Duty to Supply, Contracts and Information SLR Workgroup

Meeting 2, 08 December 2005

Minutes

Attendees:

Philip Davies	Ofgem	PD
Nigel Nash	Ofgem	NN
Andrew Wallace	Ofgem	AW
Michael Knowles	Ofgem	MK
Robert Hammond	energywatch	RH
Clover Powell	energywatch	CP
Ljuban Milicevic	Ofgem	LM
Mark Watson	ERA	MW
Francesca Dixon	Centrica	FD
Roger Barnard	EDF Energy	RB
Ruth Ashworth	Ofgem	RA
Jacqui Gehrmann	Scottish Power	JG
Laurence Poel	npower	LP
John Sykes	SSE	JS

1. Introduction

PD welcomed the Duty to Supply, Contracts and Information workgroup to its second meeting. He apologised for the late delivery of the draft Duty to Supply Impact Assessment which was tabled at the meeting. This was due to Supplier of Last Resort issues.

2. Minutes and action

AW said that one set of comments had been received on the circulated minutes. The amended minutes were agreed.

3. Duty to supply – Draft impact assessment

AW introduced the main agenda item, a draft Impact Assessment on Duty to Supply issues, including the obligation to offer terms to domestic customers, the obligation to offer certain methods and frequencies of payment, the obligation to publish terms and conditions, and provisions in relation to security deposits. As agreed at the previous meeting, Ofgem had drafted the IA based on the standard Ofgem template. It was explained that the draft IA provided initial thoughts on the issues and did not represent the formal view of the Authority. The aim of the meeting was to review the IA, get the comments of the group and amend where required.

3.1 Summary

Before reviewing the detail of the IA, AW outlined the IA's initial conclusions. There was disagreement about what had been agreed at the previous meeting. AW said that the first meeting had involved a wide-ranging discussion of the issues. The role of this

meeting was to review Ofgem's interpretation of these discussions as they had been translated into the draft IA.

On the *obligation to offer terms*, AW expressed the view that there is no overwhelming case either to remove or retain that obligation. There is little evidence that the obligation changes supplier behaviour and suppliers do not view the obligation, in isolation, as a significant constraint. However, retaining it may offer some reassurance that all customers, including vulnerable customers, will be able to be offered supply terms.

AW suggested that the requirement to *offer certain payment methods and frequencies* should be removed. If there is a need for specific requirements for Vulnerable Customers (i.e. to assist them in paying energy charges) then this should be considered by the Vulnerable Customer and Codes workgroup.

RB noted that the licence went beyond the provisions of Schedule 6 paragraph 2 of the Electricity Act. The Act implies choice for the supplier; it allows the supplier to disconnect or install a PPM where charges have not been paid. It was suggested that the licence requirement to offer a PPM where reasonably practicable should be retained as an alternative to disconnection. RB was also concerned that provisions that relate to vulnerable customers (even to a small extent) would be moved to the vulnerable customer workgroup, with the result that the vulnerable customer workgroup might choose to retain provisions that this workgroup considers unnecessary/undesirable.

On the *obligation to publish principal terms*, the view set out in the IA was that this obligation should be removed. Suppliers would seek to promote their products as they saw fit and Ofgem and energywatch could obtain the details from suppliers using their information collection powers.

The draft IA recommended that the *restriction on the use of security deposits* (i.e. where a customer is prepared to accept a PPM meter and it is reasonably practicable to do so or where it is unreasonable to require a deposit), should be retained. The restriction on the level of security deposits could be removed if it can be adequately regulated under the Unfair Terms in Consumer Contract Regulations (the "UTCCRs"). At this stage gas and electricity were not considered to be significantly different from other products with regard to security. Therefore, the requirements on paying interest and repaying deposits were candidates for removal in favour of consumer protection law being applied.

3.2 Objectives

AW then took the group through the detail of the draft IA. He underlined Ofgem's principal objective to protect the interests of customers by promoting effective competition wherever appropriate. Of particular additional relevance was the requirement to pay special regard to the needs of vulnerable customers and the IMED and IMGD EU Directives which place requirements on member states in relation to duty of supply. RB expressed his view that the group have to make sure that there is no gap between these EU Directives and the licences.

3.3 Key Issues

AW introduced the next section of the IA – Key issues. This sets out the requirements of each licence condition being considered and the key questions in relation to these requirements.

SLC 32 requires *domestic suppliers to offer terms* to any customer who asks for them. Ofgem considers that, unless there are exceptional circumstances, all customers should be able to secure offers from suppliers for terms of supply. A key question is whether this has to be regulated or whether the market will provide. Of particular note here are the requirements of the IMED and IMGE EU Directives. There was a discussion about whether customers should have rights to be able to obtain an offer of terms from all or only some suppliers.

With regard to SLC 43, which requires a supplier to *offer a set range of payment methods and frequencies*, Ofgem's view is that customers' reasonable demands for payment types and frequency should be met. The key question is whether the market can provide this or whether this can only be secured through regulation. The general view expressed during the discussion was that the market will provide different payment types if there is sufficient demand for them. It was noted that that the existing rules were established at the start of the domestic market when the level of competition was different from the current level of competition, and effectively codified the range of payment methods available at that time.

The next key issue discussed around SLC43 was the requirement on suppliers to *publish their principal terms* to ensure that customers have visibility of the prices being offered. The key issue here is whether the obligation to publish prices distorts suppliers' actions in offering different terms and conditions. If this is the case, the question is whether this distortion acts to the benefit of customers or leads to customer detriment by restricting innovative or more varied and flexible contract terms.

A view expressed was that *publishing prices* provided a commitment on behalf of suppliers. RH noted that this information must be available before contract. On the other hand JS thought that if the supplier did not provide information they would not have any business. If the duty to offer terms was retained then suppliers would be required to provide information to customers on the terms upon which they were prepared to supply. MK said that to achieve transparency of price a better route may be to encourage price comparison websites rather than individual publication of prices. There was the general view by suppliers that commercially they would want to publish prices anyway.

AW then introduced SLC 45 which sets out a framework for *security deposits* to be required from domestic customers in certain circumstances. It also provides that individual security deposits should not be unduly onerous in value, limits the length of time that deposits can be held, and requires them to be paid back with interest once certain conditions have been met. The key issues are the extent to which domestic customers need to be protected from unduly onerous security deposit terms and whether other general customer protection legislation can provide sufficient (not necessarily equivalent) customer protection in this area (e.g. the UTCCRs). Another key question is whether the gas and electricity arrangements can be demonstrated to be materially different from other markets in this area. If this is the case it may be appropriate to regulate the provision of security deposits.

3.4 Options

AW then reviewed the options explored in the draft IA. These were the three options agreed by the workgroup at the last meeting:

- Option 1 - Do nothing (retain existing arrangements)
- Option 2 - Remove (remove these obligations and rely on the market, self regulation and/or customer protection legislation)
- Option 3 - Redraft (there are several potential options for redrafting the existing provisions and the one focussed on here was retaining the obligation to offer terms but removing the other licence conditions noted)

3.5 Competition

The discussion then moved on and AW said that a key consideration would be what impact retaining, redrafting or removing the duty to supply obligations would have on competition in the energy market (in particular whether competition will deliver offers of supply, methods and frequency of payments, and appropriate use of security deposits). Input from the group was very important here. RB pointed out that the question should focus on what the impact would be on consumers. RH agreed with this.

AW explained that in order to understand the requirement to maintain the duty to supply obligations the section on competition reviewed the current state of the market and then examined the counterfactual of what could happen if options one, two or three were applied.

Currently all suppliers are required to *offer terms* with some exceptions. Price levels are not regulated but some contract terms are. Suppliers could price themselves out of certain market sectors and effectively avoid obligations to offer terms. There is a high rate of switching in the domestic market (which is marginally lower for rural customers and customers with prepayment meters); but this could be explained through factors other than a deliberate attempt by suppliers to avoid certain customer groups. Domestic customers are being offered new contract terms from a wide range of sources. The main question is whether there is evidence that competition is not effective in some sectors of the domestic market.

JG questioned whether Option 2 was a viable option given the requirements of the EU Directives. AW explained that the issue will be further discussed with the DTI. LP noted that we should also consider how Northern Ireland has complied with the Directive requirements. RB's view was that the regulatory framework would need to deliver universal service obligations and that, for political reasons if no other, a supplier must be shown to have a legal requirement to supply. MK thought that the DTI may be able to say that in respect of EU directives the UK market is different and that protection of vulnerable customers is safeguarded.

In terms of *methods and frequency of payments*, currently all domestic customers are offered a wide range and frequency of payment including credit, prepayment, twice monthly and fortnightly cash, and paying monthly a predetermined sum. Suppliers offer payment methods other than those required by licence, such as direct debit arrangements and flat rate tariffs [the latter are not a payment method – RB] not linked to consumption. Some suppliers are more active in promoting certain payment types and some suppliers (not all) set domestic price rates according to payment type. AW also presented statistical evidence on the numbers of customers on each payment type (see draft IA). MK noted that the requirement to offer Fuel Direct was separately covered under the Debt and Disconnection Code of Practice under SLC 35.

There followed a discussion about the issue of *methods and frequency of payments* which were thought to be required in a market to meet different customer needs. The view was expressed that, without regulation, some customer groups, e.g. vulnerable and low income customers, might not be offered the payment types and frequencies that they require to help them manage their fuel bills and that there is potential for a reduction in choice for these customers. JG noted that the State has changed the way that benefits are paid to customers while JS said that the current list of payment methods and frequencies had been put in place to assist with the smooth roll-out of domestic competition (i.e. these methods may now be out of date).

RH expressed his view that we have to know the exact percentage of customers who demand fortnightly payment methods; this would give us an indication of whether or not we still require any of the existing payment regulations. LP questioned whether there is a threshold that would amount to an "appropriate percentage" for these purposes. It was also suggested that Ofgem ought to ask consumers what they want and then decide on the best method to meet those needs. If vulnerable customers are identified as having specific needs, Ofgem must consider whether they need protection.

AW than explained the current state of market in relation to the *publication of terms* requirement. Suppliers are required to publish terms and they do this in a manner that they see fit to secure adequate publicity. These prices are used by organisations that provide price comparison services.

On the issue of requirement to *publish the terms* MK thought that the price transparency was important but questioned whether, in order to compare prices, the consumers should have to approach individual suppliers or whether they would rather go to a price comparison service. It was a question of consumers being able to make an informed decision.

Currently suppliers may not request *security deposits* from customers where the customer is prepared to accept supply through a prepayment meter or where it is unreasonable to do so. Suppliers can demand a deposit in a number of different circumstances, typically where a contract is being entered into, for example on change of tenancy, where a customer has requested new terms and conditions, or where the customer has breached the terms of their contract and been subject to disconnection. Security deposits may be unattractive to customers; but they are demanded in other markets where customers are given credit.

NN said that we should look at whether gas and electricity markets are significantly different from other markets in this regard. If the issue of protection of vulnerable customers arises then this may be something for Vulnerable Customers Group to discuss. Whilst the overall level of security deposits had fallen MK asked whether it would be worth reviewing evidence on how much security deposits impact on vulnerable customers. SSE stated that in its opinion most security deposits were required from "won't pays" rather than "can't pays". BGT agreed to look at how many of its security deposits are held by PSR customers.

Action: BGT

RB stated that even if all other issues relating to deposits could be covered adequately by other law, the regulatory framework would probably still need to provide a determination role of some kind for the Authority in this area.

AW then gave an overview of impacts, costs and benefits of each option with particular regard to distributional effects and small businesses.

Workgroup members were asked to provide comments on the draft IA prior to the next meeting once they had had a chance to discuss it internally. They were asked to circulate any comments to the entire group.

Action: Workgroup members

4. Contracts – Approach to January workgroup discussion

AW presented the key areas that the group is going to discuss at the 12 January meeting. He explained that the workgroup will deal with contracts which are linked to a number of licences: SLC 30 – Non-Domestic Transfer Blocking (gas only), 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 and Domestic Transfer Blocking and SLC 47 – Termination of Contracts in Specified Circumstances.

SLC 30 relates to gas only and allows suppliers and non-domestic customers to determine terms for objections. Key issues here are whether to amend this licence condition further (not intended to be amended at the moment) and whether to retain electricity provision within the MRA.

The purpose of SLC 41 is to stop suppliers giving themselves rights incompatible with licence through contract. The key question is whether it is needed or whether it can it be dealt with through licence enforcement or consumer protection and contract law.

SLC 42 sets out aspects of the domestic contractual framework (definition of contract, requirement to supply through contracts, all terms and conditions to be agreed between supplier and customer, etc). The key issue is whether its provisions are still required and whether they can be dealt with through consumer protection and contract law.

SLC 44 deals with the provision of information to customers about contract terms when entering the contract; the key issues are the same as in the case of SLC 42.

SLC 46 requires that contracts must be terminable on provision of a valid termination notice (defined in accordance with the 28 day rule) and specifies circumstances where a termination fee shall not be demanded. It also deals with circumstances for objection and assignment of charges in respect of PPM customers. In addition to the key issues which apply in the case of SLC42 and 44, removal of debt objections and removal of 28-day termination must be considered.

SLC 47 specifies that contracts must be terminable, that customers are liable for charges until termination, and that fixed term contracts (> 12 months) are able to be terminated within five working days of date of contract. The key issue is whether the provision is still required and whether it can be dealt with through consumer protection and contract law.

A discussion paper will be issued by Ofgem for the group to debate in its next meeting scheduled for 12 January 2006. The key themes will be the overlap with other customer protection legislation and contract law, EU Directives and in particular focusing on the 28-Day rule, other contract termination arrangements, and objections.

5. Work plan

The timetable will be kept under review to understand possible slippages or where work could be brought forward.

6. AoB

Date of next meeting 12 January 2006