

# **Duty to Supply, Contracts and Information Workgroup, 10 November 2005 – Discussion Document**

The purpose of this document is to provide an overview of the key areas to be tackled in the Duty to Supply, Contracts and Information workgroup and propose a draft work plan for reviewing each of these issues. Please note that this paper is for discussion purposes only and does not seek to represent the view of the Authority.

Because of the complex nature and significant impact of some of the issues, discussion will also be required at workgroup meetings to determine the methodology for determining how conclusions should be sought. This is likely to follow Ofgem's published Impact Assessment (IA) methodology.

## **1. Key policy areas**

### **Duty to supply**

SLC 32 requires (with specified exceptions) domestic suppliers to offer terms to any customer who asks for them. This "universal service obligation" was originally perceived as a defence against the risk of 'cherry-picking' by suppliers and the concern that therefore certain groups of customers would be excluded from the benefits of the competitive market.

In practice, Ofgem's domestic competition market reviews have indicated that switching rates have been marginally lower for rural and customers with PPM meters; but these could be explained through other factors than a deliberate attempt by suppliers to avoid certain customer groups. Other suppliers have deliberately targeted specific offerings at vulnerable customer groups. SLC 43 additionally requires that requests for supply shall be processed in a non-discriminatory manner.

To make SLC 32 work, the original policy makers considered that certain loopholes needed to be plugged. SLC 45 places limits on a supplier's ability to demand a security deposit. A security deposit cannot be required where the customer is willing to be supplied through a PPM (even if the practicality of fitting a meter is in question). The security deposit may not exceed 1.5 times an average expected quarterly bill, interest must be paid on the deposit and the deposit must be repaid where the customer has paid their bills on time for a year.

SLC 43 forbids a supplier from only offering a single payment method; e.g. entering the market on a direct debit tariff only. Suppliers must offer a range of payment methods, including PPM and cash.

SLC 43 also requires the supplier to publish in advance the principal terms of his contracts. It does not restrict the supplier from having different terms for different cases and classes of customer. There are no rules which specify the relationship between the terms offered to different classes or cases of customer.

### Questions:

- If we consider that the market is competitive and suppliers will seek to supply customers at the appropriate price then are any of these provisions still needed?
- Are provisions still needed to secure offers of supply for certain classes and cases of customer for example vulnerable customers?

- How would the case for their removal or retention be made?
- To what extent should suppliers be required to offer a specified range of payment methods?
- Should the requirement to offer a range of payment methods apply to all suppliers and what is the impact on potential niche suppliers entering the market?
- Is the required range of payments still consistent with customer requirements? Is there for example a continuing need to offer fortnightly cash payments?
- Does the requirement to offer a range of payment methods link to debt and disconnection provisions and specifically to the requirement to offer prepayment meters prior to disconnection?
- Other markets provide credit to customers and require security arrangements to be made against these credit arrangements. To what extent are the gas and electricity markets sufficiently different from other markets to require sector specific regulation of security deposits? Are provisions of general contract law sufficient?
- To what extent does the restriction on security deposits prevent innovative offerings to the market?

### **Contracts and Information; express contracts**

There are a range of licence obligations that require information to be made available to customers, for example the reference number that aids the transfer process or the method for calculating energy values for gas. The group will need to log and review each of these requirements to understand the need for them in a competitive market.

However, from a policy viewpoint, the more contentious issues are around the obligations relating to domestic contracts.

SLC 41 attempts to mitigate suppliers removing the obligations established in the other licence conditions by ensuring that contract terms comply with the SLCs. Under SLC 43, contracts must, as far as possible be in a standard form, set out all terms and conditions and reflect SLC termination provisions (SLC 46 & 47). In addition, SLC 44 requires that the principal terms of the contract must be notified to the customer in advance. In addition, this condition provides for a process for notifying customer of proposed changes to terms. Where there is a price rise SLC 44 also requires that the supplier must notify the customer and advise them that they can terminate the contract.

There has already been considerable debate about the impact of the termination requirements specified in SLC 46 and 47. In particular the '28 day rule' (SLC 46 .2) has come under close scrutiny. This provides that the customer must be able to terminate any contract where notice is given within 28 days. Commentators have argued that this restricts innovation in contracting arrangements and the packaging of other goods and service (for example energy efficiency services), suggesting that if the customer can switch supplier, any investment made by the supplier is lost. It has further been argued that the 28-day rules prevents suppliers from providing innovative contract offerings to respond to the credit risk signals that are also evident in other markets.

There is a distinction between on the one hand the removal of the 28-day rule and freeing up suppliers to provide more innovative offerings and on the other hand the use of the objection

mechanism as a tool for enforcing breaches of contract. This 'right' to prevent a customer transferring supplier is an element of the current trial suspension of the 28 day rule for energy efficiency schemes.

Suppliers in the domestic market are also permitted to prevent their customers from transferring supplier in certain defined circumstances where the customer is in debt. This right, it has been argued, is either a distortion in the market place that prevents suppliers from fully responding to the credit risks posed by customers or an efficient way of managing customer debt that does not lead to an increase in the cost to serve prompt paying customers.

A further element of the current termination arrangements permits suppliers to charge a termination fee where a contract is terminated early, although the circumstances where a termination fee can be charged are restricted by SLC 46.5.

### Questions

- What makes the gas and electricity markets different from other markets where goods and services are contracted for?
- What overlap exists between the SLCs and general contract law?
- To the extent that termination arrangements distort suppliers' decision to offer innovative products and respond to the credit risk posed by customer debt, why should these provisions be retained?

### **Deemed Contracts**

SLC 28 sets out rules for the operation of deemed contracts. This condition sets limits on the degree to which a supplier can exploit their right to charge a customer who is taking a supply where no express contract is in place – typically following a change of tenancy. In particular SLC 28 limits the price that can be charged by introducing the notion that the tariff cannot be 'unduly onerous'. This is defined in SLC 28 (3) as where the terms a) significantly exceeds the costs of supply; and b) exceeds such costs of supply by significantly more than the licensee's revenue exceeds the costs of supply in the case of the generality of its domestic customers....(and equivalent for non-domestic customers)

### Questions

- To what extent is it prudent to retain rules relating to the terms and visibility of deemed contracts, given that by definition; those terms have not been negotiated between the customer and supplier?

## 2. Workgroup Work Plan

The following work plan is for agreement by the workgroup and groups policy issues starting with Duty to Supply issues, then dealing with contracts, deemed contracts, information and other issues in that order. This work plan uses the SLCs to group areas of work.

Stage	SLCs	Proposed meeting schedule
Stage 1 – Duty to Supply	SLC 32 - Duty to supply domestic customers  SLC 43 - Contractual Terms – Methods of Payment  SLC 45 – Security deposits	10 November 2005  8 December 2005
Stage 2 – Contracts	SLC 30 – Non-domestic transfer blocking  SLC 41 – Terms for Supply of Electricity / Gas Incompatible with Licence Conditions  SLC 42 - Domestic Supply Contracts  SLC 44 - Notification of Terms  SLC 46 – Termination of Contracts on Notice  SLC 47 – Termination of Contracts in Specified Circumstances	January 06
Stage 3 – Deemed Contracts	SLC 28 – Deemed Contracts	February 06
Stage 4 - Information	SLC 15 - Security and safety of Supplies  SLC 21 – Publication of information to customers  SLC 30A – Fuel Mix disclosure  SLC 40 – Information given to domestic customers	March 06
Stage 5 – Other issues	SLC 22 – Domestic premises  SLC 23 – Payments received in relation to Standards of Performance  SLC 25 – Efficient use of Electricity / Gas  SLC 49 – Assignment of Outstanding Charges  SLC 50 – Modification of Provisions under Standard Conditions 46 and 49	March 06
Draft Report to Steering Group		April 05
Final report to Steering Group		May 2006