



The voice of the energy industry

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24 April 2015

Supplier objections: a call for evidence

Dear Andy,

I am pleased to attach Energy UK's response to the above consultation. It is not confidential.

If you have any questions, please do not hesitate to contact me on 020 7747 2963 or daisy.cross@energy-uk.org.uk

Yours sincerely

Daisy Cross
Policy Manager

Supplier objections: a call for evidence

Energy UK response

24 April 2015

- 1.1. Energy UK is the trade association for the energy industry. Energy UK has over 80 companies as members that together cover the broad range of energy providers and supplies and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested £10billion in the British economy.
- 1.2. We strongly believe in the value of a competitive energy market underpinned by a stable and independent regulatory regime. Together these can foster innovation, support market development, bring benefits to consumers and help provide the certainty that is needed to encourage investment and enhance the competitiveness of the energy sector, a key part of the British economy.
- 1.3. Energy UK welcomes the opportunity to respond to Ofgem's call for evidence. We are happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

2. Executive summary

- 2.1. Members agree that removing suppliers' ability to object for debt or contract stipulation would lead to increased costs within the industry and undesirable outcomes for many customers. This response explores the unintended consequences implied by the removal of debt and contract objection under the following circumstances: domestic change of supply; domestic change of tenancy; and non-domestic change of supply.
- 2.2. The existence of an objections regime does not in itself provide a barrier to switching for the vast majority of customers. Debt management is a fundamental aspect of competitiveness in any industry, and particularly in industries which provide goods or services on credit such as energy. The ability of companies to manage their debt portfolio effectively to drive down costs for their customers determines their success in the market.
- 2.3. Energy supply is a unique market in that suppliers' duty to offer terms (SLC 22) prevents them from mitigating action against adverse selection, exposing them to the high costs implied in inertly taking on customers with a propensity for bad debt. By using the objections process appropriately suppliers have a tool with which they can manage debt risk and protect their wider customer base from higher prices. Removing their ability to do so would not only affect suppliers themselves, but would have a negative impact on the deals that are available to all customers. The effects would be felt disproportionately by small and non-incumbent suppliers, and could well act as a disincentive to market entry

3. Timings

- 3.1. The change of supply landscape will fundamentally change as government and industry work towards building systems and implementing modifications to accommodate smart roll-out, DCC centralised registration and 24 hour switching. We welcome Ofgem's initiation of this review, but would advise that until there has been wider experience of smart meters in prepayment mode it is unlikely that robust conclusions can be drawn.
- 3.2. In a smart/24 hour switching world Ofgem would like to see customers have the ability to change supplier on a daily basis. It is yet too early to predict the effect this capability could have on customer behaviour, or the repercussions it could hold for suppliers and their ability to manage debt risk.
- 3.3. An independent market investigation is also underway, and members note that the CMA may come to different conclusions or present conflicting recommendations to those of Ofgem's review with regards to switching and the competitiveness of the domestic and micro business markets.
- 3.4. Energy UK's comments relate to the existing market structure and objections regime. Our members may highlight innovations relating to smart in their individual responses.

4. Unintended consequences

- 4.1. In most competitive markets the supplier of products or services can market to, and actively choose to enter into a contract with, a customer. Where goods or services are supplied on credit, the supplier will have the opportunity to assess the suitability of the customer and their ability to pay before contracting with them to ensure they are able to deal with any potential debt risk. Domestic energy suppliers have a duty to offer terms to supply and supply under deemed contracts, and this process of selection and risk assessment is limited.
- 4.2. Removing suppliers' ability to object for debt or for a contract stipulation (in the non-domestic market) would imply a number of unintended consequences for domestic and non-domestic customers alike. These are set out in detail below.

Prices:

- 4.3. Increased credit management and bad debt costs would likely be reflected in final consumer prices. For domestic customers the effect would likely be greatest on the standard variable price and on the 'on demand' (QCC) differential to direct debit as these are the predominant terms for new occupants. For non-domestic customers the effect would likely be reflected in pricing to customers with a perceived higher credit risk.

Contracts:

- 4.4. Suppliers do not have the ability to object on grounds of a domestic customer being in a fixed-term deal, but have this ability in the non-domestic market. Members report that the most common objections in the non-domestic market are related to customers seeking to leave mid contract. This could hold a number of implications for the market:
 - The use and value of security deposits would increase, both as a means of reducing debt risk and to reduce the need for legal enforcement of contractual penalties for breaking contract.
 - Debts could increasingly need to be pursued through the courts.
 - Energy performance contracts and other incentives to reduce usage could be affected if there was increased risk of customers leaving mid-term, and could lead providers of such services to include termination fees in fixed-term contracts in order to cover the cost of equipment provided. Similarly the range and terms and conditions of other bundled services offered through suppliers or TPIs could be affected.

Mitigation activity:

- 4.5. Credit checks at point of customer acquisition as a tool to discern a customer's ability to pay are used in a wide range of markets including bank account services, credit card services, the mortgage market, purveyors of interest free credit (such as car companies), broadband providers, mobile phone and landline providers, paid-for television providers, insurers and catalogue companies. Removing suppliers' ability to manage debt risk in other ways may lead to credit checks becoming more widespread in order to limit suppliers' exposure to increased debt risk.

In addition:

- The number and value of security deposits asked of customers could increase. However, security deposits are ineffective in domestic change of tenancy situations, where a customer is able to consume before a contract is agreed. Requirement of advanced payment could also increase, which would be detrimental to customers.
 - The number of disconnections could increase, and the fitting of prepayment meters could occur earlier in the debt journey. Disconnection is a last resort and a protracted process for suppliers. Some suppliers do not disconnect customers for debt.
 - Customers with a bad credit rating may find it more difficult to access the market, or find an affordable deal.
- 4.6. Alternative debt management activities (e.g. disconnection, County Court Judgements, sale of bad debt to Debt Collection Agencies) are not only undesirable for customers, but are likely to be less effective and more costly. Furthermore, alternative options to collecting a debt (if objections were removed) are also significantly less effective. Once a debtor has left a supplier, the ability of that supplier or any outside agency to secure repayment terms and recover the debt is significantly reduced. While members recognise that similar issues apply to other creditors, it is important to remember the energy supply industry has unique requirements to offer terms, and suppliers are bound to supply under deemed contracts.
- 4.7. Prices offered to customers could increase in line with the added cost burden to industry. Along with these cost implications, Energy UK members believe that the risk of debt management becoming more aggressive could in fact deter responsible customers who are trying to manage their debt from switching.
- 4.8. Regarding non-domestic customers, if suppliers are unable to object to transfer on contractual grounds and customers are allowed to terminate fixed-term contracts before the agreed supply end date, take or pay charges could also be incurred. It may then be necessary for the supplier to resell the electricity or gas – often purchased through a long-term commitment - at a loss, depending on season and prevailing spot market prices.
- 4.9. Consideration should be given to the impact removing key debt management tools has had in other industries. Since the 1999 Water Act came into effect, water companies have been unable to disconnect customers for debt. According to an industry overview¹ debt increased by 17% the year following the removal of water companies' ability to disconnect, and aged debt had increased by over 71% by 2006.

5. Requiring more proactive engagement with customers

- 5.1. Suppliers already work hard to assist domestic customers into a position where they can repay any debt that has accrued in line with their ability to pay and where they are able to switch easily, for instance through: their requirements to point customers towards cheaper tariffs; offering a range of different payment method options; allowing pre-payment customers to switch with a debt of £500 or less; setting up repayment plans, and regularly checking customer's ability to pay. From the 30th April, ten suppliers will have also taken steps to change how they operate the Debt Assignment Protocol, voluntarily adopting the Point of Acquisition (POA)

¹ Domestic Customer Debt and the Right to Object, an Ilex Energy Consulting report produced for Ofgem, May 2006

model to help make it easier and simpler for customers who use a prepayment meter to switch supplier². Energy UK members have forged good collaborative working relationships with debt advice charities such as Citizens Advice, Money Advice Trust, Business Debt Line and Money Advice Service. Earlier this year the sector agreed to help fund the delivery of MAS for the year 2015/16 via a £1m of voluntary contribution for the first time.

- 5.2. It is in suppliers' interest to ensure customers do not move into debt, and they make every effort to communicate with customers to help them avoid accruing debt. This includes informing them of the assistance available, including through their own special assistance funds in some cases.
- 5.3. At the end of a fixed-term contract domestic customers will be moved on to their supplier's cheapest standard variable tariff. All Energy UK members currently allow their domestic customers to switch fixed-term contracts internally while still mid- contract if they are in debt, and will not levy a termination fee.
- 5.4. Ofgem noted in its 2007 consultation looking at non-domestic objections³ that suppliers have strong commercial incentives to make contract terms and termination arrangements clearer, and to differentiate themselves by adopting simpler contracts.
- 5.5. Since this time, Ofgem has directed a series of wide-ranging measures which address clarity and adequacy of domestic and non-domestic customer communications⁴, including prominently displaying cheapest tariff messaging on the bill.
- 5.6. In light of the above points, Energy UK members believe further requirements on suppliers to proactively engage with domestic and non-domestic customers in this regard would be redundant.

6. Eliminating debt-related objections

Domestic

- 6.1. Debt is the main driver of domestic objections, and debt objections help mitigate the most fundamental cost risks for suppliers and their customers.
- 6.2. At the stage of the customer lifecycle at which objection is considered, a supplier will have invested considerable resources (time and communication) in the customer. If unable to object to transfer, a supplier would be compelled to pursue other avenues to recover monies owed, such as through the use of bailiffs, County Court Judgements, and the selling of bad debts to collection agencies. As noted above, these measures are not currently widespread and suppliers are reluctant to use them as they are not conducive to good customer experience, and could place financially insecure customers in vulnerable positions.
- 6.3. Credit checking is not alone an adequate tool to offset the detrimental consumer impacts of removing debt objections in a Change of Tenancy situation. If a customer is acquired via a Change of Tenancy, they will likely already be taking supply through a deemed contract.
- 6.4. The increased risk of bad debt from a new occupant would likely lead to greater reluctance among suppliers to remove a PPM in favour of a credit meter, particularly following a change of tenancy. Suppliers would likely seek greater reassurances, for example increased credit checking before agreeing to offer a customer terms under a standard credit meter.

² Under the POA model, suppliers continue to use the existing DAP processes and flows as set out in MRA MAP 13 and SPAA Schedule 9. However, instead of waiting on the Old Supplier Debt Objection Letter (DOL) to prompt the customer to call the New Supplier to fulfil the requirements of section 2.3 in MAP 13 and Schedule 9 and to initiate a switch under the DAP, suppliers build the provision of information about the DAP and customer consent to debt assignment in the event of a debt objection (as required by section 2.3 of MAP 13 and Schedule 9) into all of their sales channels (e.g. telephone, online, switching sites, collective switches) for all prepayment customers at the point of acquisition. By operating the POA model, the New Supplier is then in a position on receipt of all supply point objections related to a prepayment customer to automatically issue a Request for Debt Information flow (D/G0306) and for the switch to continue under the DAP where appropriate, as per MAP 13 and Schedule 9. The POA model thereby removes the need for a prepayment customer with a debt of £500 or less per fuel to take action (either proactive or reactive) to "restart" their switch under the DAP. The customer makes one decision to switch at the point of acquisition.

³ <https://www.ofgem.gov.uk/ofgem-publications/38560/final-proposal-non-domestic-objections-final-version.pdf>

⁴ Ofgem's Retail Market Review, domestic and non-domestic decisions

Non domestic

- 6.5. As suppliers have no duty to supply in the non-domestic market it would be likely that businesses with poor credit histories or other outstanding debts would at best pay a significant risk premium, and at worst find it difficult - or would be unable - to procure a new contract with a supplier if they were interested in switching and had a debt with the current supplier.

7. Eliminating objections relating to erroneous transfers

- 7.1. Energy UK notes that a significant amount of work would be required to develop a proposal to replace the function performed by the ability to object in the process for handling erroneous transfers. Any new process would need to allow for the unpicking of customer-supplier relationships where an erroneous transfer has occurred. This process would also need to consider 24 hour switching. An impact assessment would be required to assess whether this alternative was more effective than maintaining the ability for suppliers to object to prevent an erroneous transfer taking place, which serves to limit detriment to customers.
- 7.2. Members suggest that Ofgem should limit its review to the role of objections in resolving an erroneous transfer, and to maintain the ability for suppliers to object to prevent an erroneous transfer taking place, as this serves to limit detriment to customers.
- 7.3. Suppliers' ability to object where an erroneous transfer is due to occur could also mitigate confusion in change of supply in a smart world, particularly in the early phases where some suppliers will be DCC registered but others not. When a new supplier inherits a smart meter the previous supplier information on the meter is overwritten, which will make it more difficult to reconcile the error post-transfer.

8. Eliminating objections regarding related MPANS.

- 8.1. Members note that this objection acts more as a pause to allow an issue to be detected and resolved where customers have more than one circuit in their metering system. Members consider that this objection is not detrimental to customers and is not a barrier to switching. The ability to object should in fact highlight the potential for customer detriment and facilitate a smoother switching process, particularly in the non-domestic market where multi-site contracts and framework agreements are used. It is also worth noting that this type of objection represents a very small number of total objections. The need to utilise this right of objection will hopefully decrease further as the smart meter roll-out is completed.

9. Eliminating objections relating to indebted customers with Green Deal plans

- 9.1. It is important to clarify that obligated Green Deal suppliers cannot object to a proposed transfer on the grounds of outstanding Green Deal charges, but can object for outstanding charges for the supply of electricity.
- 9.2. However, it is not possible (except in very rare circumstances) for a customer to find themselves with outstanding Green Deal charges without also having outstanding electricity charges.
- 9.3. Under the Energy Act 2011 suppliers are required to recover Green Deal charges as debts from the relevant Green Deal bill payer in the role of agent and trustee for the relevant Green Deal Provider. The Green Deal Arrangements Agreement (GDAA)⁵ requires each supplier to use the same processes and efforts to recover Green Deal Charges from the relevant Green Deal bill payer that it uses to collect charges for electricity used. Suppliers are required to pari passu any collected amounts without any preference between them to the outstanding charges for the electricity supply and the Green Deal charges. Ofgem should consider that suppliers' duty to collect Green Deal charges is set out in the Energy Act 2011 and the GDAA, in addition to their responsibilities under the licence.

⁵ The GDAA is an industry code under which the terms of Green Deal collection and remittance process have been agreed between suppliers, Green Deal Providers (GDP) and Green Deal finance companies

- 9.4. When considering removing suppliers' ability to object on the grounds of outstanding charges it is important to consider the potential implications for Green Deal and the commercial parties involved in delivering this financial product. Energy suppliers have been elected by government to act as the collection agent for Green Deal as a direct result of the industry's outstanding collection process, particularly with regards to the very low level of customer payment defaults. The Green Deal Finance Company has lent money using a particular risk profile based on existing energy debt collection processes which includes debt objections. Any decision to alter suppliers' ability to collect charges and/or debt, therefore needs to carefully consider the potential impact and unintended consequences for commercial third parties.

10. Extending Debt Assignment Protocol (DAP) to all customers

Domestic

- 10.1. If the DAP were extended to all customers, suppliers would effectively be forced to buy customer debt at a rate which would be impossible to forecast due to the uncertainty arising from estimated reads of assessing the total debt amount in the final bill. Smaller, expanding suppliers in particular may find it difficult to manage their debt portfolios accordingly. This is why the current DAP process for prepayment customers has a threshold of £500 (demand uncertainty is also reduced for PPM). An extended DAP, therefore, has the potential to have a significant and uncontrollable impact on the profitability of suppliers and could act as a significant barrier to entry.
- 10.2. This proposal also raises a question of fairness. If a New Supplier was mandated to purchase energy debts from the customer's Old Supplier (as a combination of an expanded DAP and SLC 22 would imply), the New Supplier would effectively be asked to collect a customer debt that has accrued under the collection regime of the Old Supplier. This regime may be more or less robust than that of the New Supplier, and as a result the profitability of the New Supplier in particular could be affected if the Old Supplier operates a less adequate/robust billing and debt collection practices.

Non-domestic

- 10.3. As found by the CMA in its recent working paper on micro business⁶, the definition of microbusinesses is not clear-cut, and suppliers tend to apply micro business protections to a wider range of small and medium-sized enterprises (SMEs) than Ofgem prescribes. Each supplier has a different approach to flagging businesses to which they apply these protections. If the DAP was extended to all micro businesses this would imply extending it to all SMEs for a number of suppliers, and SMEs can use high volumes of electricity and gas, and run up significant debts into tens of thousands of pounds.

11. The Irish model

Domestic

- 11.1. Members urge Ofgem to fully consider the differences between the GB and Irish energy supply markets as it reviews the suitability of the Irish change of supply model. For instance, the application of the current Irish arrangements to the GB energy supply market would require the amendment of the current duty to offer terms licence condition, as the Commission for Energy Regulation (CER) allows suppliers the right to refuse a customer.
- 11.2. Irish suppliers have been unable to object for debt since 2005, when the market opened. In 2011 CER consulted on measures to address bad debt, after stakeholders reported an increase in customers 'debt hopping' and in debt in general. CER itself found that 'customer disconnections, for non-payment of account...increased significantly in the electricity market in 2010, with the level of disconnections peaking at over 2000 in July and August'⁷. In its decision CER found that customer and industry debt levels were 'being exacerbated by some customers' changing supplier in order to avoid paying their arrears or to avoid a pending disconnection'⁸.

⁶ https://assets.digital.cabinet-office.gov.uk/media/550085a9e5274a1414000014/Microbusiness_working_paper.pdf

⁷ CER/11/044

⁸ CER/11/106

- 11.3. Although CER highlights that the economic environment in Ireland at the time may well have influenced this trend, it helps to illustrate that there is a significant risk of unintended consequences around removing suppliers' ability to object on the grounds of debt.
- 11.4. Ireland implemented a debt flagging system in October 2011 as a tool to help try and mitigate the issues reported above. A subsequent review of the debt flagging process in 2013 found that the system implied a high administrative burden for suppliers.
- 11.5. If the right of GB suppliers to object were removed, and the ability to refuse a customer allowed (as in the Irish model), customers would be able to leave their supplier but may not be able to find a new supplier to take on their debt. The new supplier taking on the indebted customer may be contingent on a security deposit or credit check. This could mean that the end result for the customer would be the same as under the current regime where suppliers are able to object for debt, in that the customer would remain with the original supplier. Current debt management options used by Irish suppliers include security deposits, prepayment meters, credit checks and disconnection⁹. Suppliers progressing to these options in the place of objecting to transfer would mean the net impact of implementing the Irish model would be detrimental rather than beneficial for customers in debt.
- 11.6. There is also a question as to whether the necessary reforms (in particular debt flagging) would be possible to implement before smart-driven centralisation of registration systems by the DCC.
- 11.7. Objections for debt and contract default are not permitted in the non-domestic market in Ireland.

12. New rules around security deposits

- 12.1. Energy UK wishes to see more detail around Ofgem's thoughts on security deposits as an option to help manage bad debt risks, but considers that customer experience could be negatively affected (see section 4.5). Members note that such rules have previously existed in the supply licence but, as part of The Supply Licence Review, rules around size of security deposit and requirements to return after 12 months with interest were dropped.

⁹ CER/09/136