OFREG CONSULTATION PAPER ON THE CHANGE OF SUPPLIER PROCESS FOR CUSTOMERS WHO ARE IN DEBT – DOMESTIC MARKET OPENING

JUNE 2006

Introduction

Ofreg is currently working with market participants to effectively open the retail electricity market to competition for all customers by July 2007. One issue which has arisen is what the Change of Supplier process will be for domestic customers who are deemed to be in debt.

It is essential for the project design that a decision on what the necessary processes will be for customers in debt is made shortly. At this stage, it is not essential that a definition of actual debt is agreed upon. Ofreg will shortly be considering what the definition of debt will be.

It has also emerged that there will need to be provisions in place to deal with a change of tenancy in a premise. A new tenant in a premise may wish to change to a different supplier to the one which previously supplied him at his previous premise. Procedures need to be agreed so that if he is in debt, the new tenant cannot change to a new supplier without his old supplier being able to chase the outstanding debt. It is necessary to set the rules for how this debt will be recovered.

Following this consultation, Ofreg will make a decision as to what the process will be for those customers who are in debt, and how they will be able to access the competitive market.

Current Arrangements in the Non-Domestic Market

At present in the non-domestic market, a supplier can object to one of its customers being transferred to a new supplier if that customer currently has debt outstanding. Under the non-domestic market conditions, aged debt exists where an invoiced or direct debt amount greater than £50 remains unpaid after 28 calendar days.

Under these arrangements, NIE T&D informs the current supplier that a request has been made for that site to be supplied by a different supplier (NIE T&D do not name the new supplier). The present supplier then has two days in which to object to this transfer. If a valid objection is made, NIE T&D will immediately cancel the registration and any associated field work, and contact both suppliers to inform them of this. The new supplier should then contact the customer and explain to them that an objection has been made by their current supplier because they are in debt, and they can no longer continue with the registration.

If the customer pays off their outstanding debt in full to their current supplier, they will be able to commence the Change of Supplier Process again. If the new supplier wishes to continue with the registration they will be able to move to the new supplier, and the old supplier will no longer be able to object to the transfer on the grounds of debt.

What are the options available?

Ofreg has been considering what the options might be for domestic customers who are in debt, and what processes might need to be developed to accommodate the Change of Supplier Process. Several options are outlined below. These options were suggested to Ofgem in a recent consultation paper and include:

1. Blocking all transfers on the grounds of debt;
2. No objections on the grounds of debt;
3. Allow customers to assign their debt to their new supplier, provided that the new supplier is willing to take on their debt;
4. Allow customers to assign their debt to their new supplier, and the new supplier must accept that debt;
5. ‘Customer Friendly’ Option;
6. Creation of a new organisation to which customers in debt are transferred – a “supplier of customers in debt”.

These options are discussed in greater detail below.

1. Blocking all transfers on the grounds of debt

Under this arrangement, customers with debt must first pay any money owing to their current supplier before they are permitted to switch suppliers.

Having this debt objection facility would make it difficult for customers to evade payment. However, the definition does not cover all customers in debt and so many customers, such as those on direct debit that have been paying less than their usage or those who are billed quarterly and have not received a bill for nearly three months will still able to switch suppliers and leave a debt with the previous supplier. However, it is not recommended that the definition of debt be expanded to include all customers that have taken energy without yet paying, as this could potentially give suppliers less of an incentive to get on top of the debt issue.

As a definition of debt has not yet been established, it cannot be estimated at this stage the effect of this option on all customers.

It might also be argued that because companies would have the ability to retain a customer that owes them money, there is insufficient pressure on them to collect debt in a timely fashion as this would prevent customers in debt being able to switch supplier.

2. No objections on the grounds of debt.

Under this arrangement, current suppliers would be unable to object to one of their customers switching to another supplier because they have debt outstanding. The customer would be allowed to switch to a new supplier, leaving their debt with their old supplier. The old supplier would then have to pursue the outstanding debt.

This option would maximise customers' ability to switch and would provide an incentive to suppliers not to let its customers get into debt in the first place.

However, the inexistence of debt objections would allow many more customers to evade payment by switching to another supplier without paying, making debt collection more difficult for the suppliers and increasing the persistence of "debt-hopping" amongst customers. This is likely to increase the overall debt levels within the industry as a whole.

The risk of increased numbers of customers leaving with outstanding debt will place extra incentives on suppliers to reduce the number of customers in debt, and the size of each of those debts, which should hopefully result in reduced overall customer debt levels. Methods which suppliers could use to reduce the level of debt may include more frequent billing, credit vetting, security deposits, targeted tariffs, employing telephone and text reminders, moving quicker to debt collection agencies and more widespread use of prepayment meters for customers or premises which have a history of poor payment. A targeted tariff exists when high risk customers such as those with a history of bad payments get charged more. It acts as an incentive for customers not to get into debt in the first place, and also provides compensation for suppliers taking on bad customers (in the same way that banks/credit providers charge customers with a poor credit history higher interest rates). However, experience in GB has shown that greater vigilance has historically produced greater numbers of customer complaints, from which the GB companies have sought shy because of the adverse publicity and potential political reactions.

This approach theoretically maximises customers' ability to switch. However actual switching is likely to be moderated by security deposits required by the incoming supplier or targeted tariffs for customers with poor credit ratings. This may mean that those in debt are offered worse deals than the rest of the population and this may result in them being unable to switch supplier.

It is essential to consider Vulnerable Customers in this context. Vulnerable Customers who switch suppliers leaving a debt behind will become just another debtor to the previous supplier and will probably be pursued by that supplier in the same way as all other debtors. It is essential that the process for Change of Supplier for customers in debt does not disadvantage Vulnerable Customers. These customers need to be protected, and we need to ensure that the process adopted does not disadvantage them further.

3. **Allow customers to assign their debt to their new supplier provided that the new supplier is willing to take on their debt.**

With this solution, a current supplier would be able to object to customer switching on the grounds of debt. However, it would be possible for an agreement to be reached to transfer the debt to the new supplier, and the objection withdrawn. This solution would allow those customers who are in debt to switch suppliers, and the outgoing supplier to recover any money owing to it. While this potentially maximises a customer's ability to switch, suppliers taking on new customers with debt may want to ask for security deposits from these customers or put them on prepayment meters, which in turn may cause the customer to withdraw the transfer request.

It is proposed that the new process for the Change of Supplier would be as outlined below.

When the new supplier (Supplier B) signs up a customer and informs NIE T&D, NIE T&D will then send a message to the outgoing supplier (Supplier A) to inform them a request has been made from an incoming supplier to supply that premises. On receipt of this notification, Supplier A establishes if there is an outstanding debt. If there is, Supplier A can raise an objection with NIE T&D, who will then inform Supplier B of the objection.

Supplier A must then send a letter to the customer within 3 working days notifying them that an objection has been made (a sample letter is included in Annex A) and the reason for the objection. The letter must include the following three options available to the customer.

- If the debt is not repaid in full , the customer must remain with Supplier A;
- Pay Supplier A off in full and begin the Change of Supplier process again;

- Explore the possibility of debt assignment by contacting Supplier B.

If the third option is chosen, the customer will make contact with Supplier B to establish if they agree to explore the debt assignment option. If the customer and supplier agree for the debt to be assigned, Supplier B will request the debt information from Supplier A. Once Supplier A sends the details of the debt to Supplier B, Supplier B evaluates it and decides on its preferred course of action. Supplier B then contacts the customer to inform them if the transfer is to go ahead. If the transfer is not going ahead, Supplier B advises the customer to contact Supplier A to try and arrange some method for paying off their debt. If the transfer is to go ahead, Supplier B will also contact the Supplier A to inform them that they wish to proceed. Supplier B will again contact NIE T&D to ask for the customer to be registered with them, who then forward the loss message to Supplier A. On receipt of the loss message, Supplier A will no longer object.

After the final meter read, Supplier A will issue a final account to the customer but will inform them that the balance has been transferred to Supplier B, who will then recover this money from the customer. Supplier A will also send details of the final account to Supplier B.

It may be suitable for the debt assignment from Supplier A to Supplier B to be “factored” to give Supplier B an incentive to take on the customer. For example, if the factoring level was 90%, Supplier B would only have to pay Supplier A 90% of the customer’s debt, but would be able to recover the full amount from the customer, over a period of time, once the transfer takes place. This would potentially lower the costs to both suppliers as the 10% of the debt which Supplier A loses to Supplier B might be lower than what it would have cost to recover the debt via debt collection agencies and the courts.

However, this solution may not provide suppliers with an incentive to reduce the level of customer debts, as they will still be able to recover the majority of any money owed to them. They may even try to encourage some customers to switch so as they can be paid.

4. Allow customers to assign their debt and the incoming supplier must take on that debt.

This solution is not dissimilar to the option outlined above (Option 3), apart from the fact that a new supplier has no choice but to take on the customer once signed up if they later discover that the customer has debt. The customer must however, be placed on a prepayment meter with the new supplier until they have paid off their debt.

This would give customers greater ability to switch as the incoming supplier would not be allowed to turn them down.

Under this solution, the new Supplier must be made aware that the customer is in debt, and the prepayment meter must be installed before the Change of Supplier Process is completed.

5. "Customer Friendly" Option

With this option, a supplier would not be able to object to a customer switching to another supplier because they are in debt. Furthermore, suppliers would have to offer a tariff to customers switching to them that is no more expensive than the standard credit tariff. Credit vetting of customers would not be allowed and security deposits or any form of up front payment would also be prohibited.

These arrangements would have the key advantage to customers that they can freely switch between suppliers and choose the cheapest supplier at any time without restriction. It would also boost switching rates, which should promote competitive pricing behaviour between suppliers. Customers would however be able to switch supplier very easily leaving old debts behind.

It would be essential under these conditions for suppliers to be more innovative and vigilant about debt recovery and prevention. However, Vulnerable Customers who switch to another supplier and leave a debt behind would be pursued by that supplier in the same way as all other debtors.

6. Supplier of customers in debt (SOCID)

Under this arrangement, customers whose debt is greater than a certain amount and over a certain age are transferred automatically to the Supplier of Customers in Debt (SOCID). The customer is warned before the transfer takes place and given a final opportunity to settle their debt. If the customer settles their bill, they will be allowed to remain within the competitive market.

Debt objections would be removed and the SOCID would pay the existing supplier the outstanding debt upon transfer. This would have the advantage of allowing the current supplier to recover any monies owing to them and make it difficult for customers to evade payment, as they must remain with the SOCID until they settle their outstanding debt. However, the fact that suppliers are guaranteed that they will be paid by the SOCID may not incentivise them to prevent customers getting into debt in the first place.

The definition of a customer who will be transferred to the SOCID is very important and would need careful consideration to avoid customers being repeatedly switched between the SOCID and the competitive market. The tariffs offered by the SOCID would generally be higher than in the competitive market to deal with the higher levels of debt carried by the SOCID, but would be regulated and transparent.

The lower levels of debt being handled by the competitive suppliers would give them scope to reduce tariffs in the competitive market. Another key advantage is that it should improve incentives on suppliers to prevent customers going into debt since a failure to do so would result in the loss of that customer to the SOCID. This might have a large impact on a supplier if significant numbers were switched to the SOCID.

However, this arrangement removes customers in debt from the competitive market for a period. There may also be a stigma attached to consumers who are supplied by the SOCID. There would also need to be considerations taken of data protection issues under this option. Customers may have to agree to the transfer.

This option also reduces customers' ability to switch as those in debt in excess of a certain threshold are automatically transferred to the SOCID and those that are supplied by the SOCID are unable to switch until they have paid off their debts.

Another potential problem arises if the SOCID is a great success and significantly reduces the number of customers in debt. The SOCID will be left with a relatively small number of customers and the cost per customer of servicing them will be high. If the regulated tariff were not high enough then it would need to be funded from the industry.

Special rules would have to put in place for Vulnerable Customers to be treated with due consideration and give them at least the same protection as they have at present with the competitive suppliers.

While this option offers suppliers a guarantor against bad debts, by adopting this option it may be an acceptance that competitive markets have failed a section of consumers.

What must be achieved by any arrangements for the domestic market?

Ofreg has considered several options for customer switching for those customers who are in debt. However, it should be noted that these should be taken as 'last resort' measures and suppliers should all be vigilant in their debt collection policies. With increasing numbers of customers being able to switch supplier, it is essential that suppliers are innovative in their approach to collecting monies due.

Suppliers should be working to ensure that customers are prevented from falling into debt in the first place. Customers in debt will not be able to avail so freely of the competitive market and will most likely result in them paying higher tariffs.

In order to reduce overall debt levels suppliers should seek new measures by which they can recoup any money owing to them in a quick and efficient manner. The higher the debt levels of society, the higher the likelihood that more of these will be written off, possible resulting in higher tariffs for others as suppliers try to recover the lost profits.

Suppliers must be vigilant in trying to prevent customers evading payment and suppliers must be able to recoup any monies owing to them. Customers must not be allowed to evade payment forever. Customers evading payment represent a huge cost to the energy sector and push up prices for the rest of the consumers in the market.

Whilst trying to minimise debt levels, it is important that Vulnerable Customers such as the disabled and elderly are given extra special care by energy companies, especially in the winter. Every effort should be made to ensure that these customers do not suffer from disruption of supply. Energy companies should take extra consideration of ability to pay when attempting to recover debt from Vulnerable Customers.

Through increased competition and maximisation of ability to switch supplier, customers should be able to benefit from the best deals and lowest prices in the market. If this ability is limited, the effects of competition are not maximised and suppliers may not be incentivised to price as competitively as they would in a fully competitive market.

CHANGE OF SUPPLIER AND CHANGE OF TENANCY

There must be provisions in place to deal with occurrences when the change of supplier is accompanied by a change in tenancy.

If registering a customer also involves a Change of Tenancy, it is proposed that the following information will be asked for:

- Previous supplier;
- Customer Name;
- Previous MPRN/Customer Number and/or previous address.

The previous supplier will then receive notification that they have lost that customer, together with relevant information for debt checking purposes only. If it transpires that the customer has an outstanding debt which he is unwilling to settle, then suppliers will agree to either

- Allow debt to be transferred; or
- Register back to the previous supplier (of the customer) at an agreed date.

NEXT STEPS

Ofreg welcomes any comments on the proposals laid out in this consultation, along with any other suggestions which respondents might have.

Comments should be returned to Kenny Dane by 17 July 2006 at the following address:

Kenny Dane
Office for the Regulation of Electricity and Gas
Queens House
14 Queen Street
Belfast
BT1 6ED

Tel: 028 9031 6646
Fax: 028 9131 1740
Email: kenneth.dane@ofregni.gov.uk.

Please provide a one page summary and clearly label your response as confidential if you do not wish it to be published.

Annex A – Sample Objection letter to Customer

Mr AN Other
41 Main Street
Any Town
Any County
ABC 123

DD Month Year

Dear Mr Other
Re: Customer Reference Number 987654321

We are sorry to hear that you have chosen to switch your energy supply to another company. At present, there is a balance outstanding on your account and as a result we have objected to your transfer.

There are now a number of options available to you. You can decide to stay with [our name], and continue to pay off your debt as previously agreed. Alternatively, you can arrange to pay us what you owe. Once the debt has been cleared, you will be free to transfer to the company of your choice. If you would like to do this, please call us on 01234 56789.

You may also be able to transfer the debt to your preferred supplier, but they must also be willing to do this. If this prospect interests you, you should contact them to discuss this option in more detail. They will ask you for details of your outstanding balance and decide whether they still wish to take you on.

If you would like any further help or advice regarding this matter, please call us on 01234 56789.

Yours sincerely

Mr P Erson
Registrations Manager.