ESB Customer Supply Response
to
CER Consultation on Debt Blocking
CER/09/136

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Background

The issue of Debt Management as stated in the current consultation has been consulted and decided upon previously[1]. The Commission concluded that the change of supplier (COS) process should not impose restrictions on customers in arrears from switching suppliers and also listed instruments available to suppliers to mitigate debt such as deposit payments, direct debits, prepayment meters and de-energisation.

The Energy Industry is very important to the overall economy and all participants are controlled via regulatory licences. The current electricity market structure imposes obligations on all participants but suppliers incur liabilities for upstream costs which represent more than 90% of the final customer's bill. Stringent conditions apply to suppliers regarding Generation, TUoS and DUoS payments allied with requirements to have sufficient but expensive credit facilities/banking guarantees in place. However, it is the supplier who takes the full brunt of a bad debt left unpaid by a final customer even though a supplier's costs typically only represent a small proportion of the customer's bill.

Moreover, suppliers operate to relatively low margins so bad debts can have a significant impact on profits. Market opening in recent years, which is a welcome development supported by ESB Customer Supply (ESBCS), has introduced an increased risk of bad debts. As the costs of bad debts ultimately are borne by all customers, ESBCS believes that it is in the interest of all, that suppliers are enabled to take all reasonable measures to prevent and reduce bad debts and their ultimate impact on all customers.

High levels of supplier debt could result in suppliers defaulting on their payment obligations and in turn exiting from the market. It could also act as a barrier to entry in preventing new suppliers entering the market.

ESBCS concurs with the views expressed by other energy suppliers that the current debt management instruments (security deposits; direct debits; prepayment meters; credit checks and de-energisations) are insufficient for current market conditions and strongly supports the proposal to allow for a change of supplier (COS) objection where a business customer has an aged debt or defaults on a contract.

CER Concerns

CER has raised some concerns regarding the Debt Blocking Proposal.

Debt Collection Issues are common to all Industries

One of these concerns is that bad debt issues are common to all industries and not specific to the energy sector. The energy sector is a regulated industry with a small number of participants in the retail market and direct comparisons with other competitive industries is not appropriate. Suppliers who wish to participate are required to adhere to licence and market obligations.

[1] CER/04/044: 'Management of Customer Arrears' and CER/05/060: 'Management of Customer Payments and Arrears'

Commercial entities in competitive markets can use many instruments to protect their business from bad debt such as:

- differentiated pricing strategies for customer categories, often related to credit worthiness
- discounts for prompt payment
- penalties for late payment
- other more stringent terms – prepayment, COD, etc.
- refusal to continue to supply
- retrieval of goods
- obtaining personal guarantees

An important consideration also, is the scale of a supply business within the industry and the fact that a supply business has liabilities for upstream costs – e.g. in the case of electricity this includes generation, transmission and distribution charges which represent more than 90% of the customer's bill. The SEM has strict credit control requirements on suppliers in respect of generator payments. In addition conditions regarding TUoS and DUoS payments also have to be adhered to. Suppliers are also obliged to have appropriate credit facilities/banking guarantees in place. Under the current structures it is the suppliers who take the full brunt of a bad debt.

Provision being sought by Energy industry not being sought by other utilities

Other utilities have more effective debt collection instruments where service can be withdrawn or disconnected swiftly, remotely and/or automatically for unpaid bills. This is particularly evident in the telecommunications industry where, in addition, they also have some protection in that part of the service may be provided on an advance payment basis (e.g. telecoms/broadband line rental). Energy services, and in particular electricity, are more critical services with correctly inbuilt safeguards to ensure that customers are only disconnected as a last resort. While these safeguards protect those that have genuine difficulties with paying, others will and do exploit these safeguards to avoid paying their debt.

Work in Relation to Revenue Protection Procedures

CER have suggested that supplier concerns regarding increasing debt '…could be addressed in the continued work on the revenue protection procedures being undertaken...'. While ESBCS supports the continued efforts to introduce effective Revenue Protection measures, including updated legislation, such a move might actually increase the level of outstanding debt which has to be collected by suppliers. Such debt is potentially more difficult to collect and UoS charges may have to be paid before such debt is fully recovered from the customer. It may be worth considering the introduction of an objection to a COS if metering equipment is tampered with, as applies in France.

ERGEG Report on Obstacles to Supplier Switching April 2008

As outlined in the consultation paper ERGEG's 2008 report[2] on obstacles to customer switching in the electricity market states that the switching process may be divided into three stages:

1. Information gathering – customer searches for information on prices, products, contracts and suppliers

[2] 'Obstacles to supplier switching in the electricity retail market'; reference E08-RMF-0603 April 2008

2. The supplier switching procedure - lasts from when the customer signs a new contract and the customer/new supplier have collected all the required data until the agreed switch-over date and
3. Execution of the switch, delay or cancellation – takes into account where there is an error, delay or cancellation. The third stage ends when the customer receives a confirmation letter from the new supplier and/or the first new bill **and additionally when the account with the former supplier has been settled.**

The introduction of a debt blocking objection would assist in the finalisation of the third stage – if debt remains unpaid to the original supplier, can the switch be deemed to be successful?

ERGEG's report is based on questionnaire responses from 21 of the 28 EU Regulators. Based on responses received the typical duration of the switching process is 1-2 months with only four responding that their switching process and data exchanges were not satisfactory. A range of different obstacles to switching were highlighted in the report (e.g. switching at only certain times of the month, lack of efficient messaging between suppliers and DSO's, DSO obstacles, non-standard data formats, lack of economic incentive to switch etc.). None of these obstacles apply in the COS process in the Republic of Ireland as evidenced by the successful introduction of new systems in 2005. These have proven to be very effective, particularly in recent months where the volume of switching has increased significantly.

Debt Blocking procedures in NI and UK
The consultation paper states that debt blocking procedures are in place in NI (in respect of business customers) and the UK (business and domestic).
NI: In order to enhance harmonisation between NI and ROI, a stated aim of the Regulatory Authorities, similar processes (including debt blocking) in both jurisdictions should be introduced. This would also be consistent with the EU's Third Package aim of promoting cross-border collaboration.
UK: In a liberalised electricity market one of the often cited measurements of how well the market is functioning is the switching rate. The ERGEG report mentioned above shows the switching rates for the respondent countries to the questionnaire (Table 13 – switching rates in 2006). The UK, which has debt blocking procedures in place, has the highest level of customer switching at 18%. The level of customer switching for the remaining countries is much lower than this. This is confirmation that having a debt blocking process in place doesn't constrict customer switching and is not inconsistent with the promotion of open and competitive markets.

CER Proposals
Proposal 1: Maintain the Status Quo
ESBCS is strongly of the view that maintaining the status quo is unacceptable. The current electricity market structure imposes strict obligations on all participants but suppliers incur liabilities for upstream costs which represent more than 90% of the final customer's bill. Stringent conditions apply to suppliers regarding Generation, TUoS and DUoS payments allied with requirements to have sufficient but expensive credit facilities/banking guarantees in place. However, it is suppliers who take the full brunt of a bad debt left unpaid by a final customer even though a supplier's costs typically only represent a small proportion of the customer's bill.

Proposal 2: Introduce process changes
If debt blocking is not introduced ESBCS's view is that the change proposed, i.e. the 21 day change of supplier is enacted upon receipt by MRSO of a first notice of disconnection, is too limited. There could also be a significant impact in the market by increasing the level of de-energisations. Other process changes, previously suggested in 2004/5, that could be considered may include:

- transferring outstanding debt to the new supplier who collects the debt on the previous supplier's behalf
- restricting the number of COS's a customer can make during a specific period of time

Proposal 3: Introduce Debt blocking for Business Customers
ESBCS fully supports this proposal.

Practical Issues to be addressed highlighted by CER regarding Proposal 3
Issue: Who would assess, monitor and police the debt blocking process and ensure that such a system is not abused by suppliers?
ESBCS Comment: An effective governance regime to include a concise mandatory code of practice incorporating the guidelines of good practice mentioned in the ERGEG report and an annual compliance statement by all suppliers.

Issue: As with the experience in the UK, would the debt blocking system in Ireland have to be continually re-examined and altered?
ESBCS Comment: This would not be the case if an effective mandatory code of practice is adopted. Suppliers should be able to apply, in a proportionate manner, a range of instruments to manage their specific issues on debt.

Issue: What would classify as a default of contract?
ESBCS Comment: A default of contract should be limited to an aged unpaid debt (e.g. greater than 30 days) or the early termination of a fixed term contract where a supplier has forward power purchase in place. It should not include evergreen contracts and supplier terms and conditions should clearly set out full details.

Issue: What would be the debt threshold?
ESBCS Comment: An aged debt approach (e.g. greater than 30 days) in conjunction with a minimum financial threshold should apply.

Issue: Would suppliers be adequately incentivised to manage risk and minimise customer debt?
ESBCS Comment: It is in all suppliers' interest to minimise debt levels and ensure that adequate cash flow, which is critical for the successful operation of a business, is maintained. The debt blocking proposal is one of a number of options in dealing with outstanding debt. ESBCS has and will continually strive to keep debt levels to a minimum while also protecting vulnerable customers.

Issue: Would additional requirements need to be placed on suppliers to help customers who they have debt blocked pay back what they owe, e.g. payment plans?

ESBCS Comment: ESBCS has procedures in place for many years in respect of dealing with defaulting customers which includes payment plans. We would not envisage a need for additional requirements if debt blocking for commercial customers is introduced.

Issue: How could having a debt blocking procedure be reconciled with the ERGEG recommendation?
ESBCS Comment: ESBCS believes that the introduction of a debt blocking procedure with an effective mandatory code of practice applicable to all suppliers would enhance the overall COS process by ensuring that the third stage of the switching process is handled quickly and with the agreement of all parties. Where a debt is outstanding, arrangements can be made quickly with the customer to pay or arrange a payment plan. This should ensure that the time line for stage three is minimised and should prevent the minority 'rogue' customers from abusing the COS process for their own benefit to the detriment of all customers. Higher debt levels ultimately result in higher energy prices for all customers.

Issue: In approving the implementation of a debt blocking procedure, the Commission would be tacitly accepting that supplier allegations of customer debt are accurate. Would this affect the Commission's dispute adjudication?
ESBCS Comment: We have a high level of confidence in our own and CER's complaints adjudication process and see no reason why this would change with the introduction of a debt blocking process for business customers. If a dispute relates to debt blocking procedures then the supplier will be obliged to demonstrate that they have adhered to the rules as specified in the proposed code of practice. If the Commission is not minded to have a code of practice, then in a dispute situation the supplier will still need to demonstrate that the customer has been fairly treated and in particular that the allegation of debt can be substantiated.

Issue: What would be the cost of system changes to introduce debt blocking?
ESBCS Response: In respect of the Market Systems a market schema change would be required with some market message changes. These would be of medium complexity but should be implementable within a relatively short time period. We do not believe the associated cost would be prohibitive.

Issue: What would be the impact of introducing debt blocking on the overall debt levels in the energy industry?
ESBCS Comment: Due to the national economic climate debt levels have increased very significantly and the current debt management instruments are insufficient. It is not possible to evaluate the likely impact on overall debt levels in the industry but it will certainly assist in keeping them lower than they unquestionably would be in the current economic climate. In addition, any potential loophole for customers to move without penalty for non-payment of debt between suppliers will be closed. Our view is that a regulated solution to current difficulties is required.

Issue: Would pressure be put on the Commission to introduce debt blocking for domestic customers as well as debt blocking for business customers? The proposal set out in 2008 suggested an aged debt threshold of €500; however, this low threshold would presumably encapsulate some domestic customers.

<u>ESBCS Comment:</u> The circumstances giving rise to debt for domestic customers aren't necessarily similar to those for businesses and ESBCS does not support the extension of debt blocking for residential customers at this time.