

# Supplier Licensing Review: Ongoing Requirements and Exit Arrangements

26 July 2019

## Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry response to Ofgem's update 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 a number of the options being considered by Ofgem which would ensure this is achieved. Energy UK believes that Ofgem should prioritise those actions which seek to prevent 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. 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 positive engagement with Ofgem throughout its Supplier Licensing Review.

Energy UK is urging Ofgem to centre its new ongoing market requirements on promoting more responsible risk management and governance (work packages 1 and 2), as well as improved market oversight (work package 3). Most prominently, we believe any implementation of a credit-use regulation should be principles-based, 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. Energy UK supports a risk-based approach to supplier reporting, which could be based on factors such as supplier growth and operational longevity.

While improvements to the risk management of suppliers could succeed in reducing the rate of SoLR events and subsequent costs for customers, there will always be market failures in a competitive

market. It is right, therefore, that Ofgem looks to reduce customer detriment directly resulting from the SoLR process. One such area that should be addressed is the lack of regulation on the administrators involved in the SoLR process to better prevent the mutualisation of costs, potentially by Ofgem working with government to reconsider the use of the Energy Supply Company Administration regime.

Ultimately, regulation around alternative mechanisms for recovering costs of SoLR and improving the SoLR experience for consumers (work packages 5 and 6) would not be as necessary should more effective measures be successfully implemented to prevent the unsustainable practices that have caused a large number of failures to date.

### **Ongoing Market Requirements**

Energy UK's views in this response are focused on actions to prevent supplier behaviour that leads to the failure of unsustainable business models, as opposed to actions focused on curing post-failure customer detriment. Therefore, Energy UK is urging Ofgem to centre its new ongoing market requirements regulation on work package 1 with the addition of factors from work packages 2 and 3.

#### Work Package 1: Promoting more responsible risk management

Energy UK is generally supportive of Ofgem's proposal for an enforceable principle for credit balance use, but would welcome greater clarification on the practical implementation. Energy UK believes any implementation of a credit-use regulation should be principles-based, 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. Through this approach Ofgem must also avoid putting in prescription via guidance.

Ofgem will need to assess a number of practical issues, such as how the measure could alter the supplier practices already in place and, as a result, have a negative impact on market incumbents. In addition, Ofgem will need to address how it would account for suppliers using their credit funds depending on seasonality and prices of energy, and the resulting customer impact. For example, if a supplier alters its financial model to change direct debit charges depending on the season, this could have a detrimental impact on consumers who budget according to their monthly direct debit. Energy UK would like to understand how Ofgem intends to better protect credit balances and would welcome greater clarity on what compliance may look like under a principle-based risk management regime in its autumn consultation.

If implemented, Ofgem should also consider incorporating the use of credit balances within market-entry checks for new suppliers as part of its assessment of entrant's funding arrangements, and monitoring on a risk basis thereafter. Supplier activity should be closely monitored once a risk has been identified, as opposed to Ofgem continuously monitoring suppliers that present no risk of failing. We note that "risk" would likely mean the inability of the supplier to cover its customer credit balances should this supplier fail. Ofgem should also use its own experience of supplier failures to determine when risks arise and where timely intervention would be needed. We maintain that Ofgem is not to shy away from new regulation that could accelerate the SoLR process for current suppliers with poor business models. The risks associated with such regulation are worth bearing in order to protect consumers in the long-term. We propose that, through risk-based monitoring, Ofgem could limit or prevent suppliers from using customer credit balances and stop them from taking on further customers to cover their debts. Energy UK supports a risk-based approach based on supplier growth and operational longevity amongst members.

Regarding an appropriate implementation period for work package 1, on principle Energy UK believes that all suppliers should meet the same requirements as part of there being a level playing field in how they are expected to operate and protect customers. However, Ofgem should consider whether suppliers should be granted limited additional time to adjust their financial plans if required and secure appropriate protections, to minimise the risk of market failure as a result of the regulatory action. Therefore, the implementation period ought to be as soon as practicable, but with Ofgem allowing applications for derogations. Such derogations should be granted on a case-by-case basis for those suppliers that can adequately demonstrate that a set amount of extra time to become compliant is

needed, and where Ofgem judges it to be in all customers' interest. We believe that this approach would also have added benefits to Ofgem's risk-based monitoring. Energy UK acknowledges the possibility of certain suppliers ultimately not being able to comply with the consumer protection measures delivered through this reform. However, we believe Ofgem should still enforce new regulation as it would be in the long-term interest of consumers, despite the fact that it could lead to a SoLR process.

On the topic of whether all use of credit balances or an "excessive" use of credit balances should be regulated, Energy UK believes that "excessive" would be hard to define and that Ofgem should be acting on credit balance usage in a risk-based manner. If Ofgem deemed credit balances as truly "excessive" and a customer harm then it should be addressing this through existing powers.

Energy UK supports Ofgem's proposal to establish a licence condition that requires suppliers to demonstrate that they are making prudent provision to discharge their obligations under government schemes and policies. Failure to discharge the costs of social and environmental schemes is a valid precursor to supplier failures but is too late of an indication. Ofgem should also look at earlier trigger points such as credit default under Balancing & Settlement Code (BSC). Having a specific licence condition will provide Ofgem with more effective powers to address risks of failure through the use of its current provisional order powers set out in the Gas Act 1986 and Electricity Act 1989.

#### Work Package 2: More responsible governance and increased accountability

##### *2. b. Requirement for named officers*

Whilst we can appreciate the concern about some requirements being more onerous for smaller suppliers, Energy UK argues for a level playing field and the same requirements across suppliers regardless of size. However, Ofgem should not be able to dictate a certain role that should be fulfilled, rather, suppliers should be able to provide a named appointee as part of ensuring a wider system of control.

##### *2. c. Enforceable principles setting out standards of behaviour/governance*

Energy UK believes that it is unclear how enforceable governance standards would be different from the current licence standards of conduct. Furthermore, an effective monitoring and enforcement regime should promote the desired outcome in terms of company cultures and behaviours.

#### Work Package 3: Improved market oversight

##### *3. a. Cyclical reporting requirements – assurance reporting*

Energy UK maintains that Ofgem should take an efficient approach to reporting and not duplicate requests, as well as outline clear intentions of how the data is going to be used. Ofgem should also consider the timing of reporting requests to ensure these provide useful insight. Any such cyclical reporting requirements, such as financial health indicators, should be applied consistently across market participants, with further information being sought on a risk-based approach.

##### *3. b. Risk-based reporting*

Energy UK is supportive of risk-based reporting, as noted above in work package 1. Ofgem already possesses extensive powers that enable it to request information from suppliers, and such information can be requested under a risk-based approach. However, it would appear that Ofgem has historically exercised these powers (e.g. through compliance engagement) later rather than sooner. Any solution may not necessarily require expanding Ofgem's ability to request information, rather Ofgem should be willing to step in earlier and exercise its pre-existing powers to request information where it has reason to believe that suppliers are having issues.

3. *c. Requirement for suppliers to provide assurance to Ofgem through independent audits*

Energy UK is concerned with the proposed requirement for suppliers to provide assurance through independent audits. We suggest that such a process should only be used in specific and exceptional situations, where Ofgem has identified significant compliance risks/failures, with clear restrictions on Ofgem's ability to use it (such as only after a direction has been issued).

3. *d. Requirement to maintain a 'living will'*

Energy UK believes it would be a waste of resources for larger, or more established suppliers to maintain a 'living will' as the risk of these suppliers failing would not be proportionate to the proposed additional burden being placed upon them. In addition, it is unclear how maintaining a "living will" would translate in practice given that any obligation to adhere to it would fall away once the licence is revoked following the supplier's failure.

3. *e. Requirement to notify Ofgem of Change of Control events*

Energy UK stands that requirements to notify Ofgem of Change of Control events should be established along the lines of percentage of equity or voting rights.

## **Exit Arrangements**

### Work Package 4: Improving efficiency and competitiveness of the SoLR process

4. *a. Data collection and transfer to relevant parties*

Energy UK believes that the requirements on backing up and formatting of data are not ambitious enough and hold that it is the quality of the data that needs to be improved.

4. *b. Powers to revoke supply licences*

Energy UK is concerned over adding criteria that would allow Ofgem to revoke supply licences as it is not clear what that criteria would be.

4. *d. Splitting the existing supplier's portfolio*

Energy UK believes customer protection should be paramount in the SoLR process, especially as Ofgem's reforms should see the process become an actual last resort rather than the default market exit process that we have seen it become since the start of 2018. We believe 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 having the option to split supplier portfolios through the SoLR process would maximise participation by competing suppliers, thus fostering greater competitive pressure and better outcomes. Moreover, in the case of splitting a combined portfolio into Domestic and Non-Domestic market portfolios, you avoid artificially foreclosing a market (the Non-Domestic supply market) from a large number of suppliers who are designed to serve that market (i.e. Non-Domestic only suppliers). As such, Energy UK supports the idea of Ofgem having the option to split supplier's portfolio in principle.<sup>1</sup>

However, we recognise that there are wide-ranging technical challenges that must be addressed in order to ensure any such process is a positive experience for consumers and that they remain effectively protected. We believe that challenge of finding and implementing the necessary industry-wide solutions would be most suitable for an Ofgem-coordinated approach. Through this work, there will be a need to ensure that customer outcomes are not worsened by delays, complexities or confusion, and that the underlying industry processes and data are robust and reliable enough to prevent customer detriment.

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<sup>1</sup> SSE has indicated that it does not support this position, highlighting concerns with detriment being caused to the customer protection objective of the SoLR process.

Energy UK believes that a great level of customer detriment arises from the lack of regulation on the administrators involved in the SoLR process. We note that this concern is shared by others such as Citizens Advice<sup>2</sup>. One solution that Energy UK has raised previously is for Ofgem to work with government to reconsider the use of the Energy Supply Company Administration regime, initially set up when the market had fewer suppliers. The regime should be reformed to address market evolution over the past eight years. Alternatively, we think Ofgem should seek to bring in energy company administrators within some form of regulation to ensure that during the administration process they have an obligation to consider consumers' interests and follow certain rules.

#### Work Package 5: Improving the mechanisms to recover costs

##### *5. b. Accounting for costs recovered through the liquidation process*

Energy UK underlines that regulation around alternative mechanisms for recovering costs of SoLR would not be as necessary should regulation to prevent SoLR from happening be implemented. However, alongside bringing the administration process within regulations, Ofgem should seek to ensure greater transparency through the liquidation process. For example, it is not clear how the recovery of debt is then applied in the process, how it is then used to offset the credit balances that the SoLR will honour and how this all impacts upon the levy claimed by the SoLR. Depending upon how all this works, there may be other options to explore within the 'exit arrangements' area of work going forward.

##### *5. c. Alternative mechanisms for recovering costs of SoLR*

We are concerned that the 'sinking fund' could potentially lead to irresponsible behaviour and expose a number of suppliers to an additional fund they are not able to make.

#### Work Package 6: Improving the SoLR experience for consumers

Suppliers' customer service capabilities are already scrutinised through the SoLR request for information (RFI) process. Energy UK highlights that regulation to improve the SoLR experience for consumers would not be as necessary should regulation to prevent SoLR from happening as frequently be implemented. We support work package 6 but maintain that the focus of Ofgem for its ongoing requirements should be on prevention first, rather than cure.

Regarding the experiences of customers in debt to a failed supplier, Ofgem should focus on bringing administrators into regulation or reforming the Energy Supply Company Administrations regime, rather than looking to prescribe suppliers' actions on debt books. This should remain a separate commercial decision and there are significant risks introduced if the data from the failed supplier is of poor quality.

**If you would like to discuss the above or any other related matters, please contact me directly on 0207 024 7634 or at [daniella.weduwer@energy-uk.org.uk](mailto:daniella.weduwer@energy-uk.org.uk).**

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<sup>2</sup> <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/picking-up-the-pieces/>