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16 July 2026

Dear Paul,

CHANGES TO GUIDANCE ON DEEMED CONTRACTS

We welcome the opportunity to provide feedback on Ofgem's consultation on proposed changes to the Guidance on Deemed Contracts. We recognise the importance of ensuring that suppliers and customers have greater clarity regarding the application of SLCs 7.3 and 7.4 and support Ofgem's objective of improving consistency in the interpretation of deemed contract obligations across the industry.

We do however have some concerns regarding Ofgem's proposed amendments, as there are some areas where we think the updated guidance creates more ambiguity rather than less. We have set out our responses to each of the questions in Annex 1, and in certain cases have provided suggested edits to the draft guidance to address our concerns. Our key points are:

1. While the consultation sets out that feedback from stakeholders has led to Ofgem concluding that it needs to issue this updated guidance, it does not explain what this feedback is, and why it means updated guidance is required. The consultation is limited only to the updated guidance and the questions. As part of a robust consultation, it would be good practice to provide reasons why the additional guidance is needed. That would support stakeholders in providing commentary and feedback. Our feedback is provided in the absence of a full understanding of the concerns Ofgem is aiming to address, and further information on those concerns could change our responses.

2. We consider the change in interpretation of when a deemed contract can exist is a significant change. We can see a benefit in confirming that suppliers can bill standing charges to new occupants of premises before they start consuming energy, thereby potentially reducing debt build up from change of tenancy. However we think there may also be some potential risks to customers and suppliers that this consultation has not considered including risks of increased dispute, and the interaction with

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Ofgem's review of the change of tenancy process. As such we think it is important that Ofgem undertakes further review and consultation before it makes any decision on whether to proceed with this change. .

3. In the context of the current regulatory framework, we think it is sensible to include in the guidance reference to the licence conditions which mean it is prohibited to block a non-domestic deemed customer transfer for reasons of debt. This will ensure that this requirement is clear to all suppliers, particularly new entrants to the market who may not be aware of this requirement as it is a result of the interaction of other elements of the licence conditions rather than being an explicit requirement. Our agreement to the amendment however does not mean that we agree that this protection for non-domestic customers should be part of the regulatory framework, and in the context of continued high debt levels in the sector, we consider Ofgem and/or Government should undertake a consultation on the relative costs and impacts of this policy with a view to making necessary amendments to allow objections for non-domestic deemed debt.

4. We do not agree with Ofgem that "in most cases" requesting a security deposit of a deemed customer would be inconsistent with SLC 0/0A and SLC 7.3. The inclusion of bad debt costs within tariff prices seek to recover the overall costs of bad debt across the portfolio more broadly and, as Ofgem recognises, it is reasonable for bad debt costs to be different within different tariff types. Security deposits are a means for suppliers to manage the risks of individual customers, and act as one tool suppliers have which can support the reduction of bad debt costs which could be argued to reduce overall bad debt levels for all consumers. We do not think that Ofgem should remove this tool for suppliers in the current context. In addition, security deposits are not a baseline charge for energy supplied, and will either be refunded to the customer when certain criteria are met, or offset against unpaid charges.

We agree that guidance can be a helpful tool in clarifying Ofgem's expectations for certain supplier obligations. However we would note that where guidance is used to drive specific behaviours and outcomes, it may be more appropriate for Ofgem to update the relevant licence conditions than using guidance to reinterpret the conditions. Changes to guidance are subject to a less robust consultation process than changes to licence conditions, and changes to licence conditions are generally subject to greater scrutiny though the statutory consultation process, and importantly, give rise to a right of appeal to the CMA. This framework provides an important level of protection for licensees (and their investors). As a general principle, Ofgem should place such enforceable regulatory obligations, and other key elements of the relevant provisions, in the licence not in guidance.

Should you wish to discuss any of the points raised or have any questions please contact me via the details provided or contact Rhona Peat (rhona.peat@scottishpower.com).

Yours sincerely,



Richard Sweet
Director of Regulatory Policy

Annex 1

CHANGES TO GUIDANCE ON DEEMED CONTRACTS – SCOTTISHPOWER RESPONSE

Question 1. Do you agree with our proposals on situations when we will generally view a deemed contract to exist depending on a customer's ability to consume energy? Please provide your reasons.

Ofgem's updated guidance is a substantive change from its previous guidance in this area. Its previous guidance set out that it considered a deemed contract exists only from the point energy starts to be consumed within a property. However this updated guidance sets out that Ofgem considers a deemed contract can exist prior to this point, in cases where energy could be consumed by a new tenant, but the tenant is choosing not to do so.

Ofgem has provided no reasoning on the need to update its guidance in this way. We think understanding this would be helpful to support our review of the proposals. We consider Ofgem's updated guidance in this area could create the potential for issues within certain supplier processes and/or an increased potential for disputes. It is therefore important to understand the intended benefits of this change to ensure a balanced decision is taken. In particular we would highlight the following points:

- Ofgem's consultation references that this revised interpretation of the legislation would allow suppliers to bill customers for standing charges for a property from the point they move until the point that they begin to consume energy. This could support reducing bad debt build up, however it is unclear to us how material any such reduction might be. We think Ofgem should be gathering data to measure this benefit to support a full assessment of the change in interpretation of the guidance.

- Ofgem's review of the change of tenancy (CoT) process states that some suppliers are currently operating an improved CoT process which it correctly assesses as being aligned with the current regulatory framework including the rules on deemed contracts. We are concerned that Ofgem's revised interpretation of the legislation on deemed contracts could unintentionally lead to this improved CoT process as being interpreted by some stakeholders as not aligned with the current regulatory framework. We would be very concerned if Ofgem were to make changes to the rules in one area, without due consideration of the implications for other areas.

- We think there is a significant risk that this change in interpretation could lead to increased disputes. We think the language use in the relevant sections of the Gas and Electricity Acts is such that certain stakeholders could interpret it in different ways. While Ofgem issuing guidance provides suppliers with a helpful evidence base for any actions they may take to set up a deemed contract prior to energy being consumed, as Ofgem itself states, Ofgem's guidance also references that ultimately interpretation is a decision for the courts, and each case should be assessed on an individual basis. We are concerned that Ofgem's revised interpretation could lead to increased disputes, with some stakeholders prompting customers to raise erroneous complaints exploiting this new ambiguity.

- In this context, we would note that it can also be challenging for suppliers to assess whether a customer has moved into a property, but chosen not to consume. It may be helpful as part of the further consultation we suggest Ofgem undertakes on this proposal, to gather information on how suppliers would be able to do this in a manner that does not create further risk of increased complaints.

In summary, we consider this proposed change is a much more significant amendment than the consultation currently presents and we believe that Ofgem should undertake further review and assessment of the implications of revising its interpretation prior to confirming any changes.

Question 2. Do you agree with our proposal around the reasonable recovery of bad debt? Please provide your reasons.

The amendments made to the draft guidance introduce additional wording relating to the increased costs of supplying customers on deemed contracts, which Ofgem's guidance already recognised as relating to the additional risks and costs of this customer group to suppliers for a variety of reasons, including lack of engagement, higher levels of bad debt exposure and/or costs relating to hedging relating to uncertainty around future consumption.

Ofgem's guidance already noted that it would not consider increased charges in deemed contracts associated with such costs to be "unduly onerous" under the requirements of SLC 7.3. The updated guidance introduces additional text relating to the expectations of evidencing these increased costs including in relation to these same cost categories in charges for contracted customers.

While we do not disagree with the high level intent of the amendments to the guidance, as we agree that suppliers should be able to evidence their pricing methodologies for different tariff types, we have some concerns about the updated drafting and how it could be interpreted by Ofgem in the future. In particular:

- In paragraph A1.66, Ofgem has inserted additional text that states that it would not consider increased charges to be unduly onerous *"to the extent that the supplier can justify and evidence these additional costs and that they are set at a reasonable level."* We think it may be clearer to amend this statement to include reference to the methodology under which these additional charges or costs are calculated, which would then align more closely and complement the reference in paragraph A1.67 as to how Ofgem will assess deemed contract charges. We would suggest amending the text to:

  "to the extent that the supplier can justify and evidence the methodology for these additional costs and that they are set at a reasonable level."

- We think the additional text added to the end of paragraph A1.66 also needs amendments to ensure it is clear and does not create more ambiguity rather than less. In particular, we think the use of "comparative approach" is ambiguous and could be interpreted in different ways by different readers. We believe that Ofgem is intending that this should be read as suppliers being able to explain and justify the differences between the costs of bad debt factored into contracted and deemed tariff rates. However, we think it could be read as suggesting that the bad debt costs should be "comparable" or "the same". We would suggest making the following amendments:

  "At the same time, when considering their methodology for bad debt recovery and risk for deemed rates, we would expect that suppliers should be able to justify any differences compared to their ~~take a comparative~~ approach to how they recover these costs ~~to~~ from their contracted customers."

Question 3. Do you agree with our proposed text that reminds suppliers of their obligations around customer transfer blocking and delayed switching? Please provide your reasons.

Customer transfer blocking

In the context of the current regulatory framework, we think it is sensible to include this additional section within the guidance for deemed contracts to ensure that this requirement is clear to all suppliers, particularly new entrants to the market who may not be aware of this requirement as it is a result of the interaction of other elements of the licence condition rather than being an explicit clear stated requirement. Including it in the guidance should ensure that all suppliers are aware of this obligation and reduce instances where some suppliers may object to non-domestic customers on deemed contracts for the reasons of debt.

Our agreement to the amendment however does not mean that we agree that this protection for non-domestic customers should be part of the regulatory framework. We do not think there is justification for the non-domestic framework being different to the domestic framework for objections relating to deemed debt. In the context of continued high debt levels in the sector, we consider Ofgem and/or Government should undertake consultation on the relative costs and impacts of this policy with a view to making necessary amendments to allow objections for non-domestic deemed debt.

Delayed switching due to a dispute

We think that this section would benefit from a number of amendments to ensure it is clear and does not create any further ambiguity for suppliers, customers and other relevant parties. In particular:

- In paragraph A1.96, we suggest an amendment to ensure the guidance reflects circumstances where the actions to resolve the dispute are outside of the control of the supplier (ie where actions may be needed by the customer themselves, or a third party). We would propose the following text:

  > *"Where a customer has moved into a new property and is placed on deemed rates, and the customer genuinely disputes an element of the deemed bill with the supplier (e.g. the meter reading), the supplier should act promptly to resolve the dispute with the customer, where those actions are under their control."*

- We think that paragraph A1.98 more naturally follows paragraph A1.96 than paragraph A1.97, and the guidance should be reordered. In addition, we think the second part of the paragraph regarding actions taken by the supplier to address a poor customer experience should be less prescriptive on the actions and instead focus on the desired outcome. This would be more aligned with Ofgem's wider Consumer Outcomes programme of work. We would propose the following amendments:

  > *"If the supplier is responsible for delays in resolving a dispute and the customer has been paying the deemed rates during that time, we would expect the supplier to work with the customer to address any financial detriment that this could have created for the customer compared to contracted rates for that time period. This could include for example, a goodwill payment or re-billing the account ~~or look~~ to retrospectively reduce the rates which the customer has paid over that time period."*

- We think paragraph A1.97 is particularly confusing. It includes reference to both customers being blocked from agreeing a new contract with their existing supplier and being blocked

from switching to a new supplier. However, the additional guidance is then only in relation to blocked switches to a new supplier for non-domestic customers only and references the previous section of the guidance on objections for debt for non-domestic deemed customers. The requirements of SLC 14 set out the obligations in relation to objections and disputes for all customers, and includes that suppliers are not allowed to object to domestic or non-domestic customers for amounts that are entirely made up of disputed charges. We therefore think that this paragraph is confusing and creating more ambiguity than less, as is the intention. We think it may be helpful to instead amend the text to remind suppliers of their obligations with respect to objections in the context of disputed amounts. For example, we think this paragraph would make more sense if it followed the current paragraph A1.98 and was amended to read as:

> *"We have heard of cases where the customer wishes to agree a contract or switch away from the deemed rate, but the supplier attempts to block this on the basis of the dispute. In addition to the actions set out in paragraph A1.98 to address any potential financial detriment, suppliers should also consider their obligations under SLC 14 in relation to customer transfer blocking in cases of Disputed Amounts and the updated guidance set out on this topic in this Guidance. ~~As outlined above, the supplier is not able to object to this switch if the customer is a non-domestic customer.~~"*

- We note that the heading of this section has been allocated a paragraph number which is not the case for the "Customer transfer blocking" section and Ofgem should make necessary amendments to make the format for each section consistent.

Question 4. Do you agree with our proposal around the circumstances in which suppliers should ask for security deposits? Please provide your reasons.

We do not agree with Ofgem that "in most cases" requesting a security deposit of a deemed customer would be inconsistent with SLC 0/0A and SLC 7.3. The inclusion of bad debt costs within tariff prices seek to recover the overall costs of bad debt across the portfolio more broadly and, as Ofgem recognises, it is reasonable for bad debt costs to be different within different tariff types. Security deposits are a means for suppliers to manage the risks of individual customers, and acts as one tool suppliers have which can support the reduction of bad debt costs which could be argued to reduce overall bad debt levels for all consumers. We do not think that Ofgem should remove this tool for suppliers in the current context. In addition, security deposits are not a baseline charge for energy supplied, and will either be refunded to the customer when certain criteria is met, or is offset against unpaid charges.

On this basis, we do not consider it correct for Ofgem to say that customers would be "double charged" for bad debt costs where a customer were to meet a supplier's policy for a security deposit to be requested.

We would also note that the current regulatory framework for domestic contracts, does not allow supplier to charge higher bad debt costs for the deemed customers compared to contracted customers on a default tariff. It would therefore be inappropriate of Ofgem to create barriers for suppliers in requesting security deposits for those deemed customers on a supplier's SVT, but not for those contracted customers.

We note that the updated guidance does include reference to certain circumstances where it is reasonable for a security deposit to be requested for customers on deemed contracts, and we agree that the characteristics set out by Ofgem are those customers which represent particularly high risk. For example, there are circumstances where suppliers may face exceptional risks, such as previously disconnected sites, high-risk premises, customers with a history of non-payment, or situations where customers are unable to secure alternative supply arrangements. In such cases, a security deposit may represent a prudent and

proportionate risk management measure rather than a form of double recovery. We therefore think it may be more helpful for Ofgem to set out in the guidance that suppliers should be able to justify why it requests a security deposit. There are already existing provisions within the licence conditions relating to when a supplier can request a security deposit from a domestic customer, and therefore we think Ofgem should consider its position in the context of these existing requirements.

Finally, as a secondary point, but one we think is helpful to flag, we note that Ofgem's guidance considers that instead of requesting a security deposit for deemed customers, suppliers should instead reach out to a customer and attempt to enter a contract or encourage them to move to another supplier. Given the majority of deemed customers are likely those who have not engaged with their supplier, and where suppliers already have obligations to seek to engage with those customers to make them aware of the contracts available to them, this particular paragraph does not seem to address the issue.

Finally, we would note that the heading of this section has been allocated a paragraph number which is not the case for the "Customer transfer blocking" section and Ofgem should make necessary amendments to make the format for each section consistent.

Question 5. Are there any potential implications for domestic customers that the proposed guidance on deemed contract rates may impact on?

Paragraphs A1.53 and A1.54 of the guidance set out the "Implications for Domestic Suppliers and Customers" and as currently drafted is focused on the level of deemed rates for domestic customers, and notes that as domestic deemed rates are currently subject to the price cap, this is sufficient to comply with SLC 7.3 and 7.4. Ofgem also notes that if the price cap were to be removed or changed, then it may issue further guidance with respect to compliance with SLC 7.3 and 7.4. Ofgem is not proposing any changes to this section.

With respect to the proposed amendments to the guidance set out in this consultation, we do not have any specific comments with respect to domestic suppliers and customers that we think requires any additional amendments to the guidance, other than the points we have raised in response to other questions.

Question 6. Do you have any further comments on our proposals for the deemed contract guidance?

While we agree that guidance can be a helpful tool in clarifying Ofgem's expectations with regards certain licence obligations, we remained concerned by an increasing use of guidance by Ofgem which suppliers "must have regard to" which is the case for this deemed contract guidance under SLC 7.14. We have previously shared our concerns regarding the use of guidance rather than updates to licence conditions, and in particular our concerns that:

- While SLC 7.14 notes that any changes in the guidance must be subject to consultation, there are no specific requirements around the process of consultation under which changes to the guidance would be made either within SLC 7 or the guidance document itself. In this case, Ofgem has provided reasonable time for stakeholders to review and provide feedback on the guidance which is helpful, however this has not always been the case, with Ofgem in the past providing only 10 working days for consultation for other guidance.

- Changes to licence conditions are generally subject to much greater scrutiny though the statutory consultation process, and importantly, give rise to a right of appeal to the CMA. This framework provides an important level of protection for licensees (and their investors).

As a general principle, Ofgem should place such enforceable regulatory obligations, and other key elements of the relevant provisions, in the licence not in guidance.

These concerns are particularly relevant in the broader context of Ofgem's Consumer Outcomes programme of work, where there is a risk that in moving to a more outcomes based regulatory framework, Ofgem uses guidance documents such as this one to set "expectations" on supplier actions, rather than having prescriptive rules. We are sharing our views on this within our response to Ofgem's consultation on that programme of work.

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July 2026