



Suppliers, consumer groups and other interested parties

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*Promoting choice and value for all gas and electricity customers*

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Dear Colleague,

**Decision letter: Classification of premises for the purposes of the standard conditions of the gas supply licence**

This document presents our decision regarding the classification of premises for the purposes of the standard conditions of the gas supply licence. We reached the decision after considering responses to our minded to open letter consultation published in October 2011.

We consider that the clarifications are necessary and are consistent with our statutory duties. Our decision remains as set out in our previous consultation on this issue. Namely, we clarified that the non-commercial collective purchase of gas supplied to a single meter point for wholly or mainly domestic use should be classified as supply for domestic purposes, if the terms between end users and the entity supplied are not commercial in nature. We also stated that, in the case of non-standard residency structure, the supplier and the Domestic Customer may need to enter into a bespoke Domestic Supply Contract to accommodate circumstances where the volume of consumption from such residences is considerably higher than in a standard domestic residency structure. This approach may also be needed for Domestic Customers to receive the same protections as envisaged with a standard domestic residency structure.

This document outlines the background to this decision, noting responses to consultation and providing the Authority's decision and the rationale for this view. Further, we have included additional details of responses to the consultation, and our response to concerns that were raised, within Appendix 1.

**Background**

Definitions of the term Domestic Customer and Domestic Premises are given within the Standard Conditions (SLCs) of the Gas Supply Licence, published in October 2001. However, where questions over this definition arise, Ofgem may determine whether a consumer (or those who share certain characteristics) should be considered a Domestic Customer or Non-Domestic Customer.

In this context, an issue was brought to our attention regarding how suppliers classify consumers in particular residency structures - specifically, how consumers in domestic apartment blocks are treated when their gas is bought collectively by a wholly tenant owned non-commercial residential management company on a non-commercial basis for the purpose of providing heat.

Given the importance of these issues, we have reviewed whether clarification of the existing licence conditions is required to explain the licensing regime applicable to energy suppliers that supply gas to a legal entity which purchases gas on behalf of a number of individual residents. As a part of this review, over the last year we published two open letter consultations on the issue. In the first, published in December 2010, we sought stakeholders' views on whether it is necessary to clarify the definition of 'Domestic Customer' and/or 'Domestic Premises'. The second, published on 12 October 2011, presented our minded to position.

In addition to outlining our minded to position, we sought stakeholders' views on our position and whether there are any unintended consequences that may arise from it. We also asked for information regarding the number of consumers that would be affected and the potential impacts of this clarification.

### **Further background – summary of relevant SLCs and existing guidance**

The current drafting of SLC 1, in summary, defines a Domestic Customer as a Customer supplied or requiring to be supplied at Domestic Premises. SLC 1, read together with SLC 6, defines a Domestic Premises as a premises at which a supply of gas is taken wholly or mainly for a domestic purpose except where the premises is a Non-Domestic Premises and unless the context otherwise requires.

In April 2002, we published guidance<sup>1</sup> in which we clarified the interpretation of the terms Domestic Customer and Domestic Premises used in SLCs. Where the interpretation of Domestic Customer and Domestic Premises remains in dispute, we stated that Ofgem may, upon application and if appropriate, determine whether a consumer should be treated as a Domestic Customer or Non-Domestic Customer.

### **Consultation responses**

We received nine responses to our 12 October 2011 consultation. These were from a range of stakeholders: four of the Big 6 and one small supplier, one residential management company, two associations and one consumer body. All non-confidential responses are published on Ofgem's website<sup>2</sup>.

All four of the Big 6 suppliers who responded to this consultation disagree with our minded to position that non-commercial collective purchase of gas supplied to a single meter point for wholly or mainly domestic use should be classified as supply for domestic purposes. In practice, they currently class such consumers as Non-Domestic Customers, therefore they view our clarification as introducing changes to current arrangements. Given this interpretation of existing rules and guidance, they believe that the current provisions of the gas supply licence and Ofgem's guidance issued in 2002 remain appropriate and no change is needed.

These suppliers argue that the contractual relationship would be made with an organisation or collective acting on behalf of a group of domestic end users, and not with an individual Domestic Customer. Therefore, the organisation cannot be regarded as a Domestic Customer, regardless of their status or structure. One Big 6 supplier pointed out that it is illogical to make mark up (i.e. profit) the distinguishing factor in consumer classification. Another Big 6 supplier argued that the proposal does not fulfil the principles of better regulation since it would introduce a change for a small number of cases where there does not appear to be an issue.

Four respondents agree with our view. The consumer body felt that the overriding characteristic determining domestic status should be that of the end user, rather than the

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<sup>1</sup>Ofgem (2002), 'Ofgem's interpretation of the definition of the terms 'domestic customer' and 'domestic premises' as they appear in the gas and electricity supply licences', 09 April 2002.

<sup>2</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=128&refer=Markets/RetMkts/Compet>

purchaser of energy at meter point.

One respondent noted Ofgem's position but also pointed out possible unintended consequences for some residential arrangements (e.g. where residential a management company does not have all residents as members of that company, or where it delegates its functions to another legal entity such as a managing agent).

Key issues outlined in stakeholders' responses, and related Ofgem's views, can be found in Appendix 1.

### **The Authority's decision**

Having considered the issue further since our second open letter, and in light of responses to the consultation, our decision remains as set out in the minded to open letter and our guidance on this issue published in 2002. We consider the following clarifications are necessary and consistent with our duty to protect the interests of present and future consumers.

The Authority has concluded that an entity is a Domestic Customer where:

- (a) the gas is supplied to the relevant premises by a single meter point;
- (b) the supply of gas to the relevant premises is for wholly or mainly domestic use;
- (c) the owners and/or tenants of the relevant premises have direct control over the entity that enters into a Contract with the licensee for the supply of gas; and
- (d) the agreement between the entity that enters into a Contract with the licensee for the supply of gas to the relevant premises and any other person for the provision of gas at that premises is not commercial in nature.

### **Reasons for the Authority's decision**

We consider the above is an appropriate classification where a non-commercial entity holds a contract for the supply of gas for domestic use. In such a case the gas supplied must be non commercial in nature and to a single meter point. We note there are two key factors at play: (i) the nature of the relationship between residence and the management agency; and (ii) that the end use of gas is for domestic purposes, regardless of what that domestic use is.

We also note that we are not introducing any changes to the current arrangements, we are clarifying our view. Our position remains as we set out in our 2002 guidance.

However, as we previously stated there are particular cases where the size of gas consumption will be significantly higher than an average domestic residence. For example, this may occur where there are multiple tenancy flats in which one central gas-fired boiler with a single meter point provides heat to a large number of residents. For the avoidance of doubt, the size of consumption is not the defining characteristic determining whether or not a customer should be considered a Domestic Customer or Non-Domestic Customer, but the size of consumption may be relevant to the type of Domestic Supply Contract offered. We were clear on this issue in our 2002 guidance.

Where there is a traditional relationship between a supplier and the occupants of a single domestic household, there are provisions in the licence that afford that Domestic Customers particular protections, for example protections for vulnerable consumers. In the case of non-standard domestic energy supply structures, such as in the example of multiple domestic tenants described above, we would expect that the supplier and the Domestic

Customer may need to enter into a bespoke Domestic Supply Contract<sup>3</sup> to accommodate the increased volumes of supply and, within that contract, for the Domestic Customers to receive the same protections as exist for more standard domestic energy contracts.

With regard to whether certain customers should be allowed to change their classification from Domestic Customer to Non-Domestic Customer, we stand by our view that the licence is sufficiently clear on this issue. The type of contract a customer is eligible for should only change from Domestic Supply Contract to Non-Domestic Supply Contract or vice versa if the specific circumstances of that customer change accordingly.

To confirm, Ofgem's regulatory remit is restricted to the provisions governing the supply of energy between a licensed supplier and a Domestic or Non-Domestic Customer. Ofgem does not have regulatory jurisdiction over the provision of heat. However, we note that the government is currently considering this issue.

### **Decision notice**

In accordance with SLC 2.7 and 2.8 the Authority hereby concludes that an entity is a Domestic Customer where:

- (a) the gas is supplied to the relevant premises by a single meter point;
- (b) the supply of gas to the relevant premises is for wholly or mainly domestic use;
- (c) the owners and/or tenants of the relevant premises have direct control over the entity that enters into a Contract with the licensee for the supply of gas; and
- (d) the agreement between the entity that enters into a Contract with the licensee for the supply of gas to the relevant premises and any other person for the provision of gas at that premises is not commercial in nature.

**Ian Marlee**

**Senior Partner, Smarter Grids and Governance - Transmission**

Signed on behalf of the Authority and authorised for that purpose

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<sup>3</sup> We envisage the bespoke domestic contract will include terms relating to the agreed charges, duration and termination of the bespoke domestic contract, and any security deposit requirements.

## **Appendix 1 – Key issues raised in stakeholders’ responses to our questions in the October 2011 consultation**

### **Unintended consequences**

#### *Stakeholders’ comments*

Big 6 suppliers argue that our minded to position would introduce complexity and uncertainty to the existing regulatory arrangements (in particular in respect to Section B of the Licence). Their main concern is that it is difficult for them to easily determine which consumers may be a non-commercial collective entity, and therefore to classify them correctly as Domestic or Non-Domestic Customers.

They argue that, as a result, our stance would lead to increased confusion for consumers and suppliers regarding some other types of properties and arrangements (e.g. care homes; blocks of flats that do not have a resident management company as the landlord; when the supply to the premises also supplies activities that are not domestic such as café, restaurant, swimming pool or gym and the existing customers that fall within the new classification but are currently supplied under a Non-Domestic Supply Contract).

#### *Ofgem’s view*

We note that we are not introducing any changes to the current arrangements but rather clarifying our view. Our decision remains as set out in our 2002 guidance. We believe that a non-commercial collective purchase of gas supplied to a single meter point for wholly or mainly domestic use should be classified as supply for domestic purposes, if the terms between end users and the entity supplied are not commercial in nature.

We agree there could be certain specific circumstances where the characteristics of a consumer would make it difficult to ascribe a domestic or non-domestic identity, and would need to be considered individually. However, we do not have any compelling evidence to indicate this would have a significant detrimental impact on suppliers and consumers.

We also believe that our clarifications will lead to less confusion regarding some other types of properties and arrangements (e.g. care homes, etc). Based on the evidence provided to us, we believe that in majority of these cases tenants/the end users of the supply of gas do not have direct control over the entities that contract for the supply of gas, the supply of gas is less likely to be to a single meter point, and the gas supplied is commercial in nature. Accordingly, it is likely that only a very small number of consumers may fall into the category of consumers affected by our clarification.

### **Current treatment of multiple tenancy sites with a single meter point serving a small or large number of consumers and the number of consumers affected**

#### *Stakeholders’ comments*

All four Big 6 suppliers that responded to this consultation noted they currently treat multiple tenancy sites with single gas boilers with a small number of Domestic Customers and multiple tenancy sites with a single meter point serving a large number of domestic end users as Non-Domestic Customers.

However, only two suppliers provided information on the number of consumers likely to be affected by this clarification. One Big 6 supplier estimated that it supplied approximately 150 premises that could potentially be impacted (it also indicated that this is likely to be an overestimate since it is difficult to determine in all circumstances whether a contracted organisation meets the proposed criteria). One small supplier has several Non-Domestic Customers of this type and probably serves several hundred domestic end users under these arrangements.

Another Big 6 supplier explained that it is unable to quantify the number of consumers that may be impacted absolutely as it does not separately identify these from other Non-Domestic Customers (for example a multi-site contract with a university may include office buildings and residential blocks of flats). The identification of a non-commercial collective may be possible due its VAT status. However, domestic usage itself does not satisfy Ofgem's definition, and consequently suppliers would need to rely on an organisation's own view of its classification for which suppliers could not warrant its veracity.

#### *Ofgem's view*

Based on the evidence provided to us, we believe that our proposal is proportionate and appropriate. We have not been provided any compelling evidence to indicate the effect of our proposal is likely to have a significant detrimental impact on consumers. Judging by suppliers' responses we can conclude that a very small number of consumers would be affected by the proposed clarification. Given this, we do not consider it unreasonable that suppliers may need to gather further information to satisfy themselves that protections for Domestic Customers are being provided where appropriate.

### **Impact on business**

#### *Stakeholders' comments*

Suppliers that don't support our position argue that it would be difficult and costly to implement such a change (e.g. due to staff training; contract development and management; costs associated with obtaining and maintaining appropriate information, system changes, modifying processes and credit management procedures) and would ultimately result in an increase in customer bills. One of the Big 6 noted that the cost in implementing this change would be disproportionate and inconsistent with the better regulation principles. However, it was unable to provide firm data on costs.

Another Big 6 supplier considers that this change would introduce significant confusion and regulatory risk and pointed out that it is not clear what environmental/social obligations suppliers would face in respect of sites/supplies of this nature and therefore how, for example, CERT would be calculated in to such contracts.

One small supplier pointed out that this clarification would have no impact on its business as it already applies a policy very similar to Ofgem's position.

#### *Ofgem's view*

We have not received any quantitative data regarding possible impacts on business and we have no evidence, or reason to believe, that ensuring the interest of present and future consumers through any proposed clarification will be costly to implement. We also take note of the perspective of the supplier who already applies our interpretation of this issue. We note that since this is possible for one supplier, it undermines the unsubstantiated arguments that this would be difficult and costly for other suppliers.

### **Bespoke contracts**

#### *Stakeholders' comments*

Three Big 6 suppliers and one small supplier believe that it would cost more for high consumption Domestic Customers to be supplied with a bespoke Domestic Supply Contract for gas rather than a Non-Domestic Supply Contract because of higher systems and administration costs.

#### *Ofgem's view*

For Domestic Customers to receive the same protections as envisaged with a standard domestic residency structure and to accommodate the increased volumes of supply, the Domestic Customer may need to enter into a bespoke Domestic Supply Contract.

We understand that many of the Domestic Customers this clarification may impact are likely to be on bespoke contracts already. Therefore, the process of negotiating and agreeing a bespoke contract may not result in a significant change on its own. However, the terms of the bespoke contract appropriate for the circumstances and characteristics of the customer's supply, including the volume of gas to be supplied and price, may be materially different from those of a standard Domestic Supply Contract. Nonetheless, we consider that Domestic Customers should not be denied any relevant protections due to relatively small costs of changing the nature of any bespoke contracts.