

Supplier Licensing Review: Ongoing Requirements and Exit Arrangements

3 December 2019

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses. The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

This is a high-level industry response to Ofgem's consultation on the way forward for the 'ongoing requirements' and 'exit arrangements' phases of the Supplier Licensing Review. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

Minimising the detriment to customers must be the central aim of this review and Energy UK is supportive of Ofgem's efforts through the Supplier Licensing Review to engage with suppliers and ensure this is achieved. The need for action to be taken is pressing in light of the unprecedented number of failed suppliers in the previous 18 months, and the costs faced by all customers as a result of those failures. More robust ongoing requirements and market exit arrangements form part of these protections, and we look forward to continuing our engagement with Ofgem throughout its Supplier Licensing Review.

Energy UK believes that Ofgem should ensure that its proposals are proportionate to the risks to the market, and that any decision is based on a fully-informed and robust evidence base, which is currently lacking. In line with our broader support for principles-based regulation, we believe that Ofgem should be seeking to lay down what should be achieved, including necessary protections for consumers, rather than necessarily making judgements on how it should be specifically achieved by each individual business. In addition, it should remain cognisant of the developments occurring through the joint Ofgem and BEIS Future Energy Retail Markets Review to ensure that the market can capitalise on the opportunities of digitalisation for energy consumers.

Following the recent implementation of stricter market entry requirements, we continue to support Ofgem in its focus on preventing unsustainable or irresponsible business practices causing a detriment to consumers across the market. However, Energy UK is concerned that a number of the proposals outlined in the consultation do not add value or additional powers over and above what is already included in the licence. Ofgem should not be seeking to add conditions to the already lengthy licence that duplicate existing powers or requirements, or are otherwise ineffective in practice or enforcement. We have highlighted those specific conditions throughout our response. In each case more information

is needed on Ofgem's intended use and enforcement of loosely worded conditions to enable us to comment usefully on their merits and practical implementation. Ofgem should not be seeking to add to the licence extra conditions to grant it powers it already holds, and yet to date has been unwilling to use to address concerns with suppliers or practices.

While we generally welcome Ofgem's continued policy development through its Supplier Licensing Review to minimise customer detriment, doing so should not negate the need to take action in the meantime. In the interest of current and future consumers, Ofgem must do more with its existing extensive powers to protect against detriments by intervening where they suspect a supplier will not be able to meet its financial obligations, thus helping to minimise the amount of any money to be mutualised.

Promoting better risk management

5. Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible any evidence, to support your position.

Cost mutualisation protections

Overall, Energy UK recognises Ofgem's efforts in this proposal to better protect customers from the growing costs of mutualisation seen in the previous two years, including those resulting from the protection of customer credit balances. We support the stricter entry requirements recently implemented by Ofgem and believe that they will have a positive benefit preventing unsustainable businesses entering the market and ultimately failing at a cost to all consumers.

Energy UK has previously given support for an enforceable principle for credit balance use, allowing suppliers flexibility to secure arrangements that best suit their business model and that are proportionate to the risk that they pose to the wider system.¹ We continue to support action preventing supplier behaviours that lead to the failure of unsustainable business models, ensuring responsible risk management and preventing the mutualisation of costs when a supplier does fail. However, we also highlighted a number of practical issues that Ofgem would need to assess in order to ensure that any final proposals are founded on a robust evidence base and would meet the review's intent, without having a disproportionate impact upon market incumbents.

We believe that Energy UK's members are best placed to provide detailed responses with relevant supporting evidence to Ofgem's specific proposal in this consultation. There are, however, a number of areas that Ofgem should address to ensure that its Impact Assessment is a robust basis to make decisions on cost mutualisation protections as part of its review that are proportionate to the risks.

We would expect Ofgem to seek out all necessary information to ensure it has built a robust evidence base for its assumptions when calculating costs, which we believe is currently lacking. For example, Energy UK does not view Ofgem's use of just one well-known high street bank to inform its cost assumptions as a robust basis for any decision. There is also no indication of whether Ofgem has enquired or assessed whether this indicative fee rate, or any third-party cover at all, would actually be available to all suppliers, whether currently in the market or potential new entrants. Ofgem should include an assessment of the impacts of any required alternative arrangements if third-party cover is not available which, at a minimum, should include those options it intends to place on the prescriptive "menu" of options. In addition, Ofgem should consider existing market requirements for credit collateral and assess the cumulative impact of its proposal in the wider market context in which it is seeking to add further obligations.

Energy UK would welcome Ofgem's further exploration of all options available to suppliers of all sizes and length of market incumbency to meet any requirements prior to a decision, to ensure that Ofgem is not placing costs onto the market that are disproportionate to the risks to consumers. This could include looking at other markets in the UK to see how protections are being delivered elsewhere, or comparative policies in international energy retail markets.

¹ https://www.energy-uk.org.uk/publication.html?task=file_download&id=7199

Through the building of the required robust evidence base and Impact Assessment, Energy UK would welcome clarity from Ofgem as to any consideration it has given to these proposals, including the impacts and costs, and their interaction with, and deliverability under, the default tariff cap.

We note that a substantial amount of mutualised costs in the market to date have resulted from suppliers' non-payment of obligations, such as the Renewables Obligation. Energy UK would, therefore, welcome clarity from Ofgem as to what policy costs, and what proportion of those policy costs, it would propose needs protecting. As it currently stands, without a specific proposed policy and accompanying assessment of the costs and benefits, we are unable to comment further on protections for such costs.

However, ongoing policy development in this area does not negate the need for Ofgem to reflect on its lack of action to date despite its adequate powers to do so. In the interest of current and future consumers, we would urge Ofgem to do more with its existing extensive powers in the immediate term, intervening where it suspects a supplier will not be able to meet its financial obligations, thus helping to minimise the amount of any money to be mutualised. Energy UK will be writing to Ofgem in due course to emphasise the importance of it making sufficient and effective use of the powers already at its disposal that it has so far been unwilling to use.

Operational Capability

Energy UK supports the greater use of principles-based regulation (PBR), however PBR should be used to simplify regulation rather than simply adding conditions for no discernible reason.

We are currently unconvinced that this additional condition on operational capability will deliver over and above existing conditions, such as the Standards of Conduct. We would, therefore, welcome clarity on Ofgem's understanding of what additional powers this condition would practically grant it with regards to its current powers. The condition should not be progressed unless Ofgem can demonstrate that it gives additional powers in practice to better prevent unsustainable or irresponsible business practices from operative in the market, to the detriment of all customers.

In addition, we would question the nature of the term "sufficient operational capability" as well as how this principles-based requirement would be consistently measured by Ofgem from a compliance perspective. The broad nature of this requirement means it is unclear whether Ofgem would utilise it solely in prevention of suppliers failing or whether it could be used to monitor supplier activity more generally. While we agree that Ofgem should not seek to impose additional prescription upon suppliers, clarity on its intention and examples of the checks that it would seek to put in place to measure compliance would be welcome.

Furthermore, there is a risk that Ofgem does not currently have the in-house expertise on financial and operational systems in order to adequately monitor compliance to this proposed requirement if it seeks to make value judgements on what are a wide range of differing business models. We are concerned that Ofgem would then rely heavily on independent audits, which would be wholly disproportionate, costly and contradictory to Ofgem's stated intention for the proposed new licence condition on audits.

6. Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider to help us to identify where suppliers' may be in financial difficulty?

Milestone Assessments

Overall, Energy UK agrees with the principle of the proposal for Ofgem to assess suppliers at certain milestones to ensure that they remain sustainable throughout periods of growth, as long as it is appropriately mindful of the different ways in which businesses can be robust during periods of growth. We are also supportive of Ofgem's risk-based, 'dynamic' assessment at the point at which it considers suppliers may be in financial difficulty, potentially demonstrated by outstanding payments to industry parties or statutory demands, and agree that a fixed set of criteria should not be prescribed.

However, greater clarity is needed on the nature and robustness of Ofgem's planned scrutiny of suppliers, including the specifics of what Ofgem will be assessing and how. While we believe that it is

important to ensure suppliers have a credible business plans in place as they continue to grow, there is a concern that this proposal would mean Ofgem becoming the arbiter of “good” innovation in which it makes value judgements on differing business models.

We would also urge Ofgem to provide details as to its intended approach to these reviews. In particular, how far in advance of crossing a customer number threshold Ofgem would allow a supplier to undertake the review, and whether a review for multiple milestones could be undertaken at the same time, which may allow for efficiencies for such suppliers and Ofgem.

It will be important that Ofgem strike an appropriate balance between protecting customers from supplier failure and encouraging innovation. As the regulator, Ofgem should be seeking to lay down what should be achieved, rather than necessarily making judgements on how it should be specifically achieved.

More responsible governance and increased accountability

7. Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?

Ongoing fit and proper requirement

Energy UK is broadly supportive of this proposal if Ofgem can show how it will be effective in practice, and that it would not be an additional regulatory burden that is unused by Ofgem.

We would welcome clarity from Ofgem as to what action it would expect suppliers to take if an employee failed such a check, and what action Ofgem itself would seek to take in such a circumstance. An additional licence condition which Ofgem does not, or cannot enforce against effectively in practice would not be a useful addition to the already lengthy licence, not make a positive impact upon the prevention of unsustainable or irresponsible suppliers operating in the market.

We would encourage Ofgem to adapt its wording to make clear who is understood by “relevant persons” and what is entailed by “fit and proper”. As currently worded, there is a concern that the scope would be overly broad. The language should be tightened to align with the purpose, i.e. those employees taking big commercial decisions. In doing so, Ofgem should also ensure that the requirement covers those contractors or part-time employees that make such decisions.

Open & Cooperative Principle

Energy UK does not believe that this condition would be a useful addition to the already extensive supply licence conditions. Ofgem already has powers to compel suppliers to provide information, making this proposal redundant. Inserting a short, principles-based condition into a 500+ page licence is unlikely to impact upon culture in unreasonable suppliers, and nor should the licence be used in such a way.

Energy UK would urge Ofgem to clarify what is expected from suppliers over and above current requirements in acting cooperatively with Ofgem, and how it would seek to enforce against the condition in practice. We are concerned that, as currently worded, such a requirement could be too broad a condition. For example, would Ofgem consider a supplier not to be open and cooperative if it did not respond to voluntary RFIs, or if a supplier was publicly critical of any decision taken by Ofgem?

Increased market oversight

8. Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?

Living Wills

Energy UK acknowledges the intent of this proposal, and the importance of improving data quality overall in the sector, and for the specific instances of supplier failures and SoLR events. However, we remain unconvinced that a living will would translate in practice to reliable improvements. For most suppliers, it would likely just result in an additional burden in terms of costs and resources that would never be utilised. For those suppliers that are beginning to fail, or find themselves in financial distress, it is unlikely that maintaining an up to date living will would be the highest priority, undermining Ofgem's main intent for its existence. Given that Ofgem does not regulate administrators, it is unclear how Ofgem would hold a failed supplier to account in line with any living will it had produced.

Ofgem should instead continue to explore alternative methods to meet its aim. For example, the need for improving data quality in the sector which could be better achieved through more effective, targeted and standardised reporting of operational data relating to the aims of this review. By requiring all suppliers to provide specific, targeted information as necessary to Ofgem, such evidence would be easily accessible by Ofgem prior to licences being revoked and the proposed burdensome living will requirement would not be relevant.

9. Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.

Independent Audits

Ofgem already has powers of direction to instruct suppliers to undertake independent audits where a case can be robustly built, and it has used this power previously. Energy UK does not believe that Ofgem has sufficiently set out its reasoning for the inclusion of this proposed new licence condition.

Energy UK is concerned that the overly broad scope of power granted to Ofgem through the current wording of the draft licence condition does not align with Ofgem's stated intent of its use. Independent audits should only be requested in instances where Ofgem can robustly demonstrate that suppliers have materially failed to meet their obligations, yet the wording allows Ofgem to require a supplier to undertake an audit in any circumstance that it deems fit. Conducting these audits is cost-intensive, and their overuse will ultimately increase customer costs.

We note that the text of the consultation, and the Impact Assessment, highlight Ofgem's intention to use the power sparingly and proportionately, but this is not reflected in the wording of the condition. No restrictions are currently included in the wording, and Energy UK believes that this condition would grant Ofgem disproportionate power. If it is able to set out a robust case for the continued inclusion of this new licence condition, we believe that at the very least the wording would need to be tightened to ensure that its scope remains true to the intention, potentially by including sufficient checks and balances on Ofgem's ability to use it. For example, Ofgem's scope should be restricted to enforcement of the new licence conditions resulting from the Supplier Licensing Review.

Market Monitoring

Energy UK supports Ofgem's efforts to adopt a risk-based approach to monitoring supplier compliance.

Exit arrangements

10. Do you agree with the near terms steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?

Administrators

Energy UK has previously highlighted concerns with the current practice of some administrators of failed suppliers, and supports action to better protect customers from sharp practices and to improve their overall experience.

We acknowledge that the regulation of administrators is outside of Ofgem's remit, and welcome its efforts exploring what can be done within the current regulatory framework. Energy UK is concerned that its proposed changes would, however, have limited, if any, impact on influencing administrator

behaviour when acting for a failed supplier. We note that back billing constraints are generally already included in supplier T&Cs, yet there have been cases of administrators ignoring these.

Energy UK is keen to understand the legal impact Ofgem believe this requirement will have, and if there is any evidence supporting that view. While the proposed changes may have relatively low-impacts on suppliers, it is unclear how beneficial these changes will be in actuality, if at all.

More importantly, we would urge Ofgem to approach the appropriate regulator with the power to influence administrator behaviour to ensure that concrete action can be taken to better protect customers of failed suppliers. Ofgem should build on its recent open letter about insolvency practitioners and work towards getting endorsement and support from the Insolvency Services for appropriate services standards continuing for customers when they undertake their work.

11. Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?

Portfolio Splitting

Energy UK continues to support Ofgem having the option of portfolio splitting in principle. We believe that maximising competition in any market is the best way to improve consumer outcomes overall and ensure the most robust protection. In that regard, we believe that Ofgem having the option to split supplier portfolios through the SoLR process could maximise participation by competing suppliers (e.g. Domestic and Non-domestic), thus fostering greater competitive pressure and better outcomes.

However, as outlined in our response to Ofgem's Working Paper in July, customer protection should be paramount in the SoLR process and there are wide-ranging technical challenges that must be addressed in order ensure any such process is a positive experience for consumers, and they remain effectively protected.² As such, we welcome Ofgem's intention to engage with the wider industry to explore these challenges.

Prior to recommending or coordinating any required changes to industry systems, Ofgem would have to make a full assessment of the costs and benefits of such changes to ensure that there is a positive case for its proposals.

Trade Sales

Energy UK would welcome clarity on Ofgem's understanding of its legal remit to include itself into such commercial decisions. Ofgem should be wary of pushing forward with proposals that dampen the appetite for commercial transactions. We do not believe that Ofgem has put forward a robust rationale for its proposals, and we are concerned that interfering with commercial transactions could set a dangerous precedent, even if it is well meaning.

Appendix 1:

12. Do you think our draft supply licence conditions reflect policy intent?

As highlighted in responses above to individual proposals, Energy UK is concerned that the wording of a number of the draft licence conditions proposed by Ofgem are too broad, expanding their scope far outside their intended purpose. For example, the definition of 'Senior Management Responsibility or Influence' is open for interpretation as organisations will have different organisational structures and so there will be uncertainty as to who should be included. Ofgem should review the wording to ensure that it accurately reflects the intended scope and aim of each condition.

Energy UK notes that Ofgem has included a draft licence condition on improvements to SoLR process in the appendix which was not referenced within the main text or questions of the consultation. The

² https://www.energy-uk.org.uk/publication.html?task=file_download&id=7199

appropriateness of such a condition on commitment during the SoLR process has been questioned previously. There is a concern that it could limit the willingness of suppliers to be the SoLR as it is dependent upon the information eventually received from the failed supplier, potentially making it unable to meet any commitment previously made. Ofgem should ensure that any proposals are put to proper consultation before pushing forward with any decisions.

If you would like to discuss the above or any other related matters, please contact me directly on 0207 747 2931 or at steve.kirkwood@energy-uk.org.uk.