

# Supplier Licencing Review: Reducing Credit Balance Mutualisation

## Energy UK Response

12 May 2021

### 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 over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. 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

Energy UK continues to support Ofgem's Supplier Licensing Review and its aim to protect customers from the impact that financially ill-prepared suppliers have on their competitors and the market more generally. We, therefore, welcome Ofgem's continued work in this area and are pleased to see that Ofgem has sought to take onboard industry feedback on its previous proposals.

Energy UK's members, however, continue to hold a range of differing views on the new proposals put forward by Ofgem in this consultation, reflecting the different views on the impact the proposals will have on reducing mutualisation risks and, more generally, ensuring a sustainable and competitive retail market. As a result, Energy UK's response does not address the underlying merits of the proposals themselves. Instead, we have focused on highlighting our overarching concerns with Ofgem's policy development process, and the practical points with regards to the two proposed interventions, which we hope will be helpful.

In particular, while we recognise that Ofgem has stated its policy intent is to minimise the costs associated with mutualising excess customer credit collected by failed suppliers, Ofgem has not shared a full Impact Assessment in support of its proposals on which effective judgements can be made. A robust Impact Assessment, based on the latest data, is essential in order for stakeholders to scrutinise a significant intervention that is likely to have consequences for the nature of competition in the retail energy market.

With regards to the two specific proposals themselves, if Ofgem decide to move forward we believe that there are a number of practical changes that must be addressed to ensure that they are proportionate to the risk, that customers preferences are able to be taken into account, and that suppliers have sufficient time to migrate their business models accordingly to minimise impacts on customers.

## **Ofgem's Policy Development Process**

### ***Research, Data and Evidence***

Whilst Energy UK agrees with and is supportive of the intent behind the proposals, we are concerned that Ofgem has not undertaken sufficient research to understand whether its specific proposals would bring about tangible benefits to customers and the market.

Whilst we recognise Ofgem's acknowledgement that the threshold model will require up to date data, we are concerned that Ofgem's current proposals are predominantly built on 2017/2018 data. To develop effective policy, we would expect Ofgem to base its policy development and decision making on up-to-date data and evidence. We, therefore, believe Ofgem should look to conduct such an assessment prior to making a decision on the implementation of any changes which takes into account the latest supplier data, and evidence from the most recent SoLR events. This should consider the drivers of supplier failure, including, but not limited to, governance and ongoing compliance issues, financeability of operations, and rising industry/policy costs. The market has changed significantly over the past few years, not least due to the implementation of the Default Tariff Cap, and should be assessed based on its current composition and behaviours, rather than those of the pre-price cap market.

We note that Ofgem has also not undertaken analysis of the costs of its new proposals on suppliers and, therefore, welcome its data request from suppliers to support forthcoming analysis. The initial proposals - which required suppliers to protect a minimum of 50% of customer credit balances and a proportion of government scheme costs, including the Renewables Obligation - were not deemed to be a cost-effective way of protecting customer credit balances. In this consultation, Ofgem claim its new proposals should only impose minimal costs on suppliers. However, as Ofgem have not provided a full assessment of the costs of its new proposals at this time, we are unable to determine the potential cost-savings when compared to the initial proposals, or the costs of mutualisation. As such, Energy UK urges Ofgem to conduct a full cost breakdown of its new proposals using up to date data provided by suppliers, including any associated implementation and administrative costs, before taking action to implement any changes.

We are also concerned that Ofgem will not be seeking to take into consideration any cumulative impacts upon suppliers or customers by the separate development of any potential requirements around the RO. It would be prudent to ensure that the simultaneous development of two market interventions with potentially significant impacts upon suppliers' financeability are not considered in complete isolation of one another.

Overall, while we recognise that Ofgem is seeking to minimise the costs of mutualisation by limiting the amount of excess customer credit held by suppliers, Ofgem should ensure that it has assessed the full impacts of its proposals on competition in the market and that, if these proposals are progressed, they represent an overall benefit to consumers.

With this in mind, we do, however, agree that the proposed measures would be unnecessary in the non-domestic market. Current licence conditions mean that non-domestic credit balances are not claimed for under the Supplier of Last Resort process, and, therefore, do not pose any mutualisation risk to the sector. Additionally, as Ofgem acknowledges, credit balances in the non-domestic market do not build up to the same extent as in the domestic market because a significantly higher proportion of customers pay on receipt of an invoice (e.g. Variable Direct Debit or BACS payment) and manage their accounts much more closely, with payments tending to match usage.

### **Autorefund Proposal**

#### ***Refund Limit***

Energy UK is concerned that Ofgem has not undertaken any customer research in order to understand whether an autorefund policy is indeed what consumers want. Under Ofgem's current autorefund proposals, a customer would receive a refund at the end of the 12<sup>th</sup> month no matter how large or small their credit balance is, and there is no option to take into account the customer's preferred approach for controlling their own account.

A number of Energy UK members have conducted primary research into consumer refund preferences. This research has shown that, generally, customers would rather not receive refunds up to a certain level, especially if, for whatever reason, their direct debits (DDs) payments are set to increase for the next year and any credit balance could otherwise be used to offset this. Based on this, some suppliers have set refunds to only above a certain level. Whilst this research is insightful, we reiterate that, prior to the implementation of any SLC changes, Ofgem should seek to conduct its own research to understand exactly what consumers want, and what policy interventions would bring about the greatest benefits.

We also note that at present, the proposals would require suppliers to refund any credit balances above £0 at the end of each contract year, which could include refunds of very small amounts that may result in a poor customer experience or confusion. Energy UK members will be able to comment on whether there will be any material costs associated with refunding small amounts, but if this is the case then setting a threshold could help to avoid this. If Ofgem are to progress with an automatic refund proposal, we believe it would be appropriate for Ofgem to determine the minimum threshold amount via means of research and collecting evidence to understand consumer preference.

### ***Opt-out Policy***

Given that Ofgem have stated they are aware that some consumers may prefer for their energy account to be in credit, it is not clear why Ofgem has not considered a consumer opt-out policy. Some customers may consider these proposals to encroach upon their autonomy over their own account. As such, an opt-out (with additional safeguards if appropriate) policy may be beneficial to limit customer detriment in this respect.

### ***Reporting Challenges***

The autorefund proposal also raises the question about how suppliers would prove that they have refunded all customer credit balances above £0 at the end of each customer contract within their portfolios. Energy UK is concerned that such proposals may, in practice, be cumbersome and practically unworkable for Ofgem to ensure compliance with, only serving to create further reporting burdens for suppliers. We, therefore, welcome clarification from Ofgem on how it envisages suppliers reporting and how it intends to ensure compliance, also noting the challenges associated with a risk-based approach highlighted above.

### ***Meter Reads***

We are also surprised that Ofgem do not propose to link the refund of surplus credit balances to a supplier gaining a meter read. We are concerned that, at least until the Government's smart meter rollout is completed, this proposal will only lead to further consumer detriment and a poor customer experience – particularly, where consumption has been underestimated. If a meter read was achieved before the refund, the customer would then be confident that they are not indebted to their supplier at the end of their contract year. It would be a poor consumer experience to be auto-refunded at the end of a fixed term only to have their account be in debt once an updated meter read is submitted. As such, we encourage Ofgem to consider, if it were to introduce this policy, whether autorefunds of surplus credit balances should only be based on actual meter reads and not estimates.

### ***Threshold Proposal***

We are concerned that the current draft Licence Conditions regarding when a customer's annual reassessment takes place may be too restrictive. We note that the current drafting may adversely impact a number of suppliers across the market, potentially creating unnecessary additional administrative burdens and costs to suppliers if system and/or existing contract changes are required to align with the current drafting.

In order to maximise the level of actual reads that feed into the annual reassessment, Ofgem should allow for greater flexibility in setting reassessment dates for both existing and new customers to ensure annual reassessment processes remain efficient. This should allow better alignment with many suppliers' existing processes while still maintaining the original policy item. We would welcome Ofgem

working with suppliers to revise the current drafting to most appropriately provide this flexibility in setting reassessment dates; thereby minimising any adverse impacts by better aligning with the processes and meter read schedules currently used by suppliers.

## **Monitoring & Enforcement**

In general, Energy UK has been supportive of Ofgem's risk-based approach to monitoring, compliance and enforcement. However, we also note that it is not clear whether a strictly risk-based approach to either the existing or the new proposals can, in practice, actually drive and ensure compliance in this space. We note, for example, that recent SoLR events would suggest that financially ill-prepared suppliers have been at the smaller end of the market, where the potential and extent for consumer detriment, and, therefore, risk, by the very nature of companies' relative size, is smaller. Ofgem must ensure that its monitoring and enforcement work captures and drives compliant behaviours across suppliers of all shapes and sizes if any new rules are to be effective in this space.

## **Implementation**

When considering the implementation of these proposals Ofgem should factor into any timeline the processes that some suppliers will need to undertake (such as potentially migrating business models) to ensure the implementation deadline is reasonable and allows for cost-effective compliance from suppliers to minimise the impact upon their customers. Consideration should also be given to the point in the year in which changes are implemented, due to the seasonal nature of direct debits and credit balance.

**We trust Ofgem will find these comments of use. However, for further information or to discuss our response in more detail please contact Paige Truelove at [paige.truelove@energy-uk.org.uk](mailto:paige.truelove@energy-uk.org.uk).**