

December 1999

Customers in Debt and their  
Access to the Competitive Market

## Table of Contents

1.	Introduction	2
2.	Licence Provisions	5
3.	Customer and Supplier Views	8
4.	Survey of Current Practice: Objection to Debt and Assignment	11
5.	Dealing with Utility Debts: Alternative Options	16
6.	The Industrial and Commercial Markets	20
7.	Conclusions and Next Steps	23
Appendix 1	Legal Provisions	26

# 1. Introduction

## *This Document*

1.1 This document sets out Ofgem's proposals for the reform of arrangements for customer transfers in the domestic and industrial and commercial electricity and gas markets, where customers are in debt. The overall objective of reform is the removal of barriers to competition, thus enabling customers to exercise choice of supplier more easily.

1.2 It considers the current legal and industry provisions concerning debt and debt avoidance, including suppliers' rights to object to transfers, and assignment of customers' final bill debts when they change supplier. The document reviews practical experience with these arrangements, and makes comparisons with other markets.

1.3 The document considers the implications of various possible options for reform, and concludes with Ofgem's proposals for licence and other relevant changes. It proposes that these should be brought into operation in April 2000, if possible.

## *Background*

1.4 In March 1998, in its Green Paper "A Fair Deal for Consumers",<sup>1</sup> the Government asked the electricity and gas regulators, in consultation with customer groups and in partnership with the electricity and gas industries, to prepare an industry wide action plan to ensure efficiency, choice and fairness in the provision of electricity and gas to disadvantaged customers. The Government's objective is to ensure that the economic benefits of liberalisation are spread fairly amongst everybody, including the most vulnerable customers.

1.5 In its October 1999 paper, "Social Action Plan: Framework Document" (the Framework Document), Ofgem outlined a programme of work, including a commitment to review, in the context of customer transfers, arrangements for debt blocking and assignment. The right of the existing supplier to block the transfer of customers in debt

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<sup>1</sup> "A Fair Deal for Consumers: Modernising the Framework for Utility Regulation": CM3898, March 1998.

is seen by many customer groups as preventing disadvantaged customers who are experiencing payment difficulties from participating in the competitive market. Such customers should particularly welcome the opportunity to make savings on their bills through choosing an alternative gas or electricity supplier.

1.6 While some of the issues were summarised in the Framework Document, this document sets out the issues in more detail. It also considers the position in the industrial and commercial market.

### ***Structure of Document***

1.7 The chapters in this consultation document are structured in the following way:

- ◆ **Chapter 2** describes the relevant licence provisions (including, for electricity, the industry's Master Registration Agreement (MRA)).
- ◆ **Chapter 3** sets out customer and industry views on the issues.
- ◆ **Chapter 4** describes a survey on current practice by suppliers.
- ◆ **Chapter 5** considers the current treatment of debt by utilities and considers some options for dealing with debts on customer transfer.
- ◆ **Chapter 6** considers issues specific to the industrial and commercial markets.
- ◆ **Chapter 7** draws conclusions, and sets out Ofgem's proposals for reform and a timetable.

### ***Comments Invited***

1.8 Comments are invited on the issues raised in this document and in particular on Ofgem's proposals. It would be helpful to receive replies by Monday 10<sup>th</sup> January 2000. Responses should be sent to:

Tony Boorman  
Deputy Director General  
Ofgem  
Stockley House  
130 Wilton Road  
London SW1V 1LQ  
Or by e-mail: [boormant@ofgas.gov.uk](mailto:boormant@ofgas.gov.uk)

1.9 It is open to respondents to mark all or part of their responses as confidential. However, we would prefer it if, as far as possible, responses were provided in a form that can be placed in the Ofgem library. If you have any queries concerning this document, Dave Barnes (0171 932 1634) would be pleased to help.

## 2. Licence Provisions

### *Objection for Debt*

2.1 Electricity and gas suppliers may object to the transfer of certain customers to other suppliers on grounds of unpaid debt in the following circumstances. That is:

- ◆ The customer has failed to pay charges;
- ◆ The amount is due, i.e. there is no dispute;
- ◆ A written demand has been made; and
- ◆ 28 days have passed since the making of the demand.

2.2 In the gas market, the right to object for debt concerns all customers (domestic, commercial and industrial), whereas in the electricity market the right to object relates only to domestic customers (defined as customers at premises used wholly or mainly for domestic purposes).

2.3 For gas, these arrangements are set out in paragraph 4 of Standard Condition 7 of the Suppliers' Licence. There is no directly comparable licence condition relating to objection for electricity, but similar arrangements to gas are included in Clause 16 of the Master Registration Agreement (MRA) between electricity suppliers. The MRA sets out rules for customer transfers in the electricity market. All suppliers are required to sign the agreement if they wish to participate in the competitive market. Provisions contained in Public Electricity Supply (PES) Licence Condition 38, and Second Tier Supply Licence Condition 46 (England and Wales), and the respective Scottish Conditions 33 and 47, are relevant to debt in relation to termination of contracts on notice.

### *Assignment of Debt*

2.4 Although the arrangements described above can be used to prevent a customer with debt from switching supplier, these do not provide for all the circumstances in which debt can arise on transfer. The incoming supplier will be supplying the customer before the final bill from the outgoing supplier will arrive. If the customer does not pay this final bill the outgoing supplier is unable to raise an objection.

2.5 To provide for this, the outgoing supplier can in certain circumstances assign final bill debts to a customer's new supplier. The rules for assignment are contained in the electricity and gas suppliers' licences, and are essentially the same for both fuels. They apply to domestic customers<sup>2</sup> only and are as follows:

- ◆ Only debt that has remained unpaid for less than 28 days at the time of transfer and could not have been objected to can be assigned. (**note:** this may include an outstanding debit balance on a payment plan if a supplier had not billed for this when the customer changed supplier) ;
- ◆ Notice of the intention to assign must be given by the old supplier to the new supplier within 90 days of the transfer date, provided reasonable endeavours have been made to recover the amount due over a period of at least 42 days in electricity and 40 days in gas from the making of the demand;
- ◆ The amount is not in dispute and does not exceed one third of the customer's annual charges;
- ◆ Only a "reasonable" administrative charge can be made by the supplier to whom the debt is assigned (in gas suppliers have agreed a sum of £25.00, but this is not specified in electricity).

2.6 An assigned debt becomes the responsibility of the new supplier, which can disconnect (subject to powers of entry where needed) if having billed for the debt, the customer fails to pay it or to make arrangements for doing so.

2.7 Assignment arrangements are contained in PES Licence Condition 40, and Second Tier Supply Licence Condition 48 (England and Wales). In Scotland, the relevant conditions are 35 and 49. The arrangements for gas are contained in paragraphs 5-11 of Standard Condition 7 of the Gas Suppliers' Licence.

2.8 Reflecting the novel and untested nature of assignment when introduced, the licences give discretion to the Director to provide, on the basis of representations made to him (either that assignment does not significantly reduce unrecovered debts, or the costs are disproportionate), that the operation of assignment should cease to have effect.

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<sup>2</sup> Defined in gas as customers using less than 73, 000 kilowatt hours per year. In electricity this relates to customers at premises used wholly or mainly for domestic purposes.

(PES Licence Condition 41; Second Tier Supply Licence Condition 49 (England and Wales); and Conditions 36 and 50 respectively in Scotland; and paragraph 10 of Standard Condition 7 of the Gas Suppliers' Licence, refer).

2.9 The relevant extracts from the above mentioned licence conditions, and the electricity Master Registration Agreement are reproduced as Appendix 1.



### 3. Customer And Supplier Views

3.1 Provisions enabling suppliers to object to a customer transferring due to outstanding debt were made in response to concerns that otherwise it could be possible for customers to switch between suppliers without paying their bills – “bill switching”. Such a practice was considered to have the potential to increase suppliers’ costs and thus the cost of supply to customers. However, concerns have been raised during consultation on Ofgem’s Social Action Plan about whether the right to object is weighted too much in favour of suppliers.

3.2 Several authoritative organisations (including the Gas Consumers Council (GCC), the Electricity Consumers’ Committees, and Public Utilities Access Forum (PUAF)) have called for changes in the arrangements for objection for debt. In its investigation into the introduction of competition into the domestic gas market, the National Audit Office raised the question of lack of competition for prepayment meter customers. The Comptroller and Auditor General’s Report<sup>3</sup> commented as follows:

“An additional factor is that approximately 80% of customers who use prepayment meters do so because they owe money to British Gas Trading. Any supplier that is owed money by a customer can veto an application by that customer to transfer to another supplier until the customer pays off the debt.

...the right of all suppliers who are owed money to veto a transfer reduces the incentive for new suppliers to seek out such customers. The real choice available to such customers is correspondingly reduced.”

3.3 Among the recommendations of the report was that Ofgem should “... consider the scope for customers to move their debts with them when they change company, while safeguarding the rights of suppliers to whom money is owed”.

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<sup>3</sup> “Giving Customers a Choice – The Introduction of Competition into the Domestic Gas Market”: HC 403 Session 1998 – 99, 12 May 1999.

3.4 In its August 1999 report, "Final Demand – Ending Fuel Poverty", the Consumers' Association considered the offers available to low income customers. It commented:

"For many low income customers in debt, this point is academic. Firstly, most companies will not allow you to switch over to a new, cheaper company if you have an existing debt. The whole area of debt transfers is unclear. The responses to CA's survey indicated that this is an issue which is still being worked out.

...in order for vulnerable customers to play an active part in the competitive market the rules regarding debt transfer need to be changed. The companies are concerned, however, that any relaxation of the guidelines in this area could lead to some customers running up massive debts by continuously switching between suppliers. A compromise is needed. The Regulator should introduce a new licence condition which would say that customers with debt should be able to transfer to a new supplier at least once, unless it can be proved by the company that they are a "won't" as opposed to a "can't" payer."

3.5 Most customer groups consulted on the Social Action Plan have asked Ofgem to remove or amend the objection process. The GCC points out that in other markets, debt does not prevent transfer between different service providers. The National Electricity Consumers' Council, whilst accepting that there might be a problem with some customers seeking to avoid paying their debts, concludes that "... so long as all parties are in agreement and arrangements to clear debts are made, we can see no reason why a supplier should block any transfer."

3.6 Concerns were, however, also raised concerning the possibility of additional administration charges on collection of debts by suppliers or debt collection agents. PUAf suggest that if debt blocking arrangements are removed there might be a higher incidence of companies insisting on security deposits or putting customers on prepayment meters, because suppliers will be more sensitive to debt. Some groups therefore favour delaying any change until the market has been open longer, in order to give suppliers time to adjust.

3.7 Customer groups also suggest a review of the rules surrounding assignment of debt and the administration fees charged by companies. Energy Action Scotland raises concerns that the addition of administration fees means that it could take some time before customers see any saving from switching. In this regard, National Energy Action feels that “imposing an administration fee serves as an additional punishment for having a debt”.

3.8 Suppliers on the other hand almost unanimously support the present rules for debt blocking in the competitive market. They believe the present rules provide the right framework to avoid debt escalation, increased debt recovery costs and to prevent abuse by customers seeking to evade their debts.

3.9 Changing the rules therefore, would not, in the view of suppliers, be in customers’ long-term interests. It could lead to higher costs to customers in general, there could be more disconnections, an increase in the numbers of prepayment meters and more legal action through to enforced County Court judgements. In the end this would impact adversely on the development of competition including benefits for disadvantaged customers.

3.10 A minority of suppliers, however, believe that the rules should be changed to enable those in debt to switch and to benefit from lower prices. These do not, however, suggest complete removal of the supplier’s ability to object because it is felt that this would lead to indiscipline in the market. The assignment rules are thought by many suppliers to be cumbersome and too complicated. There is support for a review in order to make the arrangements work more effectively. Some suppliers would be prepared to explore expanding the assignment of debt arrangements, to include previous debt.

3.11 More details on suppliers’ views and current practice are included in the following chapter. This also considers assignment in more detail, together with details on customer switching.

## 4. Survey of Current Practice: Objection to Debt and Assignment

4.1 In order to obtain a more detailed picture, Ofgem has conducted a survey of current experience among suppliers regarding the objection to customer transfers and debt assignment processes. A summary describing the questions asked and the responses received follows. It should be noted that the results draw mostly on gas suppliers, where there is most experience.

### Survey of Suppliers on Debt Objection and Assignment

Ofgem wrote in September 1999 to domestic electricity (both PES and second tier) and gas suppliers to ask for information on company policies and experience on the objection to customer transfers due to outstanding debt and operation of assignment of debt. It was made clear that Ofgem's interest was in connection with work on the Social Action Plan.

In total 10 electricity suppliers and 18 gas suppliers responded to the questionnaire. The following is the list of questions asked and a summary of responses received.

**1. What is your organisation's current policy with regard to objecting to a customer transfer where there is unpaid debt?**

All 10 electricity companies said they object for debt.  
17 gas companies also do so; 1 did not.

2. **Does your organisation have a threshold for the value of the debt below which you would not object? If so, what is it?**

Thresholds as follows (company numbers in bold):

**Electricity**

**(3)** £50; **(1)** £40; **(1)** £30; **(1)** £25; **(2)** £10; **(2)** £1

**Gas**

**(6)** £50; **(2)** £30; **(3)** £25; **(1)** £20; **(1)** £10; **(1)** £5; **(1)** £2; **(2)** £1

3. **Does your organisation currently seek to assign debt to another supplier after a customer has transferred away from you? If not, do you intend to introduce such an arrangement?**

Two companies said they currently do; one company had done so until recently but had now stopped.

Comments from companies which had tried assignment included:

"Tried assignment but found the process completely unsatisfactory and uneconomical."

"The administrative costs of the current processes, when other suppliers have not been co-operative, outweigh the benefits."

4. **Have you any experience of voluntarily transferring a customer's existing debt (i.e. a debt which would permit the incumbent supplier to raise an objection) or outstanding balance on their account at the point where a customer changes supplier? If yes, please describe the circumstances.**

Three companies said they had done this infrequently, to meet special circumstances, e.g. involuntary transfer. It was not a standard practice for any company.

**5. Have other suppliers assigned debt to you within the last three months? If so, can you please provide details including, in particular, information as to any difficulties that you may have encountered.**

Ten companies reported that they had experience of this. Comments included the following:

“After (the supplier) informed us of the assignment they still accept payments from customers. This can lead to the situation of asking customers for payment when they have already paid their previous supplier.”

“There is very little benefit to customers, as the process has taken so long to complete. Usually we have resolved the unpaid debt by a telephone call to the customer.”

**6. Do you undertake any credit checking of new customers? If so, what methods do you employ? How are customers informed that this is taking place?**

Ten companies reported that they carry out credit vetting. This takes the form of a standard scoring system and / or use of an external credit reference agency in some circumstances. The information is collected on application forms and the contracts make it clear that payment method is subject to completion of vetting.

**7. For existing customers being supplied with one fuel who have signed for the supply of the other, is the payment history for that existing fuel used for credit checking purposes? If so, is the customer's permission sought before such a check is carried out?**

Only two companies reported doing this. Permission is obtained via the contract.

### ***Conclusions from Survey: Objections***

4.2 It is clear from the survey responses that most suppliers currently exercise their right to object on the grounds of outstanding debt, although many operate a threshold below which they will not do so. This threshold varies between £50 - £1. There is

currently little experience of voluntary arrangements between suppliers, outside the licence or MRA provisions, for the transfer of customer debts.

4.3 Ofgem is aware that customers transfers have been blocked inappropriately, for example in relation to direct debit customers when the running balance is presently showing that usage has exceeded payment, but all payments have been made. There is also concern about whether the objection process is being used as a customer retention strategy. The level of objection varies significantly between companies. It seems unlikely that debt blocking for small sums of outstanding debt is economic given the administrative costs involved. However, several companies block for £10 or less. This may reflect genuine differences in circumstances but in many cases seems more a general matter of company policy. Extensive use of blocking facilities is likely to dilute competition and provide opportunities for suppliers to frustrate customers wishing to switch to a competitor.

#### ***Assignment Process: Final Bill Debts***

4.4 Ofgem's survey also shows that the assignment arrangements have proved difficult to operate. Only two companies reported that they currently assign debts to other suppliers, and a number of other companies report on difficulties in dealing with debts assigned to them. Such difficulties arose from insufficient details being provided by the assigning supplier, including advice once assignment had been made on whether the customer had paid, and general concerns about the time consuming and manual nature of the assignment process.

4.5 Such concerns are not new. A trial on assignment in the gas market by British Gas Trading in 1998 found it was difficult to meet the timescales in the licence conditions. This was largely because of the level of disputed (largely estimated) transfer meter readings at that time, resulting in delays in agreeing final bills. The permitted level of assignable debt was also found in many cases to be too low in relation to the size of debts that had accrued, and some suppliers were in effect not accepting assigned accounts because they continually raised queries on them. A further general concern that has been raised in the gas market is whether debts can be properly assigned where, for example, the previous account had been in the husband's name, but the wife had signed the contract with the new supplier.

4.6 A related issue has arisen with regard to the treatment of assigned debts for the purposes of VAT legislation. The problem is a highly technical one which is caused by differences between UK and European law, tax points for companies who use different accounting conventions (cash accounting or invoice accounting) for determining when VAT is paid, and the arrangements for bad debt relief. The result is that HM Customs and Excise fears that in some circumstances the VAT on an assigned debt will not be paid.

4.7 H M Customs and Excise says it would be content with an industry agreement as a way of establishing common practice for dealing with VAT on assigned debts. The 14 PESs and British Gas Trading are prepared to sign on to the proposals, but have indicated that there will be significant costs for systems changes. All other suppliers would need to be involved for this agreement to be effective.

### ***Customer Switching Behaviour***

4.8 There is some evidence on the extent to which debt is a major obstacle to customers switching. In their latest research for Ofgem, MORI asked customers their reasons for staying with their current electricity or gas supplier. One per cent of customers who have not switched gave their reason as arrears with their current suppliers. Ofgem believes these figures may be understated given the reluctance of customers to admit they are in difficulties.

4.9 Ofgem's own statistics on switching indicate that in absolute terms quite significant numbers of switching applications are objected to. In the domestic gas market, the percentage of attempted transfers which were objected to on grounds of debt over the last year was approximately 13%. This represents around half a million occasions when the customer has been prevented from transferring to the supplier of their choice due to debt. In the designated electricity market (i.e. premises using no more than 12,000 kWh annually), where switching rates are lower than gas, the percentage of blocked transfers was around 2%, representing approximately 80,000 occasions of inability to transfer.



## 5. Dealing With Utility Debts: Alternative Options

5.1 Utility suppliers can claim they are different from other businesses for several reasons:

- ◆ they have a legal obligation to supply domestic customers;
- ◆ they have to provide a range of payment methods to domestic customers, including cash and other credit terms (subject, in certain circumstances, to provision of security or prepayment meter);
- ◆ they have to treat domestic customers in genuine payment difficulties sympathetically;
- ◆ they have to disconnect in order to stop supply, usually first needing to obtain a warrant of entry. (Except second tier electricity suppliers, which do not currently have statutory powers of entry.)

5.2 However, suppliers can generally depend on customers' need to maintain a supply of electricity or gas to ensure payment; because they can disconnect and refuse supply until they are paid, it is only comparatively rarely that suppliers need to resort to Court action to recover charges.

5.3 If customers were able to leave without paying their bills, with no fear of disconnection by their new or previous supplier, the risks to suppliers of dealing with customers on credit would increase. Suppliers (and some customer groups) have pointed out that removal of the right to object on grounds of debt may give rise to greater insistence on credit vetting customers, resulting in more use of security deposits, and of prepayment meters, to control debt. It is clear from Ofgem's survey that a number of suppliers are already using vetting procedures to determine the credit worthiness of customers to decide what payment terms should be offered. Ofgem believes that this trend will continue to grow - whether or not arrangements for debt objection or assignment are changed - reflecting competitive pressures on suppliers to keep debt levels under tight control. The emphasis will, it is expected, change from debt recovery to debt prevention. Ofgem believes such change is desirable.

## ***Alternative Options***

5.4 Ofgem has considered options for dealing with debt (other than Court action or write-off), in the absence of suppliers' ability to object to transfer. The following are possible options:

### (i) Extension of Assignment

The extension of the assignment provisions to enable previous debts as well as final bills to be assigned is an option favoured by some customer groups. The current provisions safeguard the outgoing supplier; not only is the debt transferred but so is the right to disconnect for non payment.

However, in practice the assignment arrangements on final bills have not worked well and most suppliers no longer use them. The current arrangements are dictated by the procedures in the licences, which experience shows tend to be inflexible. A further difficulty with assignment is that for VAT purposes the procedure is currently insufficiently transparent to give HM Customs & Excise confidence that VAT will be properly accounted for.

While assignment is in principle attractive to the outgoing supplier, it is less welcome to the new supplier. The inclusion of previous debts in the assignment process could result in suppliers taking on new customers with several hundred pounds of debt, compounding existing problems. Assignment is unlikely to be an effective solution without significant revision.

The problems above would be eased if the new supplier purchased debt from the old supplier at a reasonable discounted value, outside the assignment process, or if a third party did so.

### (ii) Use of Third Parties

The factoring of debts via third party financial institutions may be a way forward. Agents may be prepared to purchase debts at a discount. This would relieve the outgoing and incoming suppliers of responsibility for the debt. However, customer groups have raised concerns about the possibility of customers being

involved with payment of additional debt charges. The conduct of third party debt collection agencies is outside the remit of Ofgem, so Ofgem would have no direct control of their activities.

Ofgem has seen no evidence of this type of approach to recovery of utility debts. It may not be an economic prospect for small debts. Ofgem would welcome information on any experience with this type of approach.

### (iii) Prepayment Meters

Prepayment meters offer a means of collecting debt along with payment for ongoing consumption. Debt on prepayment meters could be assigned from one supplier to another, if the meter was suitably calibrated.

Such a process is outside the existing assignment provisions since it needs to be automatic, rather than reliant on initial efforts by the outgoing supplier to obtain payment of debt before assignment is requested. There may be technical issues to overcome with some prepayment meter systems. VAT would need to be properly accounted for. A new licence provision would be needed, together with suitable supplier protocols.

An alternative is for the prepayment infrastructure agents – as third parties - to take responsibility for collecting outstanding debts when prepayment meter customers transfer. The debts could be sold to the infrastructure agent (e.g. the PESs, Siemens Metering Services, or possibly Paypoint or Post Office), which would then collect and retain this portion of customer payments. The meter would still need to be calibrated at a suitable rate. Such an arrangement is likely to be more transparent for VAT purposes than assigning the debt to the new supplier. However, there may be legal difficulties with third parties collecting debts through prepayment meters e.g., as in the recent case of SWALEC and water debts.

5.5 One safeguard which customer groups have suggested is to allow customers with debts to switch once, in order to prevent bill skipping. This is a very useful suggestion, which merits serious consideration. However, while this safeguard could be included in any of the options described above, Ofgem's initial view is that it is likely to add to the administrative burden on suppliers. Without a shared database it would be impossible for a new supplier to know whether a customer had already switched once with a debt. There could be Data Protection Act implications.

## 6. The Industrial & Commercial Markets

6.1 Although many of the issues discussed in the previous chapters also apply in the case of non-domestic customers, it is appropriate to deal more fully here with the specific circumstances of Industrial and Commercial (I&C) gas market customers. There is no right of objection in relation to debt in the I&C electricity market.

6.2 The I&C market in gas has been established for longer than the respective domestic market. Gas customers consuming more than 732,000 kWh were able to select their supplier from 1986; this threshold was lowered in 1992 to all users consuming above 73,000 kWh.

6.3 Complaints are regularly received by Ofgem from customers in the I&C gas market that their existing suppliers are preventing them from procuring their gas supplies from alternative suppliers at a time of their choosing. Customers feel that such behaviour is anti-competitive. Ofgem has been monitoring suppliers' use of the objection facility. The results over the period July 1998 to June 1999 show that around 3% of transfers were objected to for debt, representing around 3,000 occasions when customers could not transfer.

6.4 Customers have pointed out that in no other market can a supplier prevent a customer from choosing to take their goods or services from a competitor. They feel that the licences should be amended to facilitate the operation of competitive market pressures and so compel suppliers to use the normal commercial processes for recouping debt or the appropriate legal ones to settle a contractual dispute. Suppliers, though, argue that the supply of gas is different to the supply of other products because the customer can continue taking gas without the agreement of the supplier, whereas in other markets the delivery of goods or services can be halted pending resolution of disputes etc.

6.5 Gas suppliers argue that the ability to prevent a customer transfer due to debt is an important way to prevent customers running up debts. They say that if suppliers do not have the protection of being able to prevent transfer they may have to charge higher prices to reflect the increased risk. Suppliers also say that they do not want to return to

the dual billing problems that existed before the network code – when situations could arise where two suppliers both thought they were responsible for the same site and both billed the customer.

6.6 Suppliers have also argued that they should be allowed to enforce their rights under a contract i.e. to continue supplying gas under the terms and conditions in the contract until its expiry or cancellation, in the manner they expected when the contract was signed.

6.7 Whilst suppliers' reluctance to allow their customers to accrue debt is understandable, it is also a fact that this risk occurs in business generally. The response by businesses tends to be the establishment of effective credit control teams charged with the task of ensuring that customers do not fall into default with their payments which, if unchecked, result in a build up of significant levels of debt. This practice would also seem applicable in the gas market where early contact with customers as they fall into arrears, combined with accurate billing, should greatly reduce opportunities for debt build up.

6.8 The issue of regular and accurate billing is an important one. Cases have arisen where customers have queried a bill only to find they are prevented from changing supplier until the query has been resolved. Some customers have also encountered difficulties in the case of multi-sites, where bills for some of the premises have been queried, only to find that all the sites in the portfolio are prevented from transferring to another supplier until the issue has been resolved.

6.9 Disputes over outstanding debts inevitably lead to delays in customers transferring to a new supplier and, in some instances, can result in the customer having to remain with the supplier he seeks to leave. However, even when a contract just overruns this can be to the old supplier's advantage where it results in the customer being charged higher gas prices. Such occurrences result in complaints from customers that their interests are not adequately protected.

6.10 Additionally, there has been some debate on the subject of Failure To Interrupt (FTI) charges - which are levied on those customers which do not interrupt their gas

consumption when called on to do so by the public gas transporter. FTI charges can be seen as either liquidated damages or a penalty; the distinction is important since if they are deemed to be liquidated damages they can be included within the term “gas charges”, while if they are a penalty they cannot. This matter of interpretation is highly relevant since some customers have had their transfers blocked by suppliers seeking the payment of FTI charges. Although the definition of the term has not been tested in the Courts, Ofgem’s view is that FTI charges constitute liquidated damages and, as such, are admissible as gas charges; nevertheless, the issue is a confusing one for customers.

6.11 Ofgem does not see that contracts in the gas market are any different from those in other markets and the existing ability of the gas supplier to lock in a customer who wishes to transfer to another supplier – either for reasons of uncompetitive price or poor service (e.g. inadequate billing) - seems out of place and anti-competitive. The existence of the right to object is also inconsistent with the position in the electricity market, where the lack of such right does not appear to have given rise to problems.

6.12 Ofgem is aware that, in industry and commerce, it is not uncommon for a party to a contract to want to vary or even break that contract in order to benefit from more beneficial arrangements offered by a competitor. The Courts routinely deal with cases arising under contract law and it is difficult to see why gas contracts should be treated any differently. Ofgem therefore intends to consult separately on the removal of the suppliers’ right to object for contractual reasons in the I&C gas market.

## 7. Conclusions And Next Steps

7.1 Ofgem has concluded that the current arrangements on treatment of debts are not compatible with the interests of customers and the operation of a flexible, competitive market. The right of the current supplier to prevent customers in debt from purchasing elsewhere is unique to the electricity and gas markets, and amounts to a monopoly power which Ofgem considers unjustified. Not only does this constrain choice, but it also inhibits innovation and has a wider impact on low income customers, limiting their utility to enter the competitive market.

7.2 Ofgem acknowledges that removal from suppliers of the right of objection may result in increased sensitivity by suppliers to the risk of customer debt, potentially resulting in greater insistence on credit vetting, use of security deposits, and prepayment meters. Depending on customer and supplier behaviour, costs may increase as a result of increased debt collection and write-off costs, although these will be offset by the reduction in transaction costs in the transfer process. Overall, Ofgem does not believe that the effects will be unduly significant in the long run. Those customers who are "bad" credit risks may inevitably be given a more restricted range of offers than "credit worthy" ones with every supplier. However, suppliers which raise unnecessary barriers to customers either joining them, or switching away, are likely to find that their market share suffers. The enhancement of competitive activity arising from reform should benefit customers, particularly those on low incomes.

7.3 Ofgem has identified several possible options for dealing with debts of customers transferring between suppliers. None of these is straight forward, or a substitute for adequate debt management to avoid customers building up large debts. Nevertheless, Ofgem believes that the market will develop innovative solutions, given the incentive to do so.

7.4 One option for dealing with debt on transfer is the further development of the final bill assignment process, so as to include existing debts as well as final bills. Although Ofgem does not rule this out as a solution, there are clearly a number of issues to be resolved. The existing assignment process has not worked well, and is generally regarded as costly, time consuming and ineffective. In particular, the process is,



understandably, unpopular with the incoming supplier who takes responsibility for the debt. Unless the industry can demonstrate commitment to making the process work, there is no value in its continued availability as a licence obligation.

7.5 Ofgem therefore sees the simple solution of removing the right of the existing supplier to raise objections to transfer on grounds of debt as the best way forward. Once the right of objection is removed, it would be up to suppliers to decide how they wish to deal with debts owed by customers who are transferring to a new supplier – this might be by transfer of debt to the new supplier by voluntary agreement, writing off in the case of very small debts or pursuing through the courts in the case of larger ones, or transfer of debt to a third party. The new supplier would (as many already do) determine (within the framework of existing licence provisions) on what basis it wished to accept the customer – for example, whether it wished to require the customer to pay a security deposit or have a prepayment meter.

### ***Proposals, Process and Timetable***

7.6 Subject to comments on this document, Ofgem is minded to seek industry agreement for changes in the current regime, as follows:

- ◆ **To seek to remove the right of the existing supplier to raise objection to transfer on grounds of debt from gas suppliers' licences (in respect of domestic, industrial and commercial customers) and, by agreement with electricity suppliers, the Master Registration Agreement (in respect of domestic customers).**

7.7 For gas, this will require the removal of sub-paragraph (a) from paragraph 4 of Standard Condition 7 of the Gas Suppliers' Licence. This will need to be dealt with under section 23 of the Gas Act 1986. It is necessary that not less than 90% of all licensed gas suppliers, both by number and by volume of gas supplied, consent to the modification.

7.8 For electricity, a change is required to Clause 16.1 of the Master Registration Agreement. This is a matter for the parties to the MRA e.g. electricity suppliers. Although decisions by the MRA Executive can be appealed to the Director, he has no powers to initiate changes to the MRA.

7.9 However, the Director may consider proposing a new licence condition, invalidating the relevant provisions of the MRA in relation to transfers, if industry agreement cannot be reached. A change to the relevant licence provisions relating to outstanding debt and the termination of contracts on notice can be dealt with by the Director by direction (see Appendices).

7.10 With regard to assignment the Director proposes to:

- ◆ **Invite suppliers to make representation to him (in accordance with the relevant licence conditions) on Ofgem's initial view that the procedures for assignment of debt for domestic electricity and gas customers should cease to have effect on the grounds that these do not significantly reduce the number of unrecovered debts that might otherwise be expected, and that the costs are disproportionate.**

7.11 Before deciding on the most appropriate next steps, the Director would welcome views from customer groups and suppliers on the issues raised in this document **(by Monday 10 January 2000)** in particular:

- ◆ the effects of reforms on domestic electricity and gas customers and industrial and commercial gas customers; and
- ◆ the implications for electricity and gas suppliers, including any issues for company debt management and debt collection policies.

7.12 Subject to the consideration of views, formal proposals for changes in the gas licence standard condition could be made in February 2000 and, after allowing a minimum of 28 days for the making of representations following notice, could be introduced in April 2000, assuming the requisite percentage of approvals is received. Changes to the MRA would need to be considered within a similar period. **Views are invited on this prospective timetable.**

## Appendix 1      Legal Provisions

### Extract from Standard Condition 7, Gas Suppliers' Licence

- (4) The licensee shall not procure or permit the relevant shipper, in pursuance of any contract with that shipper, or otherwise request it, to prevent a proposed supplier transfer in relation to any premises at which the licensee supplies gas to a customer except for so long as –
- (a) the customer fails to pay charges for the supply of gas to those premises or any premises previously owned or occupied by him in respect of which such charges are payable which –
    - (i) are due to the licensee and have been demanded in writing, and
    - (ii) have remained unpaid for 28 days after the making of the demand, or
  - (b) the customer is bound by the provisions of a contract with the licensee for the supply of gas at those premises which will neither expire nor, to the knowledge of the licensee, be terminated on or before the date of the proposed transfer.
- (5) Subject to paragraph (10), paragraph (6) shall apply where –
- (a) the licensee has commenced the supply of gas to a domestic customer at any premises at which gas was previously last supplied to such a customer by another gas supplier ("the first supplier");

- (b) any person has failed to pay, within 28 days of the making of a demand in writing therefor, charges due to the first supplier in respect of the previous supply of gas at those or any other premises, other than charges which, before the time when the first supplier became aware of the proposed supplier transfer or the time of the implementation of that proposed transfer, whichever is the earlier -
- (i) had become due to the first supplier;
  - (ii) had been demanded in writing, and
  - (iii) had remained unpaid for not less than 28 days after the making of the demand,
- ("excepted charges") save that if at, or within 14 days of, that time it reasonably appeared to the first supplier that payment had been made of particular charges for the supply of gas but they had, in fact, not been paid (for example, where a cheque tendered in payment was subsequently dishonoured), those charges shall not be excepted charges for the purposes of this sub-paragraph; and the charges first mentioned in this sub-paragraph, other than excepted charges, are hereinafter referred to as "the charges in question";
- (c) that person has been notified by the first supplier, at least 14 days before it gives to the licensee such a notice as is mentioned in paragraph (6), that it proposes to assign the debt to the licensee and that, if he has a contract or deemed contract with the licensee which so provides, the licensee may be entitled to recover from him costs in respect of the recovery of the debt, and
- (d) that person either is supplied with gas by the licensee at the premises referred to in sub-paragraph (a) or is in occupation of those premises on the date on which the licensee receives such a notice as is mentioned in paragraph (6).

- (6) Where this paragraph applies, if, within 90 days of the licensee commencing to supply gas to the premises, the licensee receives written notice from the first supplier stating –
- (a) the amount of the charges in question which remains unpaid;
  - (b) that the first supplier had used its reasonable endeavours to recover the amount of the charges in question which still remained unpaid 40 days after the demand therefor was made, and
  - (c) that the first supplier intends to assign the debt attributable to the unpaid charges to the licensee,

the licensee shall, in consideration of such assignment and within 60 days thereof, pay to the first supplier the amount of such debt less (unless those costs are recoverable as mentioned in paragraph (5)(c)) the licensee's reasonable administrative costs likely to arise in recovering the debt from the consumer, except that this obligation shall be limited to an amount not greater than one third of that of the charges -

- (i) in respect of the amount of gas supplied to the premises in question (by the first supplier or some other gas supplier) in the year ending with the day on which the first supplier ceased to supply gas at those premises, or
  - (ii) if that amount is not known, in respect of the amount of gas reasonably expected to be supplied to the premises in question in the year beginning with the day on which the licensee commenced to supply gas thereat,
- calculated, in either case, on the basis on which the first supplier calculated charges in the customer's case immediately before it ceased to supply gas to the premises.

(7) For the purposes of paragraph (6), a consumer shall not be regarded as having failed to pay any charges for the supply of gas as at a particular date to the extent that any amount demanded by the first supplier is genuinely in dispute and the dispute does not relate to the amount of gas which was shown on the register of the gas meter through which the supply was taken when the first supplier ceased to supply gas to the premises.

(8) In this condition, "proposed supplier transfer" in relation to any premises means the proposed implementation of arrangements where under gas would no longer fall to be supplied to premises by one supplier but would fall to be supplied to those premises by another supplier (whether or not the supplier other than the licensee is licensed under section 7A(1) of the Act).

(9) In paragraphs (5) and (6), references to charges for the supply of gas, however expressed, do not include references to charges made in respect of the provision of a gas meter.

(10) Where, having regard to any representations made to him, it appears to the Director that, in relation to any particular class or description of cases -

(a) the application of paragraph (6), or the possibility of its coming to apply, does not significantly reduce the number of unrecovered debts which might otherwise be expected, or

(b) the application of paragraph (6) and the recovery, or attempted recovery, of assigned debts involves expenditure by the gas suppliers concerned which is disproportionate to the reduction in the aggregate amount of unrecovered debts which might otherwise be expected,

he may provide that paragraph (6) shall, subject to paragraph (11), cease to have effect in relation to that class or description of cases; and any such provision shall be made by a notice which -

(i) is given and published for the purposes of this condition generally, and

(iii) specifies the date on which the provision is to take effect.

- (11) Notwithstanding that the Director has, in pursuance of paragraph (10), provided that paragraph (6) should cease to have effect in relation to a particular class or description of cases, he may, having regard to any representations made to him, provide that paragraph (6) shall again have effect in relation thereto if it appears to him that the view he took as respects the matters mentioned in sub-paragraphs (a) and (b) of paragraph (10) is no longer justified; and any such provision shall be made by a notice which -
- (a) is given and published for the purposes of this condition generally at least 3 months before the date specified for the purposes of sub-paragraph (b), and
  - (b) specifies the date on which the provision is to take effect and, accordingly, on which paragraph (6) is again to have effect in relation to the class or description of cases in question.

**Extract from Clause 16 of Master Registration Agreement: Procedure for Objection by Old Supplier.**

16.1. An Old Supplier may issue an objection ("**Notice of Objection**") to the relevant Host PES in relation to an Application for Registration of which it has been notified pursuant to Clause 15.10 where:

16.1.1. Subject to Clause 16.2, the Application for Registration is in relation to a Metering Point which is associated with Designated Premises at which the Customer is being supplied by the Old Supplier under a contract that will neither expire nor (to the Old Supplier's knowledge) be terminated by the New Supplier's Supply Start Date notified to the Old Supplier pursuant to Clause 15.10; or

16.1.2. Subject to Clause 16.2, the Application for Registration is in relation to a Metering Point which is associated with Domestic Premises where charges for electricity supplied to the Customer (at any such Domestic Premises), having been demanded in writing by the Old Supplier, prior to the notice of termination being given remain owing to the Old Supplier more than 28 days after that demand was made; or



**Termination of Contracts on Notice: PES Licence Condition 38; Second Tier Supply Licence Condition 46 (England and Wales) ; Scottish Composite Licence Condition 33; and Second Tier Supply Licence Condition 47(Scotland).**

1. Each Designated Supply Contract shall contain a term allowing the customer to terminate such contract at any time by:
  - a) giving to the Licensee a valid notice of termination; and
  - b) subject to paragraph 6, paying to the Licensee on demand a termination fee.
  
2. A notice of termination is valid where it is given at least 28 days in advance of the date on which it is to take effect and where , not later than that date, the requirements of paragraphs 3 and (unless the Licensee expressly agrees to waive it) 4 are satisfied.
  
3. The requirement of this paragraph is that either:
  - a) another Electricity Supplier commences a supply of electricity to the relevant premises; or
  - b) the relevant premises are cut off because the customer at those premises has ceased to require a supply.
  
4. The requirement of this paragraph is that no charges for electricity supplied to the customer (whether at the relevant premises or at any premises previously occupied by him), having been demanded in writing prior to the notice of termination being given, remain owing to the Licensee more than 28 days after that demand was made.
  
5. Each Designated Supply Contract shall provide that a notice of termination which is not valid shall not be effective to terminate such contract.

6. A termination fee shall not be demanded of a customer where:
- a) the contract was terminated under any provision of Condition 39;
  - b) the contract was a contract of indefinite length, and was terminated other than during a fixed term period;
  - c) the Licensee notified the customer, under paragraph 5 of Condition 36, of a unilateral variation of the contract and the customer gave notice or termination in accordance with paragraph 6 of that Condition; or
  - d) the contract was a contract to which paragraph 4 of Condition 39 applied and the Licensee did not, before entering into it, take all reasonable steps to draw the attention of the customer to the effect of the term set out at that paragraph.
7. Where a termination fee is payable, it shall be of an amount not greater than that which the Licensee may in the circumstances reasonably require.

(**Note:** Licence Conditions numbers in para 6 relate to the PES Licence; for other types of Licences different Conditions apply).

**Assignment of Outstanding Charges: PES Licence Condition 40; Second Tier Supply Licence Condition 48 (England and Wales); Scottish Composite Licence Condition 35, and Second Tier Supply Licence Condition 49 (Scotland).**

1. This Condition shall apply where:
  - (a) the Licensee has commenced the supply of electricity to Domestic Premises at which a supply was previously given to its customer by the Previous Supplier;
  - (b) the customer has failed to pay, within 28 days of receiving a demand in writing, any charges due from him to the Previous Supplier for the supply of electricity at those premises;
  - (c) that failure occurred after either the Previous Supplier was informed of the change of supplier or the Licensee commenced supply to the premises (whichever is the earlier);
  - (d) the Previous Supplier has given written notice to the customer that it proposes to assign the debt to the Licensee, which may be entitled to reclaim from him its costs in recovering the debt; and
  - (e) the Licensee has received from the Previous Supplier a notice in accordance with paragraph 2.
  
2. A notice in accordance with this paragraph is one which:
  - (a) is given at least 14 days after the notice referred to at sub-paragraph 1(d) and is received by the Licensee within 90 days of it commencing a supply to the premises;
  - (b) specifies the amount of the debt which remains unpaid;
  - (c) states that the Previous Supplier has used all reasonable endeavours to recover the debt, which remains unpaid at least 42 days after being demanded in writing; and

- (d) states that the Previous Supplier intends to assign to the Licensee the debt, up to a maximum sum of one-third of the value (calculated in accordance with the charges of the Previous Supplier to the customer immediately before it ceased to supply him) of the average annual consumption reasonably expected of the customer.
3. Where this Condition applies the Licensee shall, within 60 days of receiving a notice under paragraph 2 and in consideration of the assignment of the debt, pay to the Previous Supplier the sum specified under sub-paragraph 2(d) (less, where they cannot be reclaimed from the customer, its reasonable costs of recovering the debt).
  4. For the purpose of this Condition, a customer shall not be regarded as being in debt to the Previous Supplier to the extent to which that debt is genuinely in dispute.
  5. In this condition "Previous Supplier" means, in relation to any premises, the Electricity supplier which supplied electricity to those premises immediately prior to the commencement of supply by the Licensee.

**Modification of Assignment Provisions: PES Licence Condition 41; Second Tier Supply Licence Condition 49 (England & Wales); Scottish Composite Licence Condition 36; and Second Tier Supply Licence Condition 50 (Scotland)**

1. In this Condition, the “relevant provisions” are the provisions of paragraph 4 of Condition 38 and Condition 40 of this Licence (or any of them).\*
2. Where the Director considers (having regard to any representations made to him) that in any specified class of cases the relevant provisions do not fulfil the requirements of paragraph 4, he may direct that they shall cease to have effect in those cases.
3. Where a direction under paragraph 2 has been made and the Director considers (having regard to any representations made to him) that in specified class of cases the relevant provisions would fulfil the requirements of paragraph 4, he may direct that they shall again have effect in those cases.
4. The requirements of this paragraph are that, in the specified class of cases, the operation of the relevant provisions:
  - (a) significantly reduces the number of unrecovered debts otherwise to be expected; or
  - (b) involves expenditure in debt recovery which is less than the reduction in the value of unrecovered debts which it achieves.
5. Any direction under paragraphs 2 or 3 shall be made by notice given to the Relevant Parties which shall specify:
  - (a) the relevant provisions to which it applies
  - (b) the class of cases to which it applies; and

(c) the date on which it shall have effect (being, in a direction under paragraph 3, at least 3 months after the notice is given).

6. In this Condition

“Relevant Parties” means the Licensee, all other Electricity Suppliers, the Electricity Consumers’ Committees and such other persons or bodies as in the opinion of the Director are representative of those likely to be affected by a revision to the relevant provisions.

(\* **Note** : Numbers are for PES Licence Conditions; for other types of licences different Conditions apply).