Making a positive difference
for energy consumers

Suppliers, consumer groups and
other interested parties

Date: 25 July 2016

Dear colleagues

Review of domestic debt objections: our decision

As part of the existing switching process, suppliers may only object to a customer switching supplier in limited circumstances. By far the most common ground for objection in the domestic market is that the customer is in debt. These 'debt objections' may occur only where a supplier has notified the customer in writing about an outstanding charge on the account and the charge has then remained unpaid for at least 28 days by the time of the attempted switch.[1] Suppliers may also object to erroneous switches or at the customer's request where the customer has not entered into a contract with the new supplier, or - in the case of electricity - where Related Meter Points are not being transferred together.

It is vital that energy consumers can easily and confidently change their energy supplier. As part of the upcoming programme of changes to move towards faster and more reliable switching, Ofgem has taken a fresh look at whether debt objections should be part of a redesigned switching process or whether suppliers should develop other ways of managing risk.

In light of the analysis conducted on data collected from a recent request for information (RFI), this decision letter confirms that we have concluded that it is in domestic consumers' interests to retain the current objections regime. We are not, therefore, making any changes at this stage to the existing transfer objections provisions in the gas or electricity supply licences. We are, however, in the context of our PPM warrant charging project, considering our approach to charges for debt recovery. We will consult separately on this matter.

In addition, as this document sets out, we are aware of varying practices amongst suppliers in relation to the threshold for which they allow transfers of indebted customers. Suppliers should continue to consider their duties under the Standards of Conduct when using their discretion as to whether it is fair to object to a transfer at low levels of debt, taking into account a customer's particular circumstances.

[1] The ability to prevent a customer switching on grounds of debt is unusual in a competitive market. However, energy is an essential service and domestic suppliers are under a duty to supply customers regardless of their financial status or any other criteria. In that context the ability to object on grounds of debt has been seen as appropriate. However, prepayment meter (PPM) customers with debts of up to £500 may (if the new supplier agrees) switch under arrangements known as the Debt Assignment Protocol (DAP). Under the DAP the customer must pay the debt to the new supplier.

We are also aware that the ways some suppliers seek to comply with the licence conditions that govern the contents of the communications customers receive when a transfer is prevented are not resulting in good consumer outcomes. In particular, we believe suppliers' debt objections letters do not fulfil their purpose of supporting more effective engagement and decision making by domestic customers whose transfer has been objected to on grounds of debt. For example, few of those customers switch contracts with their current supplier. Suppliers should review the content of these letters with a view to improving the quality of their communications with those customers and ensuring full compliance with their licence obligations.

We set out more detail below. This letter should be read alongside the impact assessment that we are publishing shortly.

The review process

In our Forward Work Programme[2] for 2015-16 we committed to a review of supplier objections. We said a key consideration would be whether the current arrangements could be improved so that indebted domestic customers are more easily able to get the best deal, while ensuring suppliers can take appropriate steps to have debt repaid.

In February 2015 we issued a call for evidence on the potential benefits, costs and risks of reforming, or removing, the right of domestic (and non-domestic) suppliers to object.[3] We considered the responses carefully and identified areas where we needed more data to inform our policy conclusions. As a result, in September 2015 we issued a request for information (the RFI) to seek more detailed information, from certain domestic suppliers (including the six largest and a cross-section of smaller suppliers). We supplemented this information through bilateral meetings with some suppliers and with consumer groups.

We also sought the views of our Consumer First Panel. Rather than abolish debt objections, the Panel wanted us to put pressure on suppliers to improve communications with indebted customers so as to increase internal switching to cheaper tariffs that would enable faster debt repayment. We published a report of the Panel's findings at the end of 2015.[4] Most recently, we commissioned the Centre for Sustainable Energy (CSE) to look in more detail at the costs and benefits of prohibiting debt objections. The CSE submitted a report in January, which we considered carefully and which helped inform our decision.

Key findings of the review

The level of objections

Data from suppliers for the period January 2013 to September 2015 indicated that the domestic debt objection rate was broadly stable over that period at 6-7% of all transfers. This finding is essentially consistent with data we receive annually on the total level of domestic objections (based on any ground set out in SLC 14). The latest such data, from March 2016, shows a total objection rate of 6% for domestic electricity customer transfers and 5% for domestic gas transfers (in each case 1% lower than in March 2015).

As noted above, objecting to a transfer is prohibited unless for a reason specified in the licence (mainly debt). A supplier can choose whether to exercise the right to object. Data from the RFI suggests that between 2 and 3 times as many customers are allowed to switch with a debt (typically 430,000 a year) than are prevented through debt objection (typically around 170,000 a year). The average debt of customers who are prevented from switching rose from £268 in 2013 to £418 in 2015. This is a trend in the right direction in that it indicates that suppliers are increasingly less likely to object at lower levels of debt.

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[2] Ofgem's Forward Work Programme 2015-16.
[3] https://www.ofgem.gov.uk/publications-and-updates/supplier-objections.
[4]https://www.ofgem.gov.uk/sites/default/files/docs/ofgem_consumer_first_panel_year_6_wave_4_report.pdf.

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On the basis of data from the RFI we estimate that the number of individual customers whose transfer is objected to on grounds of debt is around half the number of objections raised (partly because of dual fuel customers trying to switch gas and electricity accounts and partly because some suppliers try more than once to effect the same transfer). Customers paying by quarterly credit make up the largest proportion of customers who are not allowed to switch because of debt. A disproportionate number of those customers are on standard variable tariffs, typically the most expensive non-prepayment meter tariff available from their supplier.

As part of the RFI we selected two months (one in the winter, one in the spring) for a snapshot analysis of the extent to which customers who received a debt objection letter repaid their debt and switched supplier or switched tariff with their existing supplier. Just over half the customers whose transfer was prevented in the two selected months had repaid their debt at the time of reporting. Of the customers who had repaid the debt, around 70% did so within three months and about a third subsequently went on to switch supplier within a year of being notified in the debt objection letter. Only about 5% of the customers whose transfer was prevented had switched tariffs with their existing supplier.

Removing debt objections: potential impact on domestic customers' bills

Based on the available data, we have concluded that removing debt objections would be likely to increase debt across suppliers' customer bases as customers switch away, leaving a debt that is harder for suppliers to recover. This would be likely to increase suppliers' debt management costs, which may be passed on through higher bills to domestic consumers. There is a high degree of uncertainty about the scale of the bill increases. However, some of the suppliers' estimates are substantially in excess of any benefit potentially accruing to indebted customers (whether or not they had previously been prevented from switching because of a debt) who might in the absence of debt objections seek to switch supplier. This is the case even on the most generous assumption that might be made about their ability to maximise their savings.[5] We therefore think it likely that removing debt objections would increase bills for most domestic customers. In addition, the distributional impact could be significant.

Removing debt objections: other potential impacts

Without debt objections, it is likely that suppliers would turn to other credit management tools in the customer acquisition process to protect themselves from the increased risks of customer bad debt. Customers may be more likely to be offered only PPM terms or potentially be required to pay security deposits. There is a risk that suppliers could be more aggressive in recovering debt from ex-customers (rather than setting up affordable repayment plans they currently offer their customers).

Ofgem's decision

For the reasons set out in this letter and in the IA, Ofgem has decided to retain the existing domestic debt objections regime (ie, an absolute prohibition subject to the exceptions provided in the standard licence conditions). In reaching our decision we have taken into account the recommendations made to us by the CSE and the views of our Consumer First Panel, which favoured keeping debt objections and for suppliers to improve communications with their indebted consumers. We address the issue of communications later in this letter.

[5] For more detail see chapter 3 of the Impact Assessment.

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Objections at low debt levels

PPM customers with debts of up to £500 may switch supplier under the DAP if the new supplier agrees to the debt transfer. The debt moves with the customer when they switch and the customer must repay it to their new supplier. The detail of the debt assignment process is contained in an industry code.[6] Although the DAP mechanism only applies to PPM customers, our research has shown that some suppliers will allow indebted customers, particularly those with low or moderate levels of debt, to transfer supplier regardless of their payment method.

Clearly suppliers face a commercial choice in deciding whether to object to the transfer of an indebted domestic customer to another supplier. Our analysis shows that more often than not, they choose not to object. Many suppliers operate an informal threshold below which they allow the transfer of an indebted customer (ranging up to £200 per fuel, sometimes varying by payment type), while others take a case-by-case approach. Around 70% of transfers by indebted domestic customers take place without objection. In 2015, a typical customer with a debt of £300-350 was more likely than not to be permitted to switch. The great majority of customers attempting to switch with debts of up to £200 have been allowed to do so. We believe that this should continue. With this in mind, suppliers should continue to take into account their obligations under the Standards of Conduct when exercising their discretion to object to a transfer and consider whether it is fair to object to a low level of debt in the particular circumstances of the customer.

Improving suppliers' communications

Suppliers are required by their licence to provide written notice to a domestic customer when they object to a transfer. When doing so, suppliers must set out the reason for the objection and how the customer can resolve or dispute it. These letters must also contain advice (or information about how and where to obtain advice) on energy efficiency, debt management and alternative, available contracts from the supplier that may be preferable to the customer's existing contract. We require suppliers to provide this information so that objection letters can prompt a customer to engage constructively in the market (whether paying the debt and switching supplier, switching to a cheaper tariff with the existing supplier, or seeking information about energy efficiency and debt management).

We have reviewed a sample of 15 domestic suppliers' debt objection letters, including examples from all the six largest suppliers. Many of the letters failed to provide sufficient information to help an indebted customer understand what their options were and how they could repay and switch tariff. In particular, there was often a lack of information about how to dispute an objection and few suppliers informed the customer about the value of the debt. In addition, though most of the letters we reviewed said a different tariff or payment method might be available, many letters assumed that the customer would automatically make the link between a different tariff/payment method and saving money to repay their debts, and if it was provided, the information about alternative tariffs was often generic rather than tailored to the needs of the individual customer.

These shortcomings indicate that not all debt objection letters are meeting their purpose of stimulating effective engagement with the market by indebted customers. For example, the data we received from suppliers suggests that only around 5% of the customers who have been prevented from switching supplier on grounds of debt switch tariffs with their current supplier. Those customers who do not switch, many of whom may be on low incomes, are as a result likely to remain on tariffs higher than they need to be, thus lengthening the period that they are in debt.

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[6] MRA section 13: https://www.mrasco.com/admin/documents/MAP13%20v1.8%20-%20Procedure%20for%20the%20Assignment%20of%20Debt%20in%20Relation%20to%20Prepayment%20Meters.pdf.

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Our analysis suggests that a high proportion of the potential benefits of removing objections could also be achieved through internal switching. It is therefore especially concerning that so few customers who receive a debt objections letter switch to an alternative tariff with their existing supplier. We therefore request that suppliers review the content of their debt objections letters and in particular the matters set out below.

Debt objection letters must comply with SLC 14.9, including:

- stating the ground for objection at the time of the switching request and, where this is because the customer is in debt, stating that the debt had been outstanding for 28 days or more since the customer was first informed about it in writing;

- informing the customer of the amount of the outstanding debt as part of stating clearly how to resolve or dispute the objection;

- providing energy efficiency and debt management advice and clear information about third party sources of help and advice including relevant contact details for those organisations; and

- specifying an alternative, preferable tariff or payment method which would be available to that customer. In providing this information, it should be appropriate for, and bespoke to, the customer in question. Providing a link to generic tariff information on a website homepage, or an automated phone line, would not be sufficient.

Suppliers are obliged by SLC 27 to offer domestic customers options to agree an affordable payment plan to repay outstanding debt. As part of their approach to complying with SLC 27 we would encourage suppliers to offer affordable repayment options in sufficient detail within the debt objections letter.

We would also encourage suppliers, on a voluntary basis, to consider including the following elements in the debt objections letter:

- provide information that allows those customers to understand how much they could save by switching to the supplier's cheaper tariffs;

- to ensure that the customer is not put off contacting the supplier to resolve the issue, provide reassurance that the customer will receive a friendly reception if they contact their supplier to discuss their debt. This is in the spirit of suppliers' obligations under the Standards of Conduct to behave in an appropriate and professional manner and ensure that its customer service arrangements are fit for purpose in SLC 25C. Suppliers may also wish to direct customers to their Treating Customers Fairly Statement which, amongst other things, sets out the service and treatment a customer can expect from the supplier; and

- be clear that there are ways that the customer can reduce their bills, which will help them pay off their debt more quickly. Suppliers should very clearly make the link between taking these actions and resolving the debt.

Debt objection letters provide an obvious opportunity for suppliers to support effective engagement and decision making by indebted customers which can help them repay their debt. Suppliers must of course continue to send a written notice to customers whose transfer has been objected on grounds of debt. However, such letters need not be the only means by which suppliers may communicate with these customers. We encourage suppliers to consider how to make the best use of alternative channels such as SMS and email to communicate potential tariff savings at the same time that the objection letter is sent. We are open to suppliers using different approaches to improving communications with indebted customers.

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9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Next Steps - enhanced monitoring

As part of our normal market monitoring we assess the overall level of objections on an annual basis. We also track the internal switching rates of the six largest suppliers. As part of the Suppliers' Obligation Report process we analyse debt levels and repayment rates. All this will continue. We are currently considering the extent of any additional information that we will need over and above the data we already receive routinely.

As noted above, overall domestic objection rates fell over the last year. This is a welcome development. We want to see continued downward pressure on the number of objections, especially at lower levels of customer debt, and increased internal switching by customers whose transfer has been objected to on grounds of debt. If these key indicators do not improve, we will consider whether regulatory intervention is necessary. It is, for example, open to us in the future to conduct a randomised control trial of debt objections letters. Any regulatory action will be proportionate and consistent with our commitment to focus on the issues that pose the biggest risk to consumer interests.

Yours sincerely

Anthony Pygram
Partner, Consumers & Competition

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