the licensing conditions in respect of apartment blocks is required.

In summary we agree with your proposed change but it is far too limited and OFGEM needs to consider a much wider range of issues if it is to assist the government to meet its objectives with energy efficiency. ARMA's response firstly sets out the wider issues which we feel any consultation has to address and then makes more detailed comments on the specific proposal in the letter.

The Wider Issues

1. The Green Deal

The Green Deal is intended to assist residential properties to improve their energy efficiency. For blocks of flats it will require a communal approach to be taken which will involve the lessees (tenants), the landlord and the managing agent. The lessees themselves cannot implement cavity or loft insulation in a block of flats.

If the energy supply of the landlord is classed as a commercial supply then it will frustrate the application of the Green Deal to residential blocks of flats. Why? Taking the scenario in your letter of the resident management company which supplies gas from one communal supply for a communal heating and hot water system how would this work? If the licence conditions are altered to class this supply as residential then the Green Deal could work and the communal supply point meter can have a Green Deal charge be put on it. But what if that communal gas supply was in the name of a landlord that was not a resident management company, which applies in many

blocks? Then that would be classed as a commercial supply which would not be helpful in applying the Green Deal.

The importance of clarifying that landlords' supplies to any premises which are adjunct to residential flats should be residential becomes more important when considering flats where there is not a communal heating and hot water supply; that is the great majority. How will the Green Deal work for these blocks? In your current proposals that supply could still be classed as commercial and so current Green Deal

proposals would mean that to implement energy efficiency measures in a block of flats would require every lessee in the block to agree to a Green Deal charge being put on their meters; something that will very rarely happen in practice. Even if all lessees agree the administration of the charges will become very complex for the suppliers rather than dealing with one landlord's supply. It will assist the application of Green Deal to residential flats to clarify licence conditions such that any supply by a landlord to flats as an adjunct to the residential flats is a residential supply.

2. The Contradiction between Licensing Conditions and VAT Regulations

The VAT regulations concerning the supply of gas and electricity to common supplies to blocks of flats by landlords have been clear for many years. But they conflict with licensing conditions and managing agents, resident management companies and other landlords have constant battles with utility companies who incorrectly class the supplies as commercial for VAT purposes. Here are the key extracts from the VAT regulations available from HMRC.

The VAT Act 1994, Schedule 4, Paragraph 3 defines any supply of heat, power, refrigeration or ventilation as a supply of goods.
Supplies of fuel and power are subject to the standard rate of VAT unless there is a provision for a reduced rate for a qualifying use.
Qualifying use means:
"domestic use"; or
"charity non-business use".
The legal provisions for the reduced rate are in the VAT Act 1994, Section 29A.
The following supplies are charged at the reduced rate:
· *fuel and power for domestic use*
The following are treated as domestic use if they are part of the same residential unit:
· ***subsidiary buildings situated a short distance away, such as a garage in a block located away from a house; and corridors, lifts, hallways and stairways in a residential unit.***

Item 3.2 of Fuel and power leaflet produced by HMRC, which defines what is Domestic use.

"3.2.2 Other supplies that are for domestic use

Supplies of fuel and power that exceed the de minimis limits are for domestic use only if they are for use in a dwelling or certain types of residential accommodation (excluding hospitals, prisons or similar institutions, hotels or inns or similar establishments). Examples are:

• armed forces residential accommodation;
• caravans;
• children's homes;
• homes providing care for-

(a) the elderly or disabled;
(b) people with a past or present dependence on alcohol or drugs;
(c) people with a past or present mental disorder;

• houseboats;
• houses, flats or other dwellings;
• hospices;
• institutions that are the sole or main residence of at least 90% of their residents;
• monasteries, nunneries and similar religious communities;
• school and university residential accommodation for students or pupils; and
• self catering holiday accommodation.

The following are treated as part of the same residential unit:

• buildings such as garages used with houses;
• subsidiary buildings situated a short distance away, such as a garage in a block located away from a house; and
• corridors, lifts, hallways and stairways in a residential unit. "

Item 5 of the same VAT Publication states
5. Electricity
5.1 What supplies are taxed at the reduced rate?
Electricity supplied for a qualifying use (see Section 3) is subject to the reduced rate. (as explained above)
5.2 Supplies of small - de minimis - quantities
Supplies of not more than an average rate of 33 kilowatt hours per day - 1,000 kilowatt hours per month - of electricity to one customer at any one of the customer's premises are subject to VAT at the reduced rate. This applies whether the bill is based on a meter reading - by either you or your customer - or on an estimate.

Item 2.2 of the Reliefs and special treatments for taxable supplies.pdf specifically relates to Carbon Change Levy but defers to the VAT guidance as a parent document.

There is a clear contradiction in the approach to common supplies to blocks of flats between VAT rules and the current interpretation of licence conditions of some, not all, utility companies. It would make sense to clarify the licence conditions such they are in accord with VAT rules. To do this the current proposal in your letter does not go far enough.

3. The Lack of a Disconnection Protocol for Blocks of Flats

The current confusion about supplies to common parts of flats means that protocols adopted to protect domestic customers from disconnection do not apply to blocks of flats. So because the landlord's supply may be treated as a commercial supply it is

possible for utility companies to disconnect supply to common parts or to communal heating systems without regard to protecting vulnerable customers. Even if the landlord's supply is limited to light and power in communal areas there can be grave consequences of disconnection. Disconnection can lead to no fire alarm and emergency lighting, no lifts, no pumped water and sewerage in tower blocks.
To ensure that utility companies adopt sensible measures before disconnection to common parts of supplies of blocks of flats the licence conditions should be quite clear that all such supplies should be classed as residential.

4. The Attitude of Utility Companies to Resident Management Companies

ARMA estimates that for about 60% of blocks of flats in England and Wales the effective landlord for supplies to common parts is a resident management company. Utility companies have taken in recent years a tougher and tougher stance with these companies. Under Landlord and Tenant law, landlords including resident management companies have to collect and spend service charges as trustees (S42 of 1987 L&T Act). The company acts a trustee but the service charge monies do not belong to the company. This means that these companies generally have no assets and many file as dormant at Companies House.

In recent years utility companies have run credit checks on resident management companies and some have refused to supply, effectively stifling competition and any search for best value. Others will only supply if large deposits are made; this is not practical for most of these companies as they do not hold any reserves. Others demand direct debit payments; a trustee or its managing agent cannot do this. For example it is against RICS rules to set up a direct debit on a client or trust account.

In the interest of providing effective competition for resident management companies all supplies of gas and electricity to common parts of blocks of flats should be made residential supplies.

5. Other Forms of Tenure

The letter of December 14th only refers to flats. OFGEM is missing other forms of tenure that also have communal supplies. There are many developments of freehold houses either solely of houses or mixed with flats on the same development. It is entirely possible, and with the move to CHP and ESCOs more likely, that those houses will pay an amenity charge for gas and electricity to some form of specialist company or landlord. OFGEM needs to consider how freehold houses which are required to contribute to communal supplies can be brought within any change of licensing conditions.

The Current Proposal to Alter Licence Conditions

1. It is not clear whether you are considering supplies of gas and electricity or just gas. The OFGEM letter only talks about gas supply. Surely it is intended that any changes should apply to electricity supplies as well. To not do so would seem strange and not be even handed to consumers as well as utilities.

2. You state that there must be a 'legal entity acting on behalf of individual residents'. This seems to imply that the change would only apply to resident management companies. But some resident management companies do not have all residents as members of that company. Would these qualify? Then what about the other blocks of flats which do not have a resident management company as the landlord. There may be an individual or a company that provides services. Does that landlord act on behalf of individual residents? You seem to imply there is a difference here which will produce different results in supply in adjacent blocks dependent on the history of those blocks. The current proposal about licence conditions will produce more confusion. In addition there are the general issues listed above to consider.

What if the resident management company delegates its functions to another legal entity, a managing agent? Would that qualify?

3. You state also that as a condition 'the legal entity does not provide commercial services to such residents such that is does not charge residents for the supply of gas'. What does this mean? Is a resident management company that is registered at Companies House supplying commercial services? What if the resident management company appoints a managing agent who calculates and charges for the supply of gas and also charges an administration fee to the company for doing so?

What about newer developments that use combined heat and power plant or ESCOs. These schemes typically outsource the supply of light and power to others and there are also specialist companies that handle the complex billing processes involved. The current proposal from OFGEM would appear to discriminate against the use of CHP and other new ways to promote energy efficiency.

4. Would a local authority or housing association landlord meet your requirements? They do not 'act on behalf of individual residents' but they are major landlords of blocks of flats.

In conclusion ARMA proposes that the correct way forward is to adopt the definitions used in the VAT regulations that any supply which is to residential premises or to premises which are an adjunct to those premises should be classed as residential. Further there should be no distinction made according to the identity or nature of the landlord, the customer of the utility; what should matter is the end use to which that supply is made.

Yours sincerely,

John Millls
ARMA Technical Consultant

The Association of Residential Managing Agents

The Association of Residential Managing Agents (ARMA) is the only body in England & Wales to focus exclusively on matters relating to the management of residential leasehold blocks of flats. ARMA has over 250 corporate members managing some 900,000 leasehold units in more than 34,000 blocks (at least 60% of which are lessee-controlled properties) ARMA's founding principal aims are to represent its members and therefore the interests of lessees, resident management companies and investor freeholders.

It is estimated that there are over 1.8 million private leasehold flats in England and Wales. Whether the buildings in which they are situated are owned and controlled by investor freeholders or the lessees themselves, a large proportion employ managing agents to handle the day to day running and ongoing cyclical maintenance of their buildings.

Managing agents have a unique and important role to play in managing other people's homes and money - a role that requires an in-depth knowledge of residential management, a wide range of skills and the utmost professionalism.

ARMA was founded in 1991 with the aim of bringing together professionals involved in residential block management.
Its principal objectives are to...

- promote the highest standards of management.
- create and maintain an awareness amongst property owners, developers, residents as well as national and local government of the proper role of - and indeed the need for - residential managing agents.
- provide a forum where members involved in the management of residential blocks of flats can discuss and develop management practices to enhance service to clients and lessees.
- fix and endeavour to maintain consistent standards of practice amongst members in an otherwise unregulated market.

All members endorse, accept and undertake to comply with the RICS code of practice "Service Charge Residential Management Code" approved by the Secretaries of State for England and Wales under the terms of Section 87 of the Leasehold Reform, Housing and Urban Development Act 1993.