

# Energy services in the domestic sector

## *A guidance note on regulatory issues*

### *Opportunities for energy services*

1. Ofgem is keen to see energy supply companies explore the scope for providing energy efficiency for domestic customers through energy services contracts. Under such contracts, the supply of energy is linked to the provision of energy efficiency goods and services and the customer receives a single bill covering this package. The structure for providing this kind of service is commonly known as an energy services offering. An energy services offering can be based on an existing energy supplier, on a new entrant to the gas and electricity supply market or on a third party.
2. Ofgem's overall approach is to ensure a competitive market in gas and electricity supply, which allows companies to respond effectively to the needs of customers and to offer services which customers will value, whilst providing effective customer protection. Decisions on whether to bring forward energy services schemes are clearly a matter for companies, not the regulator. However Ofgem recognises that Ministers are keen to encourage suppliers to offer energy services schemes as part of their work to promote energy efficiency. It is important therefore that there are no unnecessary restrictions on energy services, and that suppliers and stakeholders understand the real opportunities for energy services which the regulatory regime permits.
3. Ofgem first issued a guidance note on regulatory issues surrounding energy services in March 2001, half way through the third Energy Efficiency Standards of Performance programme. Ofgem then held a workshop in November 2001 entitled 'What more can be done to promote energy services in the domestic sector?'.
4. Ofgem has updated this guidance to reflect a number of changes that have occurred since March 2001. These include:

- the introduction of the Energy Efficiency Commitment on 1 April 2002, replacing the previous Standards of Performance
  - changes to the standard licences for electricity and gas supply, made in the wake of the Utilities Act, and
  - issues raised at the Ofgem workshop.
5. The Energy Efficiency Commitment (EEC) contains a specific mechanism to encourage suppliers to provide energy service packages. Suppliers are credited with an additional 50% energy saving for eligible measures in energy service schemes, up to a ceiling of 10% of a supplier's overall target. To date, suppliers have shown considerable interest in the uplift provided in the Commitment for energy services, with most having already had schemes approved. Energy services action is defined in the Statutory Instrument as an action that:
- a) includes at least two activities that are qualifying action under EEC, of which one:
    - (i) may reasonably be expected to improve the insulation of the walls or loft of the domestic premises concerned
    - (ii) may reasonably be expected to improve the efficiency of the principal system for heating those premises
    - (iii) consists of the supply to those premises of electricity, heat, gas or liquid in circumstances such as from CHP; and
  - b) is undertaken in pursuance of an agreement between the supplier or a person acting on its behalf, and a domestic consumer, the terms of which also require the supplier:

- (i) to undertake an assessment of the energy efficiency of those premises
  - (ii) to provide advice to the consumer as to the means by which the energy efficiency of those premises may be improved, taking into account his circumstances and any other occupant of the premises, and
  - (iii) to offer the consumer the option of making an arrangement with the supplier for deferring the whole or any part of the cost to the consumer of the activities for which the agreement provides.
6. It is also open to companies to develop and market energy service offerings to domestic customers outside the EEC, i.e. without counting the energy savings against their overall EEC targets.

### ***Energy services contracts***

7. Gas and electricity supply licences do allow domestic supply contracts to embrace the supply of gas and/or electricity with the provision of other goods and services. Goods and services include energy efficiency products and services and the provision of heat from CHP plants. Allowing energy efficiency to be incorporated in a single contract with energy supply in itself is strongly supportive of the energy services concept.

### ***Billing***

8. So far as energy services contracts are concerned, it is a licence requirement that the contract should show separate charges relating respectively to the supply of gas and/or electricity and the provision of energy efficiency goods and services. Ofgem believes that the itemisation of charges in a transparent way is important in order that customers are fully aware of the terms of the contract and are not misled regarding their potential

future liabilities. It is also important that customers should be able to compare the cost of an energy services contract with the cost of obtaining energy supply and energy efficiency on a separate basis either from the supplier offering the energy services contract or from another supplier.

9. It is open to a company to send to customers who have entered into an energy services contract a combined single energy services bill covering energy supply and energy efficiency services and goods. This is important bearing in mind that the idea of the customer receiving a single bill is held to be a critical factor for the successful marketing and administering of energy services schemes. In line with the requirement for separate charges to be shown on contracts, Ofgem would expect energy services bills themselves to show separate charges.
10. It is also the case that suppliers are not able to offer energy services contracts to customers on prepayment meters, since the Utilities Act prevents suppliers from recovering debts other than those arising from the charges for the supply of either gas or electricity through the prepayment meter. When the Utilities Bill was being debated, Ministers saw this as an important safeguard for low income consumers, and primary legislation would now be required to alter it.

### ***28 day rule***

11. Domestic gas and designated electricity supply contracts are required by licence to allow the customer to terminate the contract by giving a maximum 28 days' notice in order to switch to a new supplier, subject in appropriate cases to the payment of a reasonable termination fee. This so called "28 day rule" is an important safeguard to ensure effective customer choice and to prevent customers being locked into long term contracts which might be unfavourable to them. Ofgem's view is that the 28 day rule is still an essential provision to promote competition in the domestic gas and electricity markets.

12. That part of an energy services contract which relates to the supply of gas or electricity is covered by the licence requirement that the customer be allowed to terminate the contract on 28 days' notice. However, this licence requirement does not apply to that part of the energy services contract which includes the provision of energy efficiency goods and services. Here the licence does not provide the customer with the automatic right to terminate the contract, although the energy services contract itself may provide the customer with that right.
13. It has been put to Ofgem that the 28 day rule is a barrier to the development of energy services, which should be relaxed. We have said that we would need to see actual evidence that the 28 day rule as presently constituted has restricted the development of any beneficial energy services arrangements before we could consider the need for possible amendments to the licence conditions. Ofgem remains ready to consider such evidence and to discuss the position with potential energy services providers.
14. Concern over the impact of the 28 day rule on the scope for energy services falls under two broad headings:

### ***Developing long-term relationships***

15. First, it is claimed that because the customer remains free to switch energy supplier this discourages suppliers from making the effort to develop the long-term relationship with the customer, which is felt to be necessary for an effective energy services contract.
16. It is also argued that an energy services offering may be structured in such a way that the energy supply element subsidises the energy services element of the package. In such a situation, suppliers who are left with just the energy services element could make a loss from it. Suppliers therefore consider such energy services offerings would be less risky if the customer could be tied in to a longer-term energy supply contract without the right to terminate with 28 days' notice.
17. Ofgem believes that, provided suppliers continue to provide good service and value to customers, they will tend to remain loyal to that supplier. In this regard, the 28 day rule

provides an incentive for the supplier to continue to meet the needs of the customer and serves to support a mutually beneficial long-term supplier – customer relationship. Ofgem does not agree that energy services contracts should receive special regulatory treatment to protect the cross-subsidy of one element of the contract by another.

### ***Customer default***

18. Second, it is argued that the 28 day rule is a disincentive to the marketing of energy services contracts because of the risk that the customer may fail to pay sums due in respect of energy efficiency goods and services provided by the supplier or fail to meet other obligations. This concern is particularly in relation to loans which suppliers might advance to customers to fund energy efficiency improvements which are intended to be recovered over the life of the energy services contract. The fear is that, once the customer has switched energy supplier, the former supplier with whom the customer had the energy services contract will face high debt recovery costs and the risk of default.
19. It is not obvious why the risk of default on the energy efficiency debt should be materially affected by the customer's changing energy supplier, bearing in mind that the supplier could not in the first place disconnect the customer for non-payment of such a debt or otherwise use his position as energy supplier to enforce the debt. Moreover, by switching supplier, the customer is not relieved of the obligations which he has entered into with the former supplier so far as energy efficiency goods and services are concerned.
20. This is made clear in the licence conditions for gas and electricity suppliers which provide that, where the customer wishes to terminate an energy supply contract, the supplier may request that the customer give reasonable security in respect of the customer's future compliance with those aspects of the contract relating to the provision of other goods and services. The customer's ability to terminate the energy supply contract is not conditional on the customer having first satisfied the supplier as regards arrangements for paying for energy efficiency goods. However, Ofgem expects

customers and suppliers to act in good faith in resolving the arrangements for providing reasonable security in a particular case.

### ***Reasonable security***

21. The right of the supplier to request reasonable security in relation to any outstanding customer obligations under an energy services scheme is intended to strike a balance between the supplier's and the customer's interests in such a situation. On the one hand, the supplier has the right to take reasonable steps to protect its financial position. On the other hand, the licence condition does not permit the customer to be exposed to unreasonable demands or pressure, not least because this would have the effect of curtailing the customer's opportunity to switch energy supplier. The right of the supplier to request reasonable security after termination of the contract does not imply that the supplier can automatically require immediate repayment of the loan in full or in part, or payment of a security deposit.
22. What is reasonable will depend on the circumstances at the time of termination. This will include the amount of any outstanding loans; the remaining period of the loan; the value of the energy savings; the nature of any other commitments which the customer has entered into; and the customer's previous payment record and financial circumstances.
23. Reasonableness will also depend on whether the requirement for security is in line with the provisions in the energy services contract covering the procedures which apply in the event that the customer terminates the energy supply part of the contract. Ofgem would expect the contract to say clearly what happens as regards any outstanding energy efficiency loans or other commitments to ensure that, when customers sign an energy services contract or are considering whether to switch energy supplier, they are fully aware of the position.
24. In certain circumstances the provision of reasonable security may have to involve the customer placing funds in an interest bearing deposit account – though not necessarily

to the full amount of any outstanding loan – as well as agreeing to a repayment schedule for the balance. In other circumstances providing reasonable security may be able to be met by the customer agreeing to a repayment schedule whereby the energy efficiency debt is repaid over the same period as it would have been paid, had the customer remained within the energy services contract. Depending on the circumstances it may be appropriate for the supplier to seek recovery through Direct Debit or Standing Order arrangements.

25. Ofgem would not expect the rate of interest payable on energy services loans to be affected by the customer's changing to another energy supplier. However, the rate of interest could be expected to reflect any increases to the actual cost of recovering the debt, or where there is a demonstrable change to the costings of the offering as a result of the customer having switched to another supplier. Again, provision for any such increase in the rate of interest payable would need to be spelt out in the initial energy services contract. Allowing a higher rate of interest to be charged to cover any higher costs in recovering debts once the customer has switched energy supplier should reassure suppliers who have expressed concern on this issue.
26. The supplier only has the right to object to the customer switching if s/he has failed to pay for the supply of electricity or gas. This right to object does not extend to instances in which the customer has failed to make payments required by an energy services contract. However, once the customer has agreed reasonable security, if s/he then defaults on those arrangements the supplier would have the normal avenues of recourse open to creditors when customers default on credit arrangements.

### ***Change of ownership or occupancy of premises***

27. The supplier's right to request reasonable security applies not only when the customer switches energy supplier, but also in other circumstances, notably when the customer moves house. (That is, when there is a change in ownership or occupancy of the premises to which the energy supply is provided under the energy services contract). Again it is important that customers are fully informed at the time they sign an energy



services contract of the conditions which will apply in respect of any outstanding loans, or other commitments which they have entered into, in the event that they move house.

28. Where the loan is for energy efficiency improvements to the building (e.g. insulation and heating systems) it might be normal for the supplier to request the loan to be cleared when the customer moves house. (The energy efficiency improvements which have been made to the house could be described in any seller's pack.)
29. In other cases, where the loan covers energy efficiency appliances or other portable items, it should be possible for the loan not to be repaid at the time of the move and to be allowed to run its course, subject to reasonable security being given in appropriate cases, the customer's own wishes, and whether there is a significant sum to be repaid. The loan could be carried forward either through a new agreement covering the repayment of the loan outside an energy services contract, or by setting up a new energy services contract covering the outstanding loan and the supply of energy to the premises to which the customer moves.
30. Ofgem would expect suppliers to offer customers who move premises a reasonable degree of choice when it comes to dealing with outstanding loans, and to make it clear to customers who move house that they are free to choose a different energy supplier for the new premises.

### ***Debt transfer***

31. It should not be assumed that a company which enters into an energy services contract will automatically be left to recover any energy efficiency loans outstanding should the customer change energy supplier or move house. There is no Ofgem regulatory barrier to the assignment or underwriting of such debts. Information on the opportunities for energy supply companies to involve independent financial institutions in this regard was presented to the EST's conference on energy services held in November 2000. It is for suppliers to take this into account when considering the scope for increasing their effort on energy services.

32. In addition to the scope for involving financial institutions, it is open to energy suppliers to assign debts between one another. This might be on the basis that, on a change of energy supplier, the energy efficiency debt would be picked up by the new supplier, who would then recover the debt from the customer. This would be a matter for the new and old supplier to agree between themselves. Ofgem would encourage parties to consider mutual arrangements for debt transfer, in order to deal with this apparent barrier to energy services, and we would welcome discussions with those who might be interested in such a scheme.

## ***Conclusion***

33. Ofgem hopes that this note will be of help to companies and stakeholders and assist them to give serious consideration to the real opportunities for energy services which have now been created. We would welcome further discussion and comments on any of the issues which arise, and will continue to monitor the position to ensure that there are no unnecessary barriers to energy services. We will also monitor and report on the successful delivery of energy services under the Energy Efficiency Commitment special arrangements.