Modification proposals:	**Uniform Network Code (UNC): UNC396 (EU Third Package: three week switching), UNC403 (EU Third Package: 21 day switching with flexible objection period); and independent Gas Transporters UNC (iGT UNC): iGT UNC 041 (EU Third Package: three week switching) and iGT UNC 042 (EU Third Package: 21 day switching with flexible objection period)**		
Decision:	The Authority[1] directs that the UNC403 and iGT UNC 042 proposals be made[2]		
Target audience:	The Joint Office, Parties to the UNC, Gemserv, Parties to the iGT UNC, and other interested parties		
Date of publication:	24 August 2012	Implementation Date:	To be confirmed by the Joint Office and the iGT UNC Panel

Background to the modification proposals

Member States are required under the European Union Energy Package[3] ("the Third Package") to ensure that customers are able to switch supplier within three calendar weeks.[4] This requirement was transposed by government into the GB market through changes to the licence requirements on gas suppliers and gas transporters.[5]

The current arrangements to support the change of supplier process[6] in the gas market are set out in the Uniform Network Code (UNC) and in the independent Gas Transporter (iGT) UNC. The current rules do not allow suppliers to switch a customer within three calendar weeks in all circumstances. Modification proposals to reform the current UNC and iGT UNC arrangements have therefore been brought forward. The ability to switch customers in three weeks will allow suppliers to meet contractual obligations to consumers required by their current licence obligations and provide faster switching arrangements for customers.

The modification proposals

UNC396 and iGT UNC 041

E.ON raised UNC396 and iGT UNC 041 in August 2011 and September 2011 respectively. These proposals seek to make equivalent changes to both the UNC and the iGT UNC.

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas.
[4] This excludes any contractual cooling-off period.
[5] See http://www.legislation.gov.uk/uksi/2011/2704/schedule/7/made. As a result, SLC 14A "Customer transfer" places requirements on suppliers to ensure that the terms of new supply contracts allow customer transfers to take place within three weeks (after any contractual cooling-off period has ended). In addition, both the Gas Supply licence and the Gas Transporter licence require licensees to use reasonable endeavours to facilitate any improvement to the process by which the responsibility for gas supply is transferred between suppliers (see SLC14A.6 of the Gas Supply licence, standard special condition A11(6A) for the large gas transporters and SLC 9(5A) for the iGTs).
[6] A fuller explanation of the current change of supplier arrangements appears in Ofgem's consultation on these modification proposals (June 2012) available here: http://www.ofgem.gov.uk/Markets/sm/strategy/Documents1/Three-week%20gas%20switching-%20consultation%20on%20UNC396%20UNC403%20iGT UNC 041%20and%20iGT UNC 042 -%20Final.pdf

They would reduce the current objection window[7] from seven to three business days. They would also reduce the current confirmation window[8] from seven to five business days.

The proposals would also add a requirement on gas transporters to send certain messages, including the notification provided by them to the incumbent shipper that a transfer request has been made, as soon as reasonably practicable. Currently they are only required to do so within two business days.

UNC403 and iGT UNC 042

SSE raised UNC403 and iGT UNC 042 in October 2011 and November 2011 respectively. These proposals also seek to make changes to both the UNC and the iGT UNC. They would introduce a flexible objection window and would not make any changes to the current confirmation window of seven business days.

Under these proposals, the objection window would vary from two to seven business days to enable suppliers to meet the three-week switching requirement. For example, where a bank holiday occurred, the objection window available to shippers would reduce. The proposer expected that whilst the objection window may at certain times of the year reduce to as few as two business days, at other times of the year it would be longer.

As with UNC396 and iGT UNC 041, these proposals would add a requirement on gas transporters to send certain messages as soon as reasonably practicable.

UNC and iGT UNC Panel recommendation

UNC Panel recommendation

At the UNC Panel[9] meeting held on 15 March 2012, of ten votes cast, the Panel voted 9 to 1 in favour of implementing UNC396. The Panel also voted unanimously in favour of UNC403. The Panel recommended implementation of either of the two proposals with a preference for UNC396 over UNC403. The views of the Panel are set out in full in each of the Final Modification Reports (FMRs) dated 15 March 2012.[10]

iGT UNC Panel recommendation

The iGT UNC Panel[11] voted on iGT UNC 041 and iGT UNC 042 at its meeting on 21 March 2012. The Panel unanimously voted in favour of both modification proposals. Of the two, four Panel members preferred iGT UNC 041, one member preferred iGT UNC 042, and one member abstained. The views of the iGT UNC Panel are set out in full in each of the FMRs dated 22 March 2012.[12]

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[7] Once a customer transfer request is submitted by the new supplier (via its shipper) following the end of a cooling off period, there is a seven business day period (the "objection window") within which the incumbent supplier may object to a customer transfer.
[8] Once this objection period has passed, there is a further seven business day period (the "confirmation window") prior to the transfer date to reallocate the energy requirements to the new shipper.
[9] The UNC Modification Panel is constituted pursuant to Special Standard Condition A11(6d) of the Gas Transporters Licence and Clause 3.1 of the UNC Modification Rules.
[10] http://www.gasgovernance.co.uk/0403 and http://www.gasgovernance.co.uk/0396
[11] The iGT UNC Panel is established and constituted from time to time pursuant to and in accordance with the iGT UNC Modification Rules.
[12] http://iGT-unc.co.uk/Modifications/Open+Modifications/iGT041 and http://iGT-unc.co.uk/Modifications/Open+Modifications/iGT042

Consultation

The change of supplier process has an important impact on consumers and their experience of the retail energy market. On 15 June 2012, we consulted on our initial thoughts about the proposed changes to the UNC and iGT UNC that aim to secure compliance with the three-week switching requirement.[13] We also requested further information to help us to reach a decision on which, if any, of these competing proposals we should approve.

In total, we received 17 responses.[14] Among other things, respondents provided information regarding the potential impact of the proposals on erroneous transfers, the ability to obtain meter reads, cost, and complexity and implementation timescales.

The Authority's decision

We have considered the issues raised by the modification proposals and the FMRs dated 15 March 2012 and 22 March 2012. We have considered and taken into account the responses to the industry consultations on the modification proposals which are included in the FMRs and the responses to our further consultation. We have concluded that, of the proposals submitted to us:

1. implementing either UNC396 and iGT UNC 041 or UNC403 and iGT UNC 042 would better facilitate the achievement of the relevant objectives of the UNC[15] and the iGT UNC[16];
2. as it is not practicable to implement both proposals, we consider that of the two options, the implementation of UNC403 and iGT UNC 042 will best facilitate the achievement of the relevant objectives of the UNC and iGT UNC; and
3. directing that UNC403 and iGT UNC 042 be made would be consistent with the Authority's principal objective and statutory duties.[17]

Reasons for the Authority's decision

The main arguments provided on these proposals were in relation to Relevant Objectives (d) and (g).[18] We agree that Relevant Objective (d) is important in making our decision. For the reasons set out below we do not consider that Relevant Objective (g) is relevant. Respondents to our June 2012 consultation did not provide any substantive views on whether the proposals have any impact relation to Relevant Objective (c). We therefore remain of the view that the proposals would be neutral against this objective. We also consider that the impact of the proposals is also neutral when assessed against the other relevant objectives.

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[13] http://www.ofgem.gov.uk/Markets/sm/strategy/Documents1/Three-week%20gas%20switching-%20consultation%20on%20UNC396%20UNC403%20iGT UNC 041%20and%20iGT UNC 042 -%20Final.pdf

[14] The responses are available on our website here: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=15&refer=Markets/sm/strategy

[15] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART_A__-_Consolidated_+-+Current+Version.pdf

[16] As set out in Standard Condition 9 Gas Transporters Licence, see: http://epr.ofgem.gov.uk/index.php?pk=folder414978

[17] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986 as amended.

[18] These are consistent with the relevant objectives of the iGT UNC.

Relevant Objective (d) – securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between Distribution Network operators and relevant shippers

We have considered the impacts on securing effective competition between suppliers and between shippers of reducing the objection window (which is an element of both sets of proposed modifications) and reducing the confirmation window (which is part of UNC396 and iGT UNC 041 only). In particular, we have reviewed the effect on: the ability of shippers to raise and withdraw objections, the potential for erroneous transfers, risks relating to disputed reads, the overall cost of the arrangements, the time taken for customers to switch supplier and licence compliance. These issues were discussed in our June consultation document. Below we set out our further views.

Meeting the 21 calendar day switching requirements

As noted above, SLC14A of the Gas Supply licence places a requirement on gas suppliers to include a term within their contracts to transfer the customer, on request, within 21 calendar days unless certain exemptions apply. The licence condition also requires suppliers to take all reasonable steps to improve the systems and processes governing the change of supplier process to allow this process to take place within 21 calendar days.

In our June 2012 consultation we set out our view that both sets of proposed modifications would allow suppliers to meet their obligations to be able to transfer customers within 21 calendar days. The majority of respondents agreed that both sets of proposed modifications would allow them to meet the 21-day requirement. The majority of shippers operating in the Larger Supply Point (LSP) market suggested that they would accommodate the nomination process[19] through the cooling-off period. Some noted that the majority of LSP customers are supplied under fixed-term contracts with defined start dates and that the requirement to transfer customers within 21 calendar days did not apply where the customer had requested a later transfer date. One shipper operating in the LSP market noted that the proposals might lead to suppliers offering customers a cooling-off period when they previously may not have done so. We continue to consider that both sets of proposed modifications will allow suppliers to meet their obligations to transfer customers in 21 calendar days.

To allow suppliers to meet their licence requirements and their contractual obligations to customers, it is imperative that changes to the central systems that support the existing change of supplier process are made as soon as possible. Information provided in response to our consultation indicates that implementation of UNC403 will take around nine months. Xoserve indicated that UNC396 would take longer to implement. We are disappointed that it did not provide further detail. IGTs did not provide a consistent view on implementation timescales. These varied from two to twelve months and six to twelve months for iGT UNC 041 and iGT UNC 042 respectively. We note the views of parties reported in the FMRs for iGT UNC 041 and iGT UNC 042 that these proposals should be implemented alongside UNC396 and UNC403 respectively. We therefore consider that both sets of proposals have similar implementation timescales although there may be scope for UNC403 and iGT UNC 042 to be implemented earlier.[20]

[19] A nomination is an extra step required in the transfer of customers in the LSP sector and must be sent prior to a transfer request.
[20] In particular, we consider that gas transporters are likely to be required under standard special condition A11(6A) and SLC9(5A) to facilitate implementation, in a reasonably expedient manner, of any proposal approved by the Authority.

In summary, we consider that both sets of proposed modifications will better facilitate relevant objective (d) by allowing suppliers to meet their contractual obligations to customers and their licence requirements. We further consider that UNC403 and iGT UNC 042 may better meet relevant objective (d) when compared to the other proposals as it would appear, based on the available evidence, to allow suppliers to meet these obligations more quickly.

Faster switching

We consider that faster switching can benefit consumers who would be able to take advantage more quickly of cheaper prices and other offerings from alternative suppliers. As stated in our June 2012 consultation, UNC396 and iGT UNC 041 would achieve faster switching (ten to twenty calendar days) while UNC403 and iGT UNC 042 would achieve a consistent transfer period (twenty one calendar days) in all circumstances. We note that such benefits may be higher for dual fuel customers where suppliers are attempting to co-ordinate gas and electricity start dates. In this situation, the consumer would be able to realise benefits under UNC396 and iGT UNC 041 more quickly for electricity as well as gas. Nevertheless, we consider that UNC403 and iGT UNC 042 are also likely to have benefits for consumers when compared to the current position.[21]

Erroneous transfers (ETs)

An ET occurs where a customer has been transferred to a supplier without a valid contract being in place. Evidence suggests that, the ET rate between January 2010 and December 2011 was approximately 1% in the domestic market. ETs are a source of frustration for consumers and can have a significant and damaging impact on the reputation of the retail energy market. ETs also lead to costs for suppliers that may feed through to higher prices.

Some respondents to our consultation were concerned that a shorter objection window would reduce the opportunity to process Customer Related Objections (CROs[22]) and co-operative objections[23], which are one way to prevent ETs. Under UNC403 and iGT UNC 042, the flexible objection window would be shorter in some instances throughout the year than the static three working days for UNC396 and iGT UNC 041[24]. However, it would be on average longer. For example, under UNC403 and iGT UNC 042 suppliers would have an objection window of five working days for 94 days of the year and six working days for 206 days of the year.[25]

In our June 2012 consultation, we asked suppliers for information on how, as the losing supplier, they contacted customers and when during the objection window the different types of objection were raised. Respondents indicated that CROs and co-operative objections were typically raised towards the end of the objection window. This is a consequence of the time taken for customers to respond to correspondence from either

[21] We did not receive empirical evidence from parties to support this point. However, we estimate that UNC396 and iGT UNC 041 could provide an additional saving of around £5m per year when compared to the other proposals. This is based on an illustrative dual fuel saving of £100/year, a reduction in the transfer period of five days and 3.7m customer transfers per year.
[22] Where a customer has informed its supplier that it has not entered into a contract with a new supplier, the supplier may attempt to block the transfer by raising an objection.
[23] A supplier may block a proposed transfer with the agreement of the supplier that is attempting to transfer the customer.
[24] There are 13 days when the objection window would be two working days.
[25] See Table 1 in our June 2012 consultation.

the losing or gaining supplier about the forthcoming transfer. While some of this contact is attempted by email and phone, most is by post. As CROs and co-operative objections typically occur towards the end of the objection window, UNC403 and iGT UNC 042 would be likely to allow suppliers to retain the greatest opportunity to prevent erroneous transfers.[26]

While our analysis indicated that both sets of proposed modifications may reduce the opportunity to prevent ETs, we consider that the longer period available on average under UNC 403 and iGT UNC 042 would have the lesser adverse impact on consumers, in comparison with UNC 396 and iGT UNC 041.

Raising and withdrawing objections

In addition to our analysis of CROs and co-operative objections, we have also considered the impact of the modification proposals on a supplier's ability to raise objections for other reasons and also to withdraw objections. Responses from suppliers indicated that the majority of debt and contract-related objections happen at the start of the objection window. Reducing the objection timescales under each of the proposals was therefore considered to have a limited impact. However, one larger supplier indicated that it operated a manual process for debt objections and that reducing these timescales could have a significant impact on it. One large supplier also noted that in the non-domestic market, a supplier might object to a transfer, often on the seventh day of the objection window, if the change of tenancy marker was incorrect.

Suppliers may also seek to withdraw objections when the reason for the objection is resolved or it is identified that the objection has been raised in error. Our analyses indicate that around 0.8% of the objections are withdrawn in the domestic market. We note that the static three working day objection window for UNC396 and iGT UNC 041 would, on average, allow less time for suppliers to withdraw objections. The consequence of this would mean that the attempts of some customers to transfer may be frustrated and costs would be incurred in any subsequent attempt to transfer the customer.

Disputed reads

Both UNC396 and iGT UNC 041 would reduce the confirmation window from seven to five working days. In response to concerns raised in the FMRs for these proposals, we asked for views on the impact of this change. In particular, we requested information on suppliers' ability to obtain and submit a change of supplier meter read and the potential consequences for increasing the number of disputed reads.

The majority of respondents considered that a reduced confirmation window would not have a significant impact on their ability to obtain opening meter reads. They therefore considered that these modifications would not increase disputed meter reads.

Nonetheless, one supplier expressed concerns that a reduced confirmation window may hamper its ability to obtain an initial meter reading in time for use in the change of supplier process, leading to an increase in disputed reads.

[26] The average number of successful CROs made in 2010 and 2011 was 7,570 per year. The average number of co-operative objections was 1,342 over the same period. Based on our illustrative analysis of impact on the objection window of the modification proposals and their timing, we consider that UNC403 and iGT UNC 042 may lead to approximately 3,000 to 4,000 more ETs being prevented each year when compared to the alternative proposals.

Currently, around 10% of domestic customer transfers have a change of supplier meter read amended through the disputed reads process. This can be a source of frustration for consumers and can increase costs for the industry, which may feed through to consumer tariffs. We recognise that suppliers may be able to make adjustments to their processes to help mitigate any concerns that they will not be able to obtain meter reads to support a smooth change of supplier process. However, UNC403 and iGT UNC 042 would not require this adjustment and is therefore likely to present a lower risk of exacerbating this issue.

Costs & complexity

In our June consultation, we asked suppliers and GTs to provide details on the estimated cost of implementing both sets of proposed modifications. Both UNC396 and UNC403 are expected to be 'user pays' modification proposals, with these central system costs being passed through to shippers.

Some respondents expressed concerns about the flexible objection window required under UNC403 and iGT UNC 042. IGTs and one large supplier considered that this might be more complex to operate. These parties indicated that these proposals were likely to be more expensive, although the difference in implementation costs between the two sets of proposals was relatively low.[27] Some parties also indicated that UNC 403 and iGT UNC 042 would have higher ongoing costs linked to this additional complexity. Again, these additional costs were relatively minor.

Xoserve and two large suppliers indicated that the reduction in the confirmation window would be the greatest source of costs. These costs tended to be more significant than the other proposals. Xoserve indicated in the FMRs for UNC396 that this proposal would cost between £710k and £970k to implement. This compared to an implementation cost of between £180k and £250k for UNC403.[28]

Summary

Both set of modification proposals would allow customers to switch within the 21 calendar day requirements. We therefore consider that both support effective competition in the retail market by allowing suppliers to meet their licence obligations and contractual requirements to customers. Without central systems that allow them to do this then there are increased risks and liabilities for suppliers and this may deter new entry. We also consider that both set of proposals offer benefits for consumers by providing faster switching arrangements than are currently the case.

We consider that the proposals set out in UNC403 and iGT UNC 042 provide a lower risk for customers that may otherwise affect their perception of competition and costs for suppliers operating in the market. In particular, this results from having an objection window that is, on average, longer. This provides a greater opportunity for suppliers to manage the objections process and prevent ETs. The longer confirmation window may also increase the opportunity for suppliers to obtain change of supplier meter reads and reduce the use of the disputed meter reads process.

[27] For iGTs, the implementation costs of iGT UNC 041 ranged from £2.5k to £75k. For iGT UNC 042 these ranged from £4.5k to £80k with one iGT indicating that this would also have an ongoing cost of £1k per year.
[28] In addition, Xoserve estimated that the ongoing costs of UNC403 would be in the range £10k to £15k per year.

UNC396 and iGT UNC 041 would lead to a faster average transfer timeframe for consumers. We think that this is an important aspiration as it allows consumers to realise benefits more quickly. However, we note that these proposals may be more costly to implement and, as noted above, come with additional risk of customer detriment.

Therefore, on balance, we consider that UNC403 and iGT UNC 042 will better facilitate the achievement of this relevant objective. Fast, as well as accurate, customer transfers are an important component of a competitive retail market. We consider that there is an opportunity to go much further than the proposals set out in this letter in the context of the roll-out of smart metering. As set out below we will pursue this aim as part of our work on longer term reform to the customer transfer process.

Relevant Objective (g) - compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators

We note that the three-week switching requirement for electricity and gas was introduced as part of implementation of the Third Package concerning common rules for the internal market in natural gas and electricity. It was not introduced in order to seek compliance with the Regulation[29] or any legally binding decisions of the European Commission and/or the Agency. We therefore do not consider that this objective is relevant in this instance.

Ofgem's statutory duties

Principal objective

Ofgem's principal objective is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition. The interests of consumers include the fulfilment by Ofgem of the objectives set out in Article 40(a) to (h) of the Gas Directive. Some of the objectives set out in Article (a) to (h) of the Gas Directive relate directly to protecting the interests of consumers. The obligation to complete a supplier transfer within three weeks is one example of the way in which interests of consumers need to be protected as required under Article 3(6)(a) of the Directive.

We have considered the alternative of delaying change until we have completed our longer-term change of supplier reform (discussed below). However, we do not consider that this is proportionate in the context of our primary objective and that UNC403 and iGT UNC 042 provide benefits for consumers in the round by allowing them to switch more quickly.

Further issues

Longer term reform of the change of supplier process

In July 2012, we set out a work programme for promoting smarter markets on the back of the roll out of smart metering.[30] This document sets out our longer-term objective for a fast, reliable and cost-effective change of supplier process, which will facilitate competition, provide substantial reforms and build consumer confidence. This is an area

[29] The Third Package is distinct from the regulation referenced in this objective. The regulation referenced is Regulation 2009/715/EC on conditions for access to the national gas transmission networks and which was made by the European Parliament and Council.
[30] Promoting smarter energy markets: a work program (July 2012- Ref 110/12) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=52&refer=Markets/sm/strategy

where we have committed over the next 12 months to assess the options for improving the change of supplier process in the medium term.

In particular, we will explore the potential changes to current arrangements, as amended by these modifications, to deliver an appropriate balance between the speed, reliability and cost of the process. We will also assess how these changes might be implemented effectively. We do not consider that our decision to approve UNC403 and iGT UNC 042 should be taken as an indicator for how we will assess any options for reform that arise from our strategy programme.

We recognise that some consequences of the transfer process, and in particular erroneous transfers, can have a detrimental impact on customers. While we will be looking at this as part of our strategy for longer-term work on the change of supplier process, these reforms may not be in place for several years. We therefore consider that suppliers should make all reasonable efforts to reduce the incidence of ETs during the intervening period.

Processing the loss notification by Xoserve

Some respondents raised concerns around the time taken by gas transporters to inform shippers that a customer intends to switch. They argued that in some occasions under UNC403 and iGT UNC 042, if gas transporters took two days to send the loss notification, the shipper, on some occasions during the year, would have no time to object. We recognise that the current proposals seek to address this issue by requiring gas transporters to send certain messages as soon as reasonably practicable where currently they are only required to do so within two business days. We therefore consider that if parties continue to have concerns that they consider addressing these through further modification proposals.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence and Standard Licence Condition 9 of the Gas Transporters Licence, the Authority hereby directs that modification proposals UNC403 and iGT UNC 042 both entitled 'EU Third Package: 21 day switching with flexible objection period' be made'.

Colin Sausman
Partner, Retail Markets and Research
Signed on behalf of the Authority and authorised for that purpose.