# Decision on the application of exit fees in the small business energy market

Addendum to Decision Paper – Measures to Enhance the Operation of the Small Business Energy Market

October 2019

# About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

## Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.

## Our vision

To ensure value and sustainability in energy and water.

## Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.

# Abstract

The UR published its final Decision Paper – “Measures to Enhance the Operation of the Small Business Energy Market” in September 2018 however implementation has been postponed as the UR published a consultation as an addendum to that decision paper in which the UR explored the specific issue of the application of exit or contract termination fees and their appropriateness in the context of a fixed term contract. Stakeholders were asked to provide their views.

The UR wishes to issue their decision, following on from the consultation, regarding when the application of an exit fee is appropriate.

# Audience

Consumers and consumer groups; industry; and statutory bodies.

# Consumer impact

This decision set out in this paper will result in suppliers continuing to be able to impose an exit fee where a Small Business Customer leaves their contract before the end of the fixed term. This is a continuation of the status quo.

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# 1. Introduction and Background

1.1 In September 2018, the Utility Regulator issued their final Decision Paper[1] "Measures to Enhance the Operation of the Small Business Energy Market". This paper was the culmination of extensive consultation with relevant stakeholders in the development of potential measures set out in the decision paper.

## Final Measures to be taken forward

1.2 The decision paper set out the final measures which are to be taken forward:

- **Measure 1** – **Tariff Transparency Requirement**
  - ♦ Suppliers to publish tariff rates including their acquisition and retention rates for small business customers.
- **Measure 2** – **Deposits – clarity on how these are set by suppliers**
  - ♦ Suppliers should provide information on their website around deposit requirements and how they are determined for a small business customer.
- **Measure 3 – Level of deposits & length of time they are held**
  - ♦ Deposits should be set at a maximum of the value of 3 months average consumption. It is at the supplier's discretion to determine when the deposit can be returned to the customer.
- **Measure 4 – Rollover of contracts**
  - ♦ These will be prohibited for small business customers, meaning that when the original contract term is finished they cannot be moved onto another fixed term contract without explicit agreement.
- **Measure 5 – Exit Fees**
  - ♦ Exit fees must be "proportionate and justifiable". Suppliers must be able to justify the level of exit fee ex-post if an issue or complaint arises, to demonstrate their compliance with the "proportionate and justifiable" obligation.

[1] https://www.uregni.gov.uk/news-centre/decision-published-measures-enhance-operation-small-business-energy-market

- **Measure 6 – Prepayment Meters for small business customers**

  - The potential for an electricity prepayment meter for small businesses will be fully examined. This has been referred to the industry working group (CDA). At this point, the potential for a prepayment meter in gas is not being progressed (however this may be revisited in the future)

- **Measure 7 Transparency of Terms and Conditions (T&Cs)**

  - Suppliers will have an obligation to inform customers if their T&Cs change and this would include:

    a. 21 day notification of price changes; and

    b. Notification of any fixed term contract periods coming to an end.

## Scope of coverage of the measures

1.3 The scope of coverage of the measures will be small business customers with 0 – 50 MWh annual consumption for electricity and up to 73.2MWh for gas.

## Implementation of measures

1.4 Measures 2-4 and 7 will be implemented through new licence conditions for suppliers. Measure 6 will be dependent on the outcome of the work carried out by the industry forum. With regard to Measure 1 (Tariff Transparency), at this point in time it will not be implemented through licence conditions which mandate price transparency. This is on the basis that suppliers voluntarily committed to provide their small business tariffs to CCNI (or another third party provider) for publication. We intend to monitor this closely to determine if the information provided fulfils the transparency requirements consulted upon. With regard to measure 5, in the course of the addendum consultation response and further internal discussion with the UR Board we have concluded that this measure should not be implemented as a separate licence condition. Under the current Condition 27 Paragraph 1 in electricity supply licences and 2.18.1 in gas supply licences 'Terms and Conditions of Supply Contracts' it states:

*"The Licensee shall ensure that any Contract it enters, or offers to enter, into with a consumer for a supply of gas/electricity contains provisions which are in clear and comprehensible language and which incorporate all relevant information so as to enable the consumer to understand the terms and conditions under which the supply of gas/electricity is, or is to be, made"*

1.5 This applies to both domestic and I&C customers and as such places an obligation on suppliers to make it clear and transparent what the level of the exit fee is (or how it will be derived) and under what circumstances it will be applied. An exit fee is an integral part of the competitive offer package that the supplier is providing (e.g. deposit, unit rate, standing charge, term, exit fee applicable). However, we will continue to monitor the area of exit fees for small business customers, and will revisit the issue if it becomes apparent that there is a problem with the application or calculation of them.

## Developments subsequent to Decision Paper

1.6 After the publication of the Decision Paper, the issue of the inclusion of an exit fee within a fixed term contract which does not have a fixed price was highlighted and discussed further within the UR. This was in relation to domestic customers and issues were raised with the UR by both customers and by CCNI. It was in this context that the UR decided to publish an addendum consultation, to further explore the area of exit fees with regard to small business energy customers as a follow on to the previous small business consultation. This was published in May 2019[2]

1.7 The UR wanted to understand the justification for the application of an exit fee (where a customer wishes to exit their contract before any fixed term has finished) in the context of a contract which does not give the customer a fixed price for a fixed term or some financial or otherwise tangible benefit that justifies the charging of an exit fee.

1.8 The addendum consultation sought stakeholder views on what is proportionate and justifiable regarding when and under what circumstances the application of an exit fee is appropriate.

[2] https://www.uregni.gov.uk/news-centre/consultation-application-exit-fees-small-business-energy-market

# 2. Stakeholder Feedback to Addendum Consultation

2.1 The addendum consultation explored the potential options that exit fees would not be justifiable where the price is:

- Not fixed for the fixed term period of the contract; or
- Where the movement in the price is not linked to an agreed and transparent, verifiable or publically available source such as the gas or electricity wholesale price; or
- The contract does not include some financial or otherwise tangible benefit that justifies the charging of an exit fee.

2.2 Respondents were asked to answer the following question with regard to exit fees:

***Q1. Do respondents agree that an exit fee should only be permissible where a price is:***

***- fixed for the fixed term period of the contract; or***

***- where the price moves up or down it is linked to a transparent, verifiable or publically available source for the period the exit fee would apply; or***

***- where it includes some financial or otherwise tangible benefit that justifies the charging of an exit fee?***

***If stakeholders disagree with this, they must provide a clear rationale as to why along with examples justifying their view.***

## Stakeholder Feedback

2.3 The UR received six stakeholder responses to the consultation (published alongside this document):

- Energia;
- Federation of Small Business (FSB);
- Consumer Council of Northern Ireland (CCNI);

- Power NI;
- SSE Airtricity; and
- Electric Ireland.

2.4 Energia were not supportive of the UR proposal to limit exit fees to only the three scenarios outlined above. However they highlighted that they had no specific objection to the wording but queried the interpretation of it particularly in relation scenario 3:

"*where it includes some financial or otherwise tangible benefit that justifies the charging of an exit fee"*

2.5 They stated:

*"It is Energia's understanding that in spite of the wording of the 3rd category the UR would not permit exit fees to apply to a fixed term, variable rate contract, even if that contract were to contain a sizeable discount. It is this understanding that informs our objection to the UR's proposed clarification of the types of offers exit fees can apply to."*

2.6 Energia argued that the restriction on exit fees could impact upon competition and limit the type of offers which are available to customers. They also highlighted that they are of the view that Suppliers in NI face risks in relation to network charges that the retail market in GB doesn't. This is due to the fact that these are set annually in NI but several years in advance in GB which allows for more certainty for suppliers there to offer fixed tariffs. In this context they stated:

*"A premature restriction on the types of tariffs that exit fees can be applied to, will increase the risk associated with heavily discounted offers."*

2.7 They went on to propose a potential alternative which would see the application of an exit fee in the case of a variable tariff only if the tariff were to increase.

2.8 They also stated that such an alternative could provide a gradual path to the removal of exit fees in the market at a later stage.

2.9 CCNI noted that they had investigated a number of complaints from small businesses where their supplier had unilaterally amended the terms and conditions and unit rates set out in the original contract. If the customer left then they would be subject to an exit fee.

2.10 CCNI noted in their response that small business customers are not covered by Consumer Rights Act (2015) which mandates that contracts should be

fair. They stated:

*"This means that in the absence of new regulatory provisions in relation to unfair terms and conditions in non-domestic energy contracts, small businesses here have limited protection against unfair contract terms."*

2.11 CCNI indicate that they are concerned with the increase in the number of fixed contract periods with early exits fees as standard. They do however highlight that exit fees should be fair:

*"which in practical terms means that they should not be allowed if the contract terms do not provide a reciprocal "financial or otherwise tangible benefit" for the customer"*

2.12 CCNI reiterate that if exit fees are applied in an unrestricted way it has a detrimental impact on consumer choice. They also state that the regulatory framework should prevent discriminatory or unfair practices against specific groups.

2.13 CCNI go on to say that financial benefit where an exit fee can be applied shouldn't include discounts related to payment, billing or meter reading methods. They also stated that clear and transparent price and contractual information must be integral to any offerings made.

2.14 Power NI noted their concern with introducing prescriptive requirements in the context of every customer which is covered in the 0-50 MWh sector (covered by the decisions made previously in 'measures to enhance the operation of the small business energy market." They stated:

*"Prescriptive requirements risk unintended consequences as a 'one size fits all' approach is not appropriate for many customers and Power NI would urge the UR as a minimum to recognise groups."*

2.15 Power NI and SSE Airtricity both expressed the view that there was no evidence that this was an issue in the market.

2.16 Power NI compared linked variable tariffs variable mortgages as they can move up or down and are tracked. They also state that there are other moveable costs that should be treated as 'passthrough' and use the example of network costs. Energia made a similar point to this.

2.17 FSB were supportive of the UR's proposal:

*"Indeed evidence shows that government policy increasingly acknowledges and seeks to address the vulnerability and overlap between the smallest businesses – unincorporated sole traders – and domestic customers.*

*We therefore welcome that the Utility Regulator has pursued the option to treat exit fees in a similar way to those under domestic consumer or 'household' based contracts."*

2.18 FSB did recognise that an exit fee may provide a supplier with a certainty of income and recover set up costs but they were of the view that they should not be used as a way of gaining additional profit. FSB went on to state that they were supportive of the UR proposal to restrict the circumstance under which exit fees are permitted.

2.19 They also endorsed CCNI's suggestion that the exit fee framework referenced in the Consumer Rights Act could be used to determine what level an exit fee should be set. They were of the view that exit fees should be tailored to customer.

2.20 SSE highlighted that their response to the consultation was provided in the context of the approach that the Energy Price Portion of the tariff is fixed or fluctuates in line with a transparent, verifiable or publicly available source. The network charges are subject to annual review and may be treated as a pass-through cost. This would result in this element of the unit rate being flexed if the network charges change.

2.21 Stakeholders noted that the situation in NI is different from that in GB where the network costs are set far in advance and run for several years.

2.22 SSE Airtricity stated:

*"SSE Airtricity is of the opinion that any fixed term contract should work in the interests of both the consumer and the supplier. In a competitive market taking the option of entering into any fixed term contract should be mutually beneficial to both the energy consumer and supplier, this can be achieved through providing a pricing benefit to the consumer at the point in time in which they sign up, as well as a degree of certainty for the supplier in hedging energy requirements."*

2.23 They were not supportive of the any requirement for the UR to approve exit fees for fixed term contracts with some other form of benefit. They were of the view that this gave the UR a role in the type of product being offered by the supplier. They also raised concerns around the process for getting approval for an exit fees for example how timely this would be and whether it could impact the ability to be competitive or responsive in the market.

2.24 SSE went on to highlight their concern around the requirement for additional regulatory intervention in a market which is price deregulated without the provision of evidence that there are material problems which exists in relation to exit fees.

2.25 Electric Ireland stated that exit fees are important as they allow suppliers to innovate and protect them from financial risk. They also expressed the view that customers benefit from better service and price on a long term basis. They do agree with the UR, that they should be proportionate and justifiable. They consider that potential costs which should be considered in the exit fee are time spent brokering the deal, energy services advice, hedged volumes and products provided to the customer. They are of the view that exit fees should be based on averages for customer class as oppose to individual customers.

2.26 Electric Ireland agree with the UR scenarios where an exit fee could be permitted but state that, in their view, two and three could be subjective and that they also saw merit in including an additional option:

*"other circumstances which arise and are agreeable to and approved by the UR"*

## UR Response to Stakeholder Feedback

2.27 We note CCNI's concern in relation to the growing number of fixed term contracts with exit fees but would like to clarify that there are circumstances under which the UR considers the application of exit fees may be justifiable. For example, if a supplier has guaranteed a fixed price for a fixed term the UR is of the view that an exit fee is justifiable in these circumstances. We agree with their view that choice of payment type discount should not warrant a contract with an exit fee as CCNI state this is also beneficial to the supplier. We also agree that it is critical that customers are provided with clear and transparent price and contractual information.

2.28 We recognise the difficulty of being prescriptive in the context of a tariff which includes pass through elements. Suppliers stated that costs such as network costs should be pass through and therefore subject to change mid contract. They noted that the situation in NI is different from that in GB where the network costs are set far in advance and run for several years. It also became apparent that there are other regulated costs which suppliers must pay and can change within the term of a customer's contract. Suppliers deem these to be pass-through, and so should be treated as such.

2.29 We have considered the views set out in the feedback, and analysed the potential for mandating elements which could be treated as pass-through, and those which couldn't. This is problematic as what a supplier may deem as a pass through cost in its contract is subjective and may be different from what the UR would define as pass through. An example of this being where the supplier has an increase in their own internal operating costs and deem that it is appropriate to pass this additional cost through in their unit rate. It

would be difficult to draft a licence condition able to facilitate these types of complexities.

2.30 We have taken into account respondent feedback raising concerns regarding negative and potentially unintended consequences of prescriptive licence modifications. For example, not permitting an exit fee in the scenario where a 'substantial discount' was offered on the basis that the customer would remain with the supplier for a fixed period of time could mean that this type of offer would be withdrawn. We can understand the supplier perception that additional regulatory restrictions could mean a limit on tariff offerings made by suppliers, and as such could damage competition in the market.

2.31 We have come to the view that there could indeed be 'unintended consequences' if the UR were to implement a decision to only allow exit fees in certain circumstances. It is likely that licence requirements would be overly prescriptive and difficult to implement and enforce, given the wide variety of different circumstances, contract types and individual contract clauses that would need to be covered. There is also the real possibility that new contract clauses could emerge specifically designed to circumvent the licence conditions. They could lead to complex tariff structures, which may be difficult for a customer to understand or know exactly what they are signing up for.

2.32 This would fundamentally go against the premise of the original objectives of the project, to implement measures to enhance the operation of the small business energy market. A primary aim of that project was to increase transparency in the market which would help customers engage meaningfully in the market and make fully informed decisions.

2.33 In addition to this, the small business energy market could see a substantial reduction in the types of offers given to potential customers if prescriptive regulation is employed.

2.34 In light of this we are of the view that where an exit fee is being applied then a supplier must be clear and transparent about this upfront in line with licence condition 27 paragraph 1 in electricity supply licences and 2.18.1 in gas supply licences. We no longer intend to include any new wording in the supply licences regarding exit fees being proportionate or justifiable, as these terms are too wide to be applied in a wide range of different contract scenarios, and exit fees are a financial element of a tariff in the same way as price is. Thus they are part of the competitive position of each supplier's offerings.

2.35 We note the FSB view that exit fees should be individualised whereas Electric Ireland though they should be averaged to customer class. We are of the view that it may be more practical for suppliers to have an average exit

fee for type of customer as long as the level can be justified.

## UR Decision

2.36 Given the feedback from stakeholders we are minded to permit suppliers to continue to apply an exit fee.

2.37 Given the potential for unintended consequences and the potential for licence modifications which are onerous and prescriptive, we are of the view that prescriptive regulation in this particular area would fundamentally undermine one of the objectives of the original project, which was to increase transparency and as such customer engagement and the ability to make an informed decision.

2.38 In addition to this, the licence obligations under 27 paragraph 1 in electricity supply licences and 2.18.1 in gas supply licences place an obligation on suppliers to ensure that small business customers are clear on what level of exit fee will be applied (or how it will be derived) and under what circumstance before they sign up to a contract.

# 3. Next Steps

## Licence Modifications

3.1 The next step in this process is for the UR to issue licence modifications to implement the previous decision paper “Measures to Enhance the Operation of the Small Business Energy Market (excluding Measure 5).

3.2 We would envisage that the Article 14 Notice will be published in Q4 of 2019 with the Article 14 Decision early Q1 2020. This would result in the modifications being live in supplier licences by the end of Q1. Given that suppliers have been aware of the measures and their implications for some time, we would expect them to be compliant from when the licence condition goes live or have in place a robust compliance plan to show how and when they will become licence compliant.