

Supplier objections: Ofgem call for evidence

Response by E.ON

General remarks

1. E.ON welcomes the opportunity to respond to this call for evidence and explore potential changes to the objections regime, even if changes aren't anticipated to be implemented until 2019. However, whilst we support Ofgem's exploration of potential changes to the objections regime now, we do not believe any change should be implemented until after the implementation of smart metering.
2. In a pre-smart world, we are concerned that removing the ability to object could create unintended negative consequences for both domestic and business customers. Should Ofgem feel a change to supplier objections is appropriate, an extensive consultation process would be required, including a full impact assessment, to ensure that the consequences of any change were fully understood.
3. We have set out our specific comments on the questions Ofgem raises in the call for evidence below.

Section 1: Introduction

Question 1: The number of domestic customers who, following an objection,

- **are provided with energy efficiency and debt management advice**
 - **decide to switch to a cheaper tariff with the same supplier**
4. All residential customers that are subject to a debt objection by E.ON receive energy efficiency and debt management advice signposting. Our domestic objections letter advises customers that we are able to offer them energy efficiency advice to try to reduce their bills; we can review their tariff to see if we can help them to save money and also review their payment arrangements. This correspondence also advises customers of the actions they need to take to complete a successful transfer, and how they can clear any amount owed through an appropriate payment arrangement.
 5. We do not produce MI of what happens after an objection.

Question 2: The extent to which non-domestic suppliers may not be complying with objection requirements and/or the extent to which their customers are being moved inappropriately onto more expensive rates

6. We have no direct knowledge or evidence of other suppliers' practices regarding debt objections for business customers.

Section 2: Key issues

Question 3: Whether the existence of any objections regime is consistent with an energy market in which all customers should be able to switch supplier readily

7. Ofgem has asked for views on whether the objections regime remains appropriate. E.ON believes that it does, and we have set out our thoughts below.
8. However, the objection regimes are quite different in the residential and business markets. In the residential market, it is an option suppliers have been given; in the business market the option arises from the contract the customer entered in to (and there is no right to object where the customer has not had a choice i.e. a deemed contract).
9. We therefore consider the two markets separately.

Residential market

10. The case for the objections regime in the residential market is entirely practical. Suppliers have to offer credit terms to new customers and therefore have a significant exposure to non-payment. Credit management and debt recovery costs and bad debt risk are higher if a customer changes supplier, but a debt objection regime reduces costs to customers overall. Indeed, the customers who would be most affected by stopping debt objections would be those perceived to have a higher credit risk who would find access to the market more difficult (e.g. an increased requirement for security deposits). Often these customers are on lower incomes or who move property more frequently.
11. The case against the objections regime rests on the scenario of a customer who has not engaged in the market and whose circumstances change. The customer initially does not act (so there is an unpaid debt rather than an agreed payment arrangement), but then engages. Switching supplier could help the customer reduce their energy bills, whilst the customer could still agree a debt repayment arrangement with the previous supplier. Unfortunately there are also scenarios where a customer would change supplier and not repay the debt.
12. It is very difficult to quantify the counterfactual to the objection regime. Our belief is that there is a definite customer benefit in the lower costs of an objection regime and a strong argument of principle in favour that the consequence of removing the objection regime would fall to customers who have been wholly diligent (but unfortunate in their credit risk).
13. These principles would still apply with smart meters, but as the case for the objections regime is practical, the balance of argument may be different. We explore this in question 6 and 7 below.

Business market

14. The case for the objections regime in the business market is equally pragmatic – it reduces the costs of credit management and debt recovery, and also avoids the premium which would be required for wholesale energy risk if there was increased likelihood of customer switching in a falling market.

The argument of principle is more clearly in favour still – removing the objections regime would load the costs caused by businesses which avoid paying their debts on to those who are responsible, but with a weak credit rating. There is some difference from the residential market in that the bad debt costs arising from change of occupancy predominantly sit within our are segmented to be within deemed contract prices as there is no right to object for debt for a deemed contract. For example within our SME Electricity Deemed prices, 19% of the revenue covers the debt risk. This cost can still

affects a responsible business, if they want to take time before entering into a contract after moving into a premise and remain on deemed.

Question 4: Whether the objections regime places sufficiently strong incentives on suppliers proactively to identify customers who may be struggling to pay and at risk of falling into debt

15. We believe it does. The costs of credit management, debt recovery and bad debt are very significant. In a competitive market, these costs are a significant disadvantage to any supplier that is not doing everything it can to help customers avoid getting into payment difficulty or, if they do, to agree an appropriate payment arrangement.
16. Moreover, debt objection does not apply if a domestic customer changes supplier before a bill has been outstanding for 28 days (which with faster switching can now mean a customer who switches in response to a bill will have left before there is any right to object), if a customer promptly agrees a repayment arrangement or if a customer moves property.

Question 5: Alternative methods that suppliers might adopt to facilitate and manage credit risks in the absence of an objections process, including any evidence from other markets where there are no or very limited rights to object or where such rights have been removed

17. We have not considered in depth how we would respond to a change to the objections regime, but at the least would expect to make two basic changes in the residential market:
 - More stringent credit checking of prospective customers;
 - Accelerated installation of prepayment meters. This would both avoid debt building up and, with the debt assignment protocol (DAP), ensure recovery.
18. In the business market, we would also expect to make credit assessments of potential customers more stringent with more refusals to supply and greater use of security deposits. It is not clear how this could be done cost effectively, but we would also likely seek to insure ourselves against a substantial fall in wholesale energy prices.

Question 6: The potential impact of smart meters on suppliers' ability to manage credit risk and the implications of this for suppliers' right to object

19. The energy industry is some way from offering a successful smart pay as you go solution, but by 2019 we would expect it to be widely available.
20. Potentially, smart meters could radically change credit risk in the residential market:
 - Monthly billing would be practical. Coupled with this, digital developments could lead to many customers agreeing to a requirement to pay within a few days, allowing us to be able to identify any payment difficulty promptly;
 - Prepayment would be more attractive to customers, with a full range of tariffs, a wider range of payment methods and, potentially, a significant payment method adjustment compared to payment on receipt of the bill;
 - It would be rare for a debt to exceed £500 (the DAP threshold). Once on prepayment, a domestic customer could therefore freely switch supplier to take advantage of the full range of tariffs in the market;
 - Prepayment should also be 'safe and practicable' for many more customers, although there will still be a need to confirm this (through dialogue with the customer or a site

visit) which could delay a switch to prepayment (and hence mean there is a higher credit risk at some sites);

- The default for new customers could be prepayment mode, so that credit terms are only offered after discussion;
 - The majority of bills would be based on monthly meter readings, reducing the risk of a surprise high bill or direct debit increase which a customer has difficulty paying.
21. These potential changes will affect the assessment of customer benefit from debt objection, but without experience of smart meter operation it is impossible to quantify.
22. We would expect that these benefits could also change credit risk at the smaller end of the business market. They would not, however, affect the risks arising from falling wholesale costs if customers chose to break their contracts.
23. However, accurate metering does not guarantee that debts cannot arise and hence there is a potential benefit in reducing costs from debt objection.

Question 7: The potential impact of smart meters on related electricity meter point objections

24. We do not expect the introduction of smart meters to have an effect on the need for related electricity meter point objections. However, we do expect the incidence of this type of objections to diminish over time. It is E.ON's intention to offer domestic customers with the most complex metering arrangements a free meter exchange to a simpler meter. This will expand the number of tariffs available to customers and also reduce dual MPAN supplies, and consequently related MPAN objections.
25. However, we do not foresee a complete eradication of dual MPAN supplies and objections of this kind are not intended to prevent the customer from transferring to another supplier, but to make sure that their supply is transferred accurately and any issues with future billing are avoided. Removal of the option to object in such cases could easily create customer confusion; we believe objection is a simple and cost effective way of dealing with this issue.

Section 3: Domestic Markets

Question 8: The potential impact of each of the options listed and of any other options we should consider, for example from other British or international markets

26. We have considered each of the options proposed by Ofgem.
- I. **No material changes to the objections arrangements**
27. We strongly recommend this option continues for the next few years. The potential benefits of smart meters may allow radical change, but earlier action is most likely to lead to higher costs and reduced access to the market for too many customers. Any change to the current arrangements would need to be the subject of a detailed consultation, with associated impact assessment.
- II. **Retain debt objections but require objecting suppliers to be more proactive in managing the relationship with their indebted customers, possibly including a requirement to move them onto a cheaper tariff to help them repay their debts**

28. Cheaper tariffs are invariably different in some way (for instance, a fixed price with an exit fee rather than standard variable) and it is for customers to choose whether this meets their needs.
29. Customers will be aware of any cheaper tariffs offered by their supplier from the 'could you pay less' message on statements and bills. E.ON also offers a price alert service to customers on fixed term tariffs should they choose to opt in, which will inform them if we launch a new tariff similar to the one they are on.
30. We do not believe that a discussion about tariff options is necessarily appropriate when the immediate question for a customer is what arrangement to make for an outstanding quarterly bill, but would agree that once an appropriate payment method is in place then the potential for a tariff change could be relevant. All E.ON's residential tariffs are equally open to customers on all credit payment methods, whether regular cash payment arrangement, on receipt of the bill or direct debit.
31. The challenge of deciding when to discuss tariff options with customers, including the cost and training implications, suggests that any further steps should arise from guidance as to how the Standards of Conduct should apply rather than any prescriptive regulation.

III. Abolish debt-related objections

32. We have outlined the consequences of this option above. We do not believe responsible customers could benefit as, except as we note below, they would be able to freely choose supplier by switching to smart meter prepayment. Whereas the higher costs of debt recovery from other customers would rebound on customers with weaker credit ratings.
33. The exception is if the prepayment meter option was not safe and practicable. With smart meters, however, this should become increasingly rare in electricity. As section 3.(1) of the Electricity (Prepayment Meter) Regulations 2006 allow, with a customer's agreement, for gas debt to be recovered through an electricity prepayment meter it would be possible for a customer prepared to take a dual fuel supply to freely switch, with some development of the DAP process.

IV. Abolish objections that relate to erroneous transfers

34. We do not believe that abolishing objections relating to erroneous transfers would be of benefit to energy consumers. The intention of this type of objection is to prevent supplies because transfer is either as a result of fraud or error. Removal of this option would result in a poor experience for customers impacted by such an occurrence.

V. Abolish objections to do with related electricity metering points

35. Please see response to question 7.

VI. Abolish objections relating to indebted customers with Green Deal Plans

36. The Green Deal is government policy that was developed on the basis that suppliers were able to object for debt as a means of reducing bad debt risks. Changes to this policy would therefore require government agreement. It would seem essential to show that bad debt risks in a revised objections regime were significantly less than when the policy was formulated. Experience of smart meter operation would be an important factor as the policy was formulated in the knowledge that smart meters were pending, albeit that the full benefits could not be known prior to implementation.

VII. If we were to abolish debt-related objections we could

- **extend the DAP to all domestic customers or**
 - **adopt arrangements like those in Ireland where suppliers cannot object to a customer leaving but new suppliers can refuse to take on a customer with debt above a certain level (€225 is the threshold in Ireland)**
 - **introduce new rules for example around security deposits.**
37. As explained above with regard to smart meters, customers would freely be able to switch to prepayment and then to switch supplier, choosing from a full range of tariffs. The complexity of introducing a new arrangement for credit customers would therefore not seem to be justified, although we consider below how it might work.
- We assume that a customer, with a smart meter in credit mode, informs the prospective supplier of whether they have an outstanding debt, but is not able to quantify it. The supplier would agree with the customer how the assigned debt would be repaid.
 - On receipt of a loss notification with a flag that the customer had consented to debt assignment, the old supplier would not object¹ if the outstanding balance on the account (debt plus charges since last payment) was below some amount, say, £200.
 - On completion of the transfer, this balance plus any further amount accrued since the date of the loss notification (which should be small with faster switching) would be factored and assigned to the new supplier.
 - The new supplier would apply the agreed repayment arrangement, but if the customer did not keep to this would be readily able to switch the account to prepayment mode.
38. The critical differences which smart meters make compared to classic meters are firstly that the old supplier can have an up to date accurate balance on the account and secondly that there would potentially² be no extra cost for the new supplier in switching the customer to prepayment.
39. However, the process would seem quite complex and would require significant development work and a robust impact assessment.

Question 9: The potential impact of abolishing domestic debt objections

40. Please see response to question 3.

Section 4: Non-domestic markets

Question 10: The potential impact of each of the options listed and of any other options we should consider, for example from other British or international markets

41. We have considered each of the options proposed by Ofgem.

¹ Please note that the DAP process currently relies on an initial objection, but this does not prevent change of supplier. For the above discussion we have classed this as 'not object'

² In some cases a site visit may be required

I. No material changes to the objections arrangements

42. We strongly recommend this option continues. Please see our response to question 3.

II. Redefine the contractual right to object to exclude debt-related objections

43. To be clear on what this option would mean: it would apply in the specific scenario of a variable priced contracts where the customer has given notice of leaving (the contractual right to object as a means of managing energy purchase risk, i.e. within a fixed term period or if there is no without notice, is discussed in Option III).
44. The benefit to customers of being able to agree in their contract to this right to object is that a supplier would perceive there to be less risk of the cost and effort of litigation as a means of recovering debt, or of bad debt. Without this right, prices would be higher, particularly for those customers with a weaker credit rating or in market segments with poorer payment records.
45. Removing the potential to agree a right to object for debt could also lead to a change in deposit requests, where customers are asked to put up more collateral in advance of supply, in order to mitigate potential write off at the end of their contract. This is likely to have a negative impact on many business customers, especially in the smaller end of the non-domestic market where cash flow can be of critical importance.

III. Abolish the contractual right to object entirely

46. In the SME market, energy for fixed price offers is purchased for the whole period of the contract and set up costs are amortised over the period of the contract. If a customer leaves mid-contract, there is a risk of stranded costs for the supplier. These would be particularly large in the scenario where a customer may see the greatest benefit in an early switch – namely a significant fall in wholesale costs.
47. In theory, suppliers could recover these costs through liquidated damages, but we would question how likely a customer who has broken a contract is to pay these without litigation.
48. These risks would be compounded by the potential for customers to inadvertently agree to change supplier (not realising the exact period of their contract) or for unscrupulous broker activity encouraging such switching.
49. The minority of bad practices in the currently unregulated TPI market could increase. The objections process is one way of flagging where a TPI moves customers' supply without their consent or knowledge; this would be able to happen unchecked (and with quarterly billing, the customer might not be aware for some considerable time).
50. The risks of stranded costs are greater still in the corporate market - please see separate confidential appendix.
51. With variable priced offers, the benefit of a customer being required to give notice of leaving (and a right to object of notice is not given) is that a supplier is better able to manage the short-term wholesale risk, without which there would be very large risk from imbalance charges (which are set to increase with implementation of P305).

IV. Abolish objections relating to erroneous transfers

52. Cooperative objections between suppliers are used in conjunction with any other available methods (registration withdrawal, for instance) in order to prevent erroneous transfers. In the half hourly market there is no erroneous transfer (ET) process, so if a site is gained incorrectly

by one supplier, it cannot be returned to the incumbent without starting the whole registration process again.

53. Unlike an ET, this leads to the customer being supplied by their chosen supplier, the erroneous supplier and then the chosen supplier again. This can have impacts on the customer (Carbon Reduction Commitment (SLC21A) reporting, for instance) as well as on the suppliers and therefore cooperative objections are an integral part of a functioning half hourly market.
54. Removing the ability to object during a fixed term period or if a customer has not given notice is likely to lead to more instances where customers are with a supplier for a matter of days, erroneously (as described in Para 48 above). Whilst the reforms made recently allow a supplier to withdraw from their registration, there can often be an overlap between the objection deadline, the supply start date and the withdrawal deadline, meaning that a supplier has to object in order to prevent an erroneous transfer.
55. Like the domestic market, the ability to object to ETs is a simple, low cost way to dealing with this issue. We would expect Ofgem to consult fully and to complete an impact assessment and explore other methods of resolving ETs if any change to the ability to object were proposed. Alternatives could be more expensive than this option.

V. Abolish objections to do with related electricity metering points

56. As with the residential market, the primary beneficiary of continuing to allow objections to do with related metering points is the customer,
57. In the current half hourly market, distribution Use of System charges (DUoS) are charged on a site-specific basis. Where metering points are related, a supplier will be in receipt of one relevant DUoS invoice covering the MPANs. Availability (the Maximum Import Capacity agreed between Distribution Network Operator and the end user) will be charged once, as will a p/kWh DUoS rate.
58. Having the MPANs with separate suppliers could lead to an increase in cost for customers, as each supplier will be in receipt of one invoice for one MPAN. This will also be true for some supplies transferred to one of the new measurement classes created under BSC P300 and moved to half hourly settlement under BSC P272. We do not foresee a similar issue in the non-half hourly market.

**VI. Abolish objections relating to indebted customers with Green Deal Plans
(objections linked to the Green Deal were introduced by the Secretary of State)**

59. Please see response to question 8 (VI)

VII. If we were to abolish debt-related objections, we could

- **extend the DAP to non-domestic customers or**
 - **adopt arrangements similar to those in Ireland**
60. The DAP works in the residential market (in helping increase choice for customers in debt without adverse side effects for competition) because the new supplier has a reasonable prospect of a return (the benefit of debt factoring compared to the risk from change of tenancy). Even so, it is an overall cost to suppliers, but as one targeted on prepayment customers, who have relatively few offers in the market, seems fair. With smart meters, the

latter rationale would disappear as prepayment customers get a wider range of offers, but conversely the administrative costs should reduce.

61. Many of these factors differ in the business market. All business customers have a wide range of offers open to them and so there is no case for subsidising a particular group. The full costs of any DAP process should be borne by the customer groups which benefit from it.
62. More subtly, the repayment arrangements would be quite different. Prepayment is unusual in the business market, but most contracts are for a fixed period and a customer would need to keep up an agreed payment arrangement. However, this potential is unlikely to even arise: a customer who had difficulty paying to one supplier seems likely to be perceived by a new supplier to have an increased risk of difficulty paying and hence would not be an attractive prospect. It would hardly help if a security deposit of £500 was required before a supplier would take on a debt of £500.
63. We do not really believe that the application of the DAP to the business market is practical, but if smart prepayment starts to be established within the business market, we would recommend consideration is given as to whether there could be a trial extension of the DAP.

Question 11: The potential impact of abolishing debt objections in the non-domestic market

64. Please see response to question 10 II.

Question 12: The potential impact of abolishing all contractual objections in a non-domestic market

65. Please see response to question 10 III.

Section 5: Timing

Question 13: The timing of any changes to the objection regime

Residential market

66. In the residential market, any change carries the risk of significant increase in credit management, debt recovery and bad debt costs. The costs would be greater still before smart meters are installed. Suppliers would need time to develop new credit management strategies, both to mitigate the cost impact and to be confident in taking on customers with weaker credit ratings without increased use of security deposits.
67. We would recommend the following timetable:
 - 2016-2017: gather information on the impact of smart meters in reducing debt through increased bill accuracy, in increasing the range of choice for prepayment customers and the application of DAP with Smart prepayment customers;
 - 2018: evaluate options and consult, with a full impact assessment;
 - 2019-2020: potential implementation, with 9-12 months' notice of change.

Business market

68. In the business market, we do not believe there is a case for change, but would suggest this is reviewed in light of the residential evaluation (2018). Were any change to be justified in some circumstances, this could apply at the start of a new contract, with 9-12 months' notice of change. It would be likely though that, prior to implementation, longer term contracts (which did not have a risk premium) would be more attractive and so any change might not be fully implemented until after 2020.

