



**Response by Energia to Commission for
Energy Regulation Consultation Paper
CER/11/044**

Customer Bad Debt in Electricity & Gas Markets

01 April 2011

1. Introduction

Energia welcomes this opportunity to respond to the Commission for Energy Regulation (CER) consultation on customer bad debts in electricity and gas market. This is a very important issue for suppliers and customers, and one that represents the final pillar in CER's three pillar approach (disconnections, prepayment meters and debt hopping) to debt issues in the energy market. As significant progress has already been made in respect of these first two pillars, it is imperative that a timely, targeted and appropriate solution is introduced to address this persistent problem which has adverse impacts for suppliers, competition and customers in electricity and gas markets. As indicated by 2009 consultation on this issue (CER/09/136) and the associated responses by market participants, an appropriate solution to this issue is overdue.

The remainder of this response is structured to provide a summary of Energia's views on the issues outlined in the consultation paper and which CER have sought views (Section 2). Section 3 provides detailed responses to the seven specific questions contained in the consultation paper.

2. Summary of response

Debt hopping represents the exploitation by certain customers of what is effectively a loophole in the market rules. In light of CER's recent increased activity in the area of customer debt (disconnections & prepayment meters), a regulatory approach to this issue is both appropriate and consistent with the CER's principal objective of protecting customers through, where possible, promoting effective competition. Customer switching for the purpose of debt hopping is not reflective of effective competition and is in fact harmful to suppliers, customers and the overall level and viability of competition in the market. Arguments to the contrary are misguided, patently wrong and reflect significant misunderstanding of competition and promotion of customers' interests.

The introductory remarks to this response have indicated that an appropriate solution to the practice of debt hopping is overdue. To this end, Energia proposes that a solution to this problem be introduced as a matter of urgency for both the electricity and gas markets. Only to the extent that it is possible should both markets be progressed in parallel and Energia caution against any approach that requires unnecessary delay in rolling out the solution for one market (electricity) due to a delay in the second market (gas) due to required system changes, or other such measures.

Energia's comments on this consultation paper are premised on our significant experience of the business market and on our observations of the domestic market. These views can be summarised as follows;

- The introduction of debt blocking for business customers is supported. As the only available option to address the issue of debt hopping in the domestic market, debt flagging is supported.
- Universal thresholds for debt should be adopted for all customers at €250 and 28 days. For customers in debt below this threshold, the timeframe should be extended to 180 days.
- LEU and LDM/DM customers should be included as part of an appropriate, proportionate, efficient and streamlined approach to addressing this issue to the benefit of suppliers, customers and competition.
- Further clarity and reference to official sources/advice is considered to be important for the purpose of agreement on the necessity of an opt-in approach to passing information on customers' debt to a third party. Any requirement to follow an opt-in approach is likely to significantly diminish the effectiveness of any debt flagging solution to the point of rendering it ineffective.
- There is no adverse impact on competition attributable to implementing a debt blocking/flagging solution in the market. If switching is an accepted metric within CER of competition, then it is imperative that the switching in the market reflects real competition and not debt avoidance. Switching for the purpose of debt hopping is not indicative of real and effective competition. Moreover, switching for the purpose of debt hopping adversely impacts competition and the products suppliers can offer to customers as the current allowed practice effectively socialises the bad debts of customers who have engaged in debt hopping.
- Finally, Energia is supportive of the proposal to introduce a Code of Practice and we look forward to engaging with the CER in development of same.

3. Response to specific consultation questions

Energia's comments in relation to the specific questions posed in the consultation paper are provided in the following section.

Q1. Respondents are invited to comment on;

- 1) the proposal to introduce debt blocking or debt flagging for business customers;***
- 2) the proposal to introduce debt flagging for domestic customers.***

As already noted, Energia considers these proposals to be both important for suppliers in the market and overdue from a policy perspective. CER has moved in recent months to address two of the three pillars of an overall debt strategy, namely disconnections and prepay meters. The issue of debt hopping is prevalent and to date has not been addressed. It is only when all three pillars of the strategy are in place will customers begin to realise the benefits associated with each of the interrelated pillars.

To this end, Energia supports the introduction of measures to, as far as possible, deal with the issue of debt hopping in the market to the benefit of all customers. In relation to business customers, Energia supports the introduction of debt blocking. Although Energia is not presently active in the domestic market, we recognise the need for commensurate measures to be taken to address this issue in the domestic market and as the only option forwarded by CER, the introduction of debt flagging is supported.

From the consultation paper, Energia notes the CER's preference for a debt notification flag over a debt blocking mechanism as a means to address the current issue of debt hopping in the business (and domestic) market. In relation to debt blocking, CER have stated;

"[H]owever, this automatically biases the objections process in favour of the old supplier, removing all customer choice and hindering their right to switch. It introduces an impediment to an efficient and seamless switching process and in this regard may not be in keeping with the stated objectives of the Third Package. Potentially, it leaves the switching process open to abuse by suppliers who may invoke the objection for reasons other than debt management."

We wish to highlight a number of issues with this statement that we consider to render it ineffective and inappropriate as a criticism of the proposal to introduce a debt blocking mechanism. Firstly, in instances where a customer has a significant outstanding debt and there is a possibility of this customer leaving their old supplier with this debt by debt hopping to a new supplier, such a customer's right to switch is somewhat questionable. Particularly when by doing so the customer is in violation of the supplier's terms and conditions of supply.

Secondly, to consider a measure that has the singular objective of preventing customers from abusing what is tantamount to a loophole in the current arrangement as being an "*impediment to an efficient and seamless switching process*", wrongly characterises the problem and displays a misunderstanding of the underlying issue and its impacts. Facilitation of customer switching is a fundamental aspect of a competitive market and particularly important in a market that had until recently been monopolised. Facilitation of customers' activities that are illegal and for which companies, in theory, have recourse to the courts over is irresponsible and as is the case under the current arrangements, should be prohibited.

It must be remembered that the only customers that will be prevented from switching are those looking to, knowingly or unknowingly, leave a considerable debt with their previous supplier unpaid. Under no basis should this be permitted in energy markets or elsewhere in the economy. One must also consider the impact of this behaviour under the current arrangements is effectively to socialise the cost of debt hopping with suppliers forced to incur increased risk/debt management costs as well as realised impairments for bad debts. Customer switching that has as its objective debt hopping, is not indicative of competition but rather harmful to competition in the market and to the vast majority of customers.

Thirdly, it is difficult to conceive of why a debt blocking measure may, according to CER, not be in keeping with the stated objectives of the Third Package. Article 3.5(a) of Directive 2009/72/EC states¹;

“5. Member States shall ensure that;

(a) where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected by the operator(s) within three weeks;

(b)...

Member States shall ensure that the rights referred to in the points (a) and (b) are granted to customers in a non-discriminatory manner as regards costs, effort and time”.

It appears to be clear from this Article of the Directive that, similar to the arguments already made herein, customers are obliged to adhere to their contractual obligations when seeking to rely on their rights in relation to the Third Package. This is a sensible approach, although we note CER arguments both here and as stated in the past have not been consistent with this approach and as we have highlighted, the forwarded arguments are somewhat inappropriate and ineffective.

Finally, Energia consider the potential abuse of a debt blocking mechanism by any supplier to be a short-sighted and anti-competitive action that should have punitive consequences. To address this concern Energia is fully supportive of the introduction of a Code of Practice around any debt blocking/debt notification measures adopted and would consider there to be an important oversight role for CER in relation to this, as there is for existing industry Codes of Practice (e.g. disconnections). As suppliers adhere to the existing Codes of Practice, it would be up to the CER to provide additional rationale for why, in their view, continued adherence to industry Codes of Practice would be unlikely should such measures to prevent debt hopping were introduced.

Q2. Respondents are invited to comment on;

1) the proposal to allow debt blocking/debt notification for small and medium sized businesses in electricity as well as all NDM business customers in the gas market. Are you in favour of the proposal?

2) the proposal not to allow debt objections for Large Energy Users (LEUs) or DM/LDM in the gas market?

Outline reasons for agreement or disagreement.

For the reasons outlined herein, Energia supports the introduction of debt blocking for small and medium sized businesses in electricity, as well as all NDM business customers in the gas market. Nevertheless, should the CER's preferred position remain unchanged, (i.e. a preference for debt notification), we would acknowledge this to be a positive move by the CER to address the issue of debt hopping.

On the proposal not to allow debt objections for Large Energy Users (LEUs) or DM/LDM in the gas market, it is difficult to understand the CER's position on this

¹ For Directive 2009/73/EC (gas market), the relevant article is Article 3.6(a).

matter and how such a stance is consistent, in principle, with that the proposed course of action in relation to all other customers. The principle relating to whether CER should continue to ignore a loophole in the prevailing market arrangements that permits customers, irrespective of size, to disregard their debt to a supplier for goods that they have consumed is universal. If CER consider it necessary to implement appropriate safeguards to prevent suppliers and the vast majority of customers from being exposed to this risk, the size of the customer or the potential monies to be recovered is somewhat immaterial.

It should also not be forgotten that the increased costs to be borne by suppliers in terms of risk management, realised bad debts and potential legal fees are all effectively socialised by suppliers who will seek to recover all costs from their overall customer base. The relative size of both LEUs or DM/LDM customers and the potential monies to be recovered are considered immaterial when considering the delay and cost associated with commercial remedies open to suppliers in relation to these customers, which will invariably be recourse to the legal system.

Pre-empting the issues contained in Question 3, it is imperative that CER understand and acknowledge the implications of contract default by LEUs or DM/LDM for suppliers who have hedged positions for their respective customers. This represents a potentially significant additional cost for suppliers that instead of indicating increased competition, is detrimental to viable long term competition.

Q3. Respondents are invited to comment on the proposed grounds for raising an objection or notification;

- 1) Do you consider that it is appropriate to raise an objection or notification on the grounds of contract default? Is it an appropriate for this provision to apply for both business and domestic customers?***
- 2) Do you consider that the proposed debt thresholds and timings in section b are appropriate? Do you think the monetary thresholds should be the same or different for electricity and gas?***
- 3) Do you consider that it is necessary, as outlined in section c above, to allow for objections or notifications to be raised for business customers for sums below the threshold where debt has remained unpaid for a longer period of time?***
- 4) Respondents are invited to propose alternative grounds or suggested modifications to the grounds outlined above?***

It is Energia's considered view, with respect to all business customers, that it is appropriate and proportionate for suppliers to raise an objection in instances of contract default². The introduction of notification for contract default would at best have a minimal impact on the current situation, particularly with respect to larger customers. In many instances there may be a commercial benefit for a new supplier

² For the purpose of this consultation and the ultimate objective of achieving a pragmatic and workable solution, we consider it appropriate in this context to consider contract default as occurrences of customers leaving their supplier before the expiry period of their contract. This is consistent with the view of CER expressed in the consultation paper.

to take on business customers (particularly larger customers) with a running contract with another supplier (or debt) under stringent terms and conditions, even with notification. As already noted, this may leave the 'old' supplier with significant costs (e.g. hedging costs) that will effectively inhibit this supplier's efforts to price competitively in the market, ultimately to the detriment of consumers. Therefore, it is important that suppliers have recourse to objection in instances of contract default and this should apply for all customers, including LEUs and LDM/DM customers. The exclusion of such customers from the enduring solution would delay and greatly increase the cost of resolving such issues through recourse to legal means that are already available to all suppliers.

To the extent that fixed term contract and contract default are prevalent issues in the domestic market, objection would be considered to be a reasonable approach to similarly adopt.

In relation to the debt thresholds and timings proposed in the consultation paper, Energia support the 28 day threshold and consider it appropriate for suppliers to block/raise a flag immediately after this threshold is breached. Should a set period of grace be applied, this would effectively extend the threshold beyond the 28 days considered to be appropriate. A question not posed in the consultation paper but important to acknowledge nonetheless is the time a supplier should have to respond to an objection/notification. In relation to this issue, 5 days is considered appropriate.

On the timing thresholds for domestic customers, there is no rationale provided in the consultation paper as to why the threshold should be doubled from 28 days to 56 days. Notwithstanding this omission but rather being cognisant of the timings around customer debt and disconnections, we consider a threshold of 28 days to be appropriate for all customers.

In relation to the monetary thresholds proposed, Energia is calling for a universal monetary threshold of €250 to be applied to all customers; domestic/residential and electricity/gas.

On the timescale for smaller debts, Energia supports the introduction of this further category of customer but considers there to be a need to modify the proposals for both the monetary and time thresholds to be applied to these customers. We consider it appropriate to include all customers with monies outstanding to suppliers, where these monies are outstanding for more than 180 days.

Q4. Respondents are invited to comment on the means of acquiring customer agreement to the information on debt being passed to a third party?

Having considered the consultation paper Energia note that this requirement to obtain customers' consent to allow for the transfer of personal information that is in a suppliers possession to a third party is applicable to domestic customers only. As such, and given Energia currently only supplies business customers, our comments are limited to a number of practical issues.

Firstly, it is necessary for suppliers and more importantly the CER to understand and communicate the specific requirements under Data Protection law. Notwithstanding the proposal contained in the consultation paper, absent reference to the relevant sections of Data Protection law and appropriate case law, there appears to be a fundamental clarification required as to whether customers can opt-out of potential changes to their terms and conditions (namely changing terms and conditions under the terms of the relevant Code of Practice to include relevant sections detailing the potential for information to be transferred), or whether explicit opt-in measures are required. In the case of the former, the introduction of a debt blocking/debt notification measure would address this important issue in a way that can be considered to be already somewhat overdue.

With respect to an opt-in provision, further clarification is likely to be required as to whether the blocking of a transfer is considered to fall within the definition of information sharing (as covered by the relevant sections of Data Protection law) as the information is held and viewed only by the existing supplier. However, without clarity on this issue one can conceive of an argument that the blocking, as an action signalling a significant bad debt, may constitute a material sharing of information.

Additionally, if CER's proposal is found to be the only possible approach by which to introduce debt flagging in the domestic market, there is an appreciable and real concern that the explicit opt-in nature of any measure adopted would render it largely ineffectual. The reasons for this are numerous and not limited to the following;

- For customers who switch;
 - There is no implied obligation on them to tick the box, therefore it is unlikely to cover all new customers and may introduce a significant moral hazard and/or adverse selection problem;
- For customers who have not switched;
 - Suppliers would be required to correspond with all customers (at a cost) requesting them to tick the box permitting the transfer of information. Not only are customers likely to be sceptical to such a provision but suppliers are at best likely to receive a single-digit percentage response rate.

Both of these examples highlight that under the proposal forwarded by CER in the consultation paper, the introduction of debt blocking/debt flagging applicable only to explicitly opted-in customers would be;

- Imperfect – it would likely cover only a small percentage of domestic customers and be subject to adverse selection and moral hazard problems.
- Inefficient – it would impose structures and procedures in the market that would only apply to a small sub-section of the market, despite the solution being required market-wide such that the costs of debt hopping are minimised and effective viable competition is allowed to develop; and,

- Ineffectual – it could not address the general issue suppliers are looking for CER to address, the issue of debt hopping.

Q5. What do you consider would be the impact on competition of a debt blocking or debt flagging solution?

To some extent Energia's view on this question have already been expressed; customer switching for the purpose of debt hopping is not indicative of competition, certainly not the type of competition the CER should be seeking to promote in accordance with their principal objective to protect the interests of consumers. It is therefore deemed to be incredible and extremely worrying that the CER have stated in the consultation paper that;

"[T]he introduction of debt blocking or debt flagging may impact on the level of switching taking place as customers may be unable to switch until their debt has been paid or unless a new supplier is willing to have the outstanding debt transferred."

This piece implies that CER support the practice of debt hopping and consider it to be a consequence of healthy competition in the market. Debt hopping is the blatant exploitation of a loophole in the market by certain customers who have effectively stolen from suppliers, an action that is detrimental to the interests of suppliers, customers and competition (as properly defined) in the market. The level of switching in the respective markets will only be impacted by the degree to which customers are seeking to switch supplier for the purpose of debt hopping. This is not a bad outcome for competition and is not one that the regulator should be offering as a counter to its introduction. Such an argument is misguided and misunderstood. Additionally, it is hard to see what one would find objectionable to preventing customers from switching until such time as a customer had cleared their outstanding debts with their supplier. One cannot conceivably consider such behaviour being tolerated in their local supermarket; this analogy is apt and often overlooked. Again, this line of argument from the CER is misguided and misunderstood.

The CER's line of argument may however be more indicative of the haste with which the price deregulation of electricity was pursued, seemingly at a cost if the switching inherent in the thresholds was driven by debt hopping behaviour. Appropriate procedures should be in place to ensure the gas Deregulation Roadmap is not potentially compromised by continued debt hopping and the conditions underlying price deregulation of the gas market are indicative of a truly competitive market.

Furthermore, debt blocking/debt flagging provides a mechanism to support effective competition in the market. CER recognise the potential benefits to customers of mitigating or reducing bad debt levels. This, along with other cost savings already identified, will ensure customers benefits from competition equitably and efficiently, and that the majority of customers are not burdened with the bad debts of those who engage in debt hopping.

Q6. What are your views on allowing for customer debts to be transferred between suppliers?

The transfer of customer debt between suppliers should not form part of a timely and necessary solution to this important issue. Debt blocking/flagging, for the reasons outlined herein, represents an important addition to the market, one that has increased importance in these economically straitened times and in light of CER's existing policies in relation to customer debt in the market. As stated numerous times elsewhere, suppliers actively engage with their customers to manage debts and ensure a workable solution of customers in financial difficulty. This would continue with the timely introduction of debt blocking/flagging in the market. Notwithstanding this, allowing for debt to be transferred between suppliers would likely have cost implications for suppliers and customers and could adversely impact on competition in the market by introduction of possible distortions to effective price competition.

In exceptional circumstances it may be possible to review this on a case-by-case basis and to this extent, suppliers to be provided with the flexibility to ensure innovative and appropriate outcomes are provided for customers in the market. However, we wish to highlight this should in no way take from or delay the implementation of a timely and necessary solution to this important issue for suppliers, as well as for customers and competition in the market.

One further issue that will need to be considered both in this context and more widely, is the treatment of energy efficiency investments made by businesses and domestic customers in a competitive market, particularly in light of Government proposals for 'pay-as-you-save' schemes. Depending on the policy and funding approach adopted, further steps may be required to ensure a second wave of debt hopping does not emerge in relation to monies owed to suppliers for any such investments. In instances where credit is not provided by suppliers but rather by a 'green bank' model, the transfer of this debt can reasonably be expected to be transferred between suppliers who would not have any exposure to this debt but rather would merely be acting as a conduit to recover repayments to the 'green bank'.

Q7. Respondents are invited to comment on the proposal to introduce a Code of Practice for a debt blocking or flagging process. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

Further to the comments already included as part of this submission, Energia fully supports the CER's proposal to introduce a Code of Practice for debt blocking/debt flagging processes. We look forward to engaging with the CER as part of the consultation process around the design of such a Code and would again call on this to be advanced in a timely manner to ensure the any possible delays to implementing a solution in the market is minimised.