

Mr. Maurice Stack,
Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.

1 April 2011.

via e-mail only

Dear Maurice,

Re: Consultation Paper on Bad Debt in Electricity and Gas Markets

The opportunity to comment on the Commission for Energy Regulation ("CER") consultation paper on bad debt in the electricity and gas markets – CER/11/044 is welcomed. Many of the introductory comments we make in this paper will be familiar from our last submission on this issue. The paper is long overdue. The CER notes that no decision on the previous consultation paper CER/09/136 – Debt Blocking was made on the basis that there was not "sufficient evidence from suppliers which definitively demonstrated the scale of the problem".

Since then there has been a further escalation of the problem. If the CER had taken note of what suppliers had highlighted, we are in no doubt that the scale of the problem would be much less than it is today. Although, we welcome the acknowledgement of the issue by the CER and the proposed measures, we strongly oppose confining the debt blocking or debt flagging proposals solely to low voltage business Customers in electricity market and all non-daily metered business Customers in the gas market. Simply put, the current proposals should not be approved, without including all business Customers in both gas and electricity.

The argument put forward by the CER that all business Customers above the proposed thresholds should seek recompense through normal commercial means is ludicrous. Why does the CER want suppliers in the retail industry to hand money over to the legal profession in resolving these issues, when there will be an industry approved methodology in place? We make more detailed comments on the proposals later in this submission.

This consultation is the third such paper the CER has consulted on with respect to the issue of managing arrears and debt blocking¹. This fact alone demonstrates how thorny a subject this is for industry. You are well aware of our view that we believe there should be arrangements in place to allow objections to a change of supplier in both gas and electricity. Suppliers have

¹ CER/04/044 – Management of Customer Arrears and CER/09/136 – Debt Blocking

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intimate knowledge of the detailed workings of the market and have highlighted their concerns with the no objection policy, going back to when competition first entered the market.

As we already noted, the problem has worsened over the past two years. The banking crisis has filtered its way into everyday business through the lack of credit from banks. This has put a severe strain on working capital, which has meant that a considerable number of businesses have taken advantage of the no objection policy, jumped supplier to maintain gas and power to their premises, but in so doing avoid paying their previous supplier. Wholesale prices across the energy complex have risen sharply over the past 12 months and this is likely to result in a large increase in gas and electricity prices at the next tariff setting window. Unless debt blocking is brought in, debt hopping as a means to maintain cashflow is going to continue and possibly escalate further.

We also strongly believe that blocking measures to prevent unauthorised Customer switches must be introduced for all business Customers in the gas and electricity sectors. The exposures for retail energy suppliers are simply too large. Vayu has hard experience of being exposed to such unauthorised switches, which have cost significant sums of money. We have highlighted examples of these to the CER in the past. As large business Customers are excluded from these proposed arrangements, the current proposals expose retail suppliers to continued significant risks.

We would support a move by the CER to introduce a robust code of practice / conduct for all suppliers that would include a new requirement on all new supply contracts that asks the question of Customers “Do you have an existing contract in place with another supplier?” This could be done by ticking a box on the front page or the signature page of each contract. We believe entities would be reluctant to sign this knowing that they have an existing contract in place.

Our responses to the individual questions follow:

Q1. Respondents are invited to comment on the proposals for the electricity and gas markets;

- 1) to introduce debt blocking or debt flagging for business customers and/or
- 2) to introduce debt flagging for domestic customers.

Vayu supports the move to introduce debt blocking measures for all business Customers regardless of size. We would also support the proposal to have debt flagging measures in place for domestic Customers as long as the Code of Practice to be introduced for the market is constructed in such a way that the new supplier would not be obliged to take on the Customer with this debt.

We do not support debt flagging proposal for business Customers, unless the new Code of Practice provides that new suppliers must not take on a Customer with this “flagged” debt. The proposed methodology does not prevent a Customer switch from taking place. If allowed to proceed, the debt flagging measure must contain arrangements that the new supplier can opt out of / halt the switching process if a debt notification has been raised.

The paper contains a comment that these measures will reduce outstanding debts and “benefit all Customers”. We are unclear why this is the CER view. Suppliers cannot simply pass on these additional bad debts to their existing Customer base, who are paying their debts on time. This is counterintuitive and runs the risk of exacerbating the problem. At the moment suppliers must take these costs to their results for the year.

Q2. Respondents are invited to comment on;

- 1) the proposal to allow debt blocking/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 blocking/notification for Large Energy Users (LEUs) or DM/LDM in the gas market?

We support the proposal to allow debt blocking for small and medium sized businesses in electricity as well as all NDM business customers in the gas market. This is a far more effective measure than debt flagging to protect suppliers and prevent less scrupulous Customers from loading the market with preventable debt.

We believe that the arrangements should not be confined to the lower consumption ends of the market. Neither do we agree with the CER view that disputes for larger business Customers should be resolved on commercial basis. In these cases, the most likely winners are the legal profession and 3rd party consultants hired to arbitrate. We are not surprised by the stance taken on this sector of the market, as it demonstrates that the CER does not appreciate or accept how much of an adverse effect even one such unauthorised switch can have on a supplier. The retail energy market is a low margin business. Any steps that can be taken which will not result in a further erosion of these margins can only be welcomed.

Q3. Respondents are invited to comment on the proposed grounds for raising a debt block or notification;

- 1) Do you consider that it is appropriate to raise an objection or notification on the grounds of contract default? Is it 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? Do you consider that it is appropriate to apply both a monetary threshold and a minimum timeframe for the monies to be owed as criteria to raise a debt block or flag?
- 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?

Contract default

To the untrained observer of energy markets, the concept of debt blocking on the grounds of contract default may not seem obvious. However, we believe the majority of entities involved in the risk management of obligations to Customers would be fully supportive of a policy to allow objections to switch suppliers where signed contracts are in place. In a tight margin business, suppliers have to manage these obligations very closely. A regime that allows Customers step away from these obligations should not be permitted.

The retail energy market operates much in the same way as any financial system. Customers enter into contracts and agree delivery of volumes of energy for fixed periods of time with suppliers; much in the same way as loans / mortgages are agreed. Suppliers acting in a reasonable and prudent manner will back off the obligations as they arise.

If two parties, be they business or individuals, enter into an agreement for a fixed period of time with an agreed set of prices and signed terms and conditions, they should abide by these as it protects both parties to the agreement. Therefore we believe that objections to a Customer switch on the grounds of a contract default should apply to both business and domestic.

Directive 2009/73/EC recognises that contract obligations should be observed. Article 3, para. 6 states “Member States shall ensure that: (a) where a customer, *while respecting the contractual conditions*, wishes to change supplier, the change is effected by the operator(s) concerned...”. We believe that procedures / business rules can be formed to ensure there is a mechanism to allow an objection where an end-user attempts to leave a contract that they have willingly entered into.

Thresholds

We believe that the proposed debt threshold levels are appropriate and we support these. For the most part they reflect a reasonable level of debt in the context of the individual sectors. However, we do not support the timings for when a debt block would be permitted.

The proposal to only allow a block 28 days after a business (56 days for domestic) debt falls due is too long. We believe it should be brought back to 7 days after the debt falls due. Otherwise, there is potentially between 40 and 50 days outstanding debt in respect of energy consumed for business Customers and 70 to 80 days for domestic Customers. A supplier’s own disconnection policy could have been initiated long before this timeframe.

Smaller debts

We do not support the proposal to move the timing of an objection for smaller debts to 56 days after the due date for payment, where the debt falls below the main threshold. It could mean that a supplier is left with up to 80 days of outstanding energy, which is unacceptably high. We acknowledge that Customers bills are invariably smaller in summer months and therefore would support a tighter timeframe of 14 days in the case of lower threshold amounts.

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

We believe that suppliers should include a section within their standard terms and conditions of domestic gas and electricity supply agreements which states that Customer information with respect to debt may be shared and that Customers must abide by this on an “opt-out” basis. Suppliers should then ensure that this is covered in the industry code of practice, whereby a Customer would not be taken on if the supplier has accessed information about the particular Customer and they have opted not to share the debt information.

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

Since the introduction of competition in the retail energy sector, suppliers in direct competition with the incumbents have highlighted the risks associated with the industry without a Customer switching objection process being in place. If anything, the level of competition may improve with such a policy in place. It may attract additional new entrants who, to date, perceived this area as one where the regulatory risks were simply too high to consider entering the market.

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

We are not opposed to this initiative, but it should not be obligatory. Each supplier should be able to make a decision whether it wishes to take on the verified debts of a new Customer on a case by case basis.

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.

Vayu is in favour of introducing a Code of Practice for debt blocking. The CER noted that it is concerned that a debt blocking measure should not be open to abuse by suppliers. We contend that supplier abuse would only be the case if the structures by which this objection process was introduced were not robust. We believe that the code of practice, which should be mandatory, should not be allowed become a frivolous and vexatious complaints process. For example, there could be a compensation mechanism for erroneous transfers by way of a fine.

We believe that all stakeholders should be involved in the process to set up the structures, business rules etc. and that the experience from how this process works in other markets should be used to ensure that this is not continually re-examined and altered. However, review procedures will need to be in place and where weaknesses have been identified in processes these can be amended and improved.

Other Comments

We believe that systemisation of rule changes should not be difficult to implement. There is no doubt that changes to the systems will be required, however we disagree with the view that the changes to the change of shipper process would be substantial. This gives the impression that the effort in making the change would not be worthwhile.

In previous consultations on this issue, the CER stated that they were concerned that that a debt blocking measure would result in them being inundated with complaints from Customers in relation to their ability to switch suppliers. The 3rd Energy Package suggests the creation of an energy ombudsman and this should ease the burden on the CER's workload. We believe that frivolous complaints could be avoided if a robust and mandatory objections code of practice was implemented by all suppliers.

Conclusion

Vayu's position on this issue remains unchanged from previous submissions. An objections process for debt and contract default represents a progressive step in the development of the retail market. End-users would be far more conscious of the implications of building up debts and can take corrective measures at an earlier point e.g. entering into a payment plan with their supplier.

We stress that we firmly do not support the view that large electricity and gas Customers should settle any unauthorised switches on a commercial basis. We believe it is discriminatory to exclude this vital sector of the market from the proposed arrangements. The amounts of money at this level are simply too large to ignore. It is in no-one's interest, apart from the legal profession, that an objections process is not introduced for these market sectors.

The CER is well aware of the narrow profit margins suppliers work within. Any move by the CER to put this under continued pressure in the current environment is very unwelcome. We, as with all supply companies, are obliged to settle our own obligations in a rigid timeframe and we cannot be expected to absorb an additional drain on working capital.

We would be grateful if the CER considers these views and we would welcome a discussion on any aspect of this response paper at a future date.

Yours sincerely,

Bryan Hennessy