

**Gas and electricity suppliers,  
consumer organisations, and  
other interested stakeholders**

Email: [RetailFinancialResilience@ofgem.gov.uk](mailto:RetailFinancialResilience@ofgem.gov.uk)

26 August 2022

Dear Stakeholders,

**Decision on licence requirements for supplier control over material assets**

On 20 June 2022 we published a statutory consultation<sup>1</sup> on a proposal to enshrine in the electricity and gas supply licences the key components of the guidance<sup>2</sup> accompanying the Financial Responsibility Principle (FRP)<sup>3</sup> and the Operational Capability Principle (OCP)<sup>4</sup>, recently updated in May 2022<sup>5</sup>.

The guidance informs suppliers how they should comply with their obligations under the OCP and FRP, as well as how the principles are implemented and fit within our existing regulatory framework. The May 2022 update confirms what is expected of suppliers in relation to ownership or control of the material assets needed to run their business.

The statutory consultation closed on 19 July 2022. We have received five responses from stakeholders. Having considered these responses, this document sets out our decision to proceed with adding the new licence drafting as proposed to ensure suppliers are clear that there is a direct obligation to comply with these requirements and enforcement consequences from a failure to do so.

**The rationale behind our proposals**

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<sup>1</sup> [Control of assets statutory consultation \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/control-of-assets-statutory-consultation)

<sup>2</sup> [Guidance on the Operational Capability and Financial Responsibility principles \(1\).pdf](#)

<sup>3</sup> Electricity Supply Licence Standard Condition 4B. Financial responsibility principle

<sup>4</sup> Electricity Supply Licence Standard Condition 4A. Operational capability

<sup>5</sup> [Decision on the proposed guidance on the Operational Capability and Financial Responsibility principles | Ofgem](#)

In our consultation we explained that where licenced suppliers do not have sufficient control over the material assets used or needed to run their supply business, this has the potential to cause significant levels of detriment to consumers and other responsible market participants. In the context of the OCP, where suppliers do not have sufficient control over material assets, this is likely to impede a Supplier of Last Resort (SoLR) or special administrator from being able to provide an effective and efficient service to customers in the event of supplier failure. In the context of the FRP, failure to have legally enforceable rights over any hedged position, or other asset a supplier relies on to meet the FRP, could increase the costs at risk of being mutualised<sup>6</sup>, placing additional costs on other market participants that will be passed on to consumers through higher bills.

Given the potential adverse consequences of failure to have sufficient control over material assets, we consider that it is prudent, and supports our principal objective to protect the interests of consumers, to place the obligation to do so directly into the licence. This ensures suppliers are clear that there is a direct obligation to comply with these requirements and highlights to suppliers the enforcement action Ofgem can take in the event of a failure to do so. In feedback to previous consultations, stakeholders indicated that they would welcome this clarity.

### **Background: changes to the Guidance on the Operational Capability and Financial Responsibility principles**

In May of this year, following consultation, we decided to implement changes updating guidance accompanying the FRP and on new guidance for the OCP<sup>7</sup>.

The OCP places an obligation on a supplier to ensure it has and maintains robust internal capability, systems and processes to enable it to efficiently and effectively serve each of its customers. We created new guidance accompanying the OCP to clarify that we expect, in complying with the OCP, suppliers to own or have sufficient control over all material assets required to run their supply business.

Material assets, in the context of the OCP, are those relied on by a supplier to run its supply business and meet its obligations to customers. Whether a particular asset is material will therefore depend on the specific circumstances and we expect the suppliers will know which assets are material to running their business. However, to assist in the amendments to the guidance, we provided a non-exhaustive list of assets which are likely

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<sup>6</sup> Has the meaning given to it at SLC 1 of the gas and electricity supply licences

<sup>7</sup> [Update to action plan on retail financial resilience: supplier control over material assets | Ofgem](#)

to be material (premises, facilities, staff, equipment, IT systems, brand name and hedging contracts).

We further specified that sufficient control means that suppliers have direct ownership or legally enforceable rights over their material assets so that they are able to rely on them legally and enjoy the benefit of them.

The FRP is an overarching obligation on suppliers to act in a financially responsible manner. It requires suppliers, at all times, to manage responsibly costs that could be mutualised and take appropriate action to minimise such costs and to have adequate financial arrangements in place to its costs at risk of being mutualised.

We updated the FRP guidance to confirm that if a supplier uses an asset to meet its obligations under the FRP, it must either own this asset or have sufficient control over it so that it can rely on it legally and enjoy the benefit of it and that it should not liquidate, sell or dispose of such an asset if doing so increases the risk and amount of mutualised costs. This was in response to the unfair and disproportionate risk faced by consumers where arrangements enable a parent or other group company to retain assets used by a failed supplier which could otherwise help offset the costs of a supplier's failure.

The reasons for our decision to make these changes, as well as a summary of stakeholder views and our responses to them, are set out in full in our May decision document<sup>8</sup>

### **Summary of our licence modification proposals**

The purpose of the 20 June 2022 statutory consultation<sup>9</sup> was to consult on the licence changes necessary to place these obligations directly into the licence. As such, the consultation was on the introduction of the proposed licence changes rather than the policy explained in the guidance, which had already been consulted on and implemented in May.

The proposed licence changes are set out in full in the decision notice accompanying this letter, but the key changes can be summarised as follows (applicable to both the gas and electricity supply licences):

- Modifications to SLC 4A to require a licenced energy supplier to have sufficient control over the material economic and operational assets to run its business.

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<sup>8</sup> [Decision on the proposed guidance on the Operational Capability and Financial Responsibility principles | Ofgem](#)

<sup>9</sup> [Control of assets statutory consultation \(ofgem.gov.uk\)](#)

- Modifications to SLC 4B to require a licenced energy supplier to have sufficient control over assets used to meet its obligations under SLC 4B.
- Obligation that the licensee shall not liquidate, sell or otherwise dispose of Material Economic and Operational Assets it uses to meet its obligations under this condition, if doing so risks an increase in costs at risk of being mutualised.
- Inclusion of the definition of "Sufficient Control", as having either direct ownership or legally enforceable rights over Material Economic and Operational Assets so that the licensee can legally rely on them and enjoy the benefit of them.
- Inclusion of the definition of "Material Economic and Operational Assets" as those assets, mechanisms or arrangements used or needed by a supplier: to run its supply business and meet its obligations with regards to customers; to manage responsibly its costs at risk of being mutualised; as adequate financial arrangements to meet its costs at risk of being mutualised, with such assets, mechanisms or arrangements including, but not limited to, premises, facilities, staff, equipment, IT system, brand name and hedging contracts.

## **Summary of consultation responses**

We received five consultation responses. Four of the five responses were supportive of the proposals, although one of the four indicated that Ofgem's proposals would not be the only way of achieving its objectives.

One stakeholder was critical. This stakeholder indicated that they did not agree that the proposal would achieve the objective of ensuring suppliers have sufficient control of assets because such arrangements that a supplier may put in place to comply could be terminated in the event of an impending insolvency. This stakeholder also indicated that they considered that compliance would require a costly range of intra-group contracts with no real benefit.

In their responses two of the respondents criticised the process Ofgem has followed in introducing the proposed changes. One of the two was the respondent who was critical of the policy. Both of these respondents considered that Ofgem could have engaged more with industry before introducing the changes, and that it would have been appropriate for Ofgem to conduct an Impact Assessment on the proposals. One of these respondents also considered that Ofgem had introduced prescriptive rules into the guidance which go beyond the reasonable scope of the licence condition in question, thereby avoiding the scrutiny that

would accompany a licence modification. For this reason, the respondent considered it would now be appropriate for Ofgem to do an Impact Assessment.

## **Our decision**

Having reviewed the responses, we continue to consider that it is prudent to place the obligations set out in the ORP and FCP Guidance directly into the licence and support our principal objective to protect the interests of consumers. As indicated in our May decision on the guidance changes, we would expect suppliers to already own or have sufficient control over their material economic and operational assets, therefore we are encouraged that a majority of respondents support our proposals.

In relation to the concern that such arrangements that a supplier may put in place to comply with the proposal could be terminated in the event of an impending insolvency, we do not agree that this is a reason to think that the policy objectives will not be met.

Any situation where, in the event of a likely insolvency, a supplier or parent sought to unwind arrangements put in place to comply with the proposed licence condition, would be treated as a serious breach of licence and would likely be subject to enforcement action.

Further, in this regard, we would expect that any supplier acting in accordance with Standard Licence Condition (SLC) 5A would notify us if it sought to terminate or materially change arrangements put in place to comply with the proposed licence condition, or indeed if its parent intended to contravene or was otherwise unable to meet such arrangements, for example if its parent sought to liquidate hedging contracts.

SLC 5A.2 requires that the licensee 'must disclose to the Authority in writing or orally any circumstance relating to the licensee of which the Authority would reasonably expect notice in order to perform its statutory functions, particularly actions or omissions that give rise to a likelihood of detriment to Domestic Customers. Such disclosure should be given as soon as the circumstance arises or the licensee becomes aware of it'. In our view, any intention to terminate or contravene arrangements put in place to ensure that suppliers have sufficient control of their assets would give rise to a likelihood of detriment to Domestic Customers and as such should be notified to the Authority.

With regard to the concern that compliance would require a supplier to put in place a costly range of intra-group contracts, we consider that suppliers should already have appropriate arrangements in place. To efficiently and effectively serve its customers and to be able to manage responsibly costs that could be mutualised and have adequate financial

arrangements in place to minimise such costs (as required by SLC 4A and 4B as they stand), we would expect suppliers to have sufficient control over the assets they rely on to do so. Suppliers can only achieve that control by having appropriate arrangements, such as intra-group contracts, in place.

In respect of the concern that it would have been appropriate for Ofgem to conduct an Impact Assessment on the proposals, as explained in the statutory consultation and above, we have already implemented guidance which confirms how we expect licensed suppliers to organise their businesses in compliance with the OCP and FRP. That guidance clarified what we already expected suppliers to have in place to meet the requirements of SLC 4A and 4B. Suppliers should therefore already be adhering to these requirements, and we consider that the impact of the licence changes will be minimal.

### **Next Steps/Closing Remarks**

In our decision letter implementing the guidance, we asked suppliers to notify us if they needed time to bring themselves into compliance and to provide us with an action plan indicating how they would do so. In addition, as part of our financial stress tests in August we asked suppliers about control and ownership of significant assets and we will also conduct a market compliance assessment on suppliers' asset control arrangements later this year.<sup>10</sup> We will continue to engage with suppliers regarding these responses and work with suppliers as needed to bring them into compliance.

For the reasons set out in this letter we have decided to implement the licence changes necessary to enshrine in the electricity and gas supply licences the key components of the FRP and OCP guidance updated in May 2022. This will ensure suppliers are clear that there is a direct obligation to comply with these requirements and that enforcement action may follow in the event of a failure to do so. The licence changes will take effect 56 days after the date of the publication of this letter.

Yours sincerely

Cathryn Scott  
Regulatory Director – Enforcement and Emerging Issues

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<sup>10</sup> [Market Compliance Assessments – Update on next steps and further annual assessments in 2022](#)