

*Response to
Ofgem Consultation
'Strengthening Retail Financial
Resilience – minimum capital
requirements and ringfencing of CCB'*

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UNISON represents over 1.3 million people working across our public services throughout the UK in local government, the NHS, education, social care, housing, policing, transport, utilities, community and environmental services. We represent approximately 25,000 members who work in the energy industry.

We are in a unique place to comment having many members who as consumers have experienced the failings in the supply industry and are having to pick up the tab for the mutualised losses incurred, because of poor business ethics, lax regulation and oversight, and a broken system.

We also have many members who work in retail supply and who have been concerned for a long time about the actions of some suppliers in destabilising the supply market, leading to a significant loss of employment and challenges to terms and conditions of employment.

This consultation response follows a previous consultation response with regard to 'strengthening retail financial resilience'. In that response we made the following key points:

- 1. Customer payments made to suppliers are for the purposes of paying for energy consumed or likely to be consumed. These payments have been misused by some suppliers with the net result being significant losses. This misuse should not have been allowed to happen.**
- 2. UNISON would argue, for the most robust regulation possible to ensure that all money received from customers is protected and used for its correct form. Otherwise, the use of Direct Debit as a means for collecting payment will be called into question by consumers and simple paper billing (which would be based on past consumption, so energy actually used) will be demanded and rightly so. On that basis we believe the suppliers should operate as they would have done if paper billing was still in operation ensuring correct practices and no reckless treatment of monies received in advance.**
- 3. Customer credit balances and renewable obligations should be ring fenced and stringent mechanisms and monitoring in place to ensure this is maintained.**
- 4. Alongside the protection of customer credit balances, strong Capital adequacy rules should be in place to ensure that any supplier in this environment is robust and able to withstand pricing shocks.**
- 5. The mutualisation of losses should cease, and greater liability placed on the operators and owners of energy supply entities.**

Ofgem is now consulting again on two specific elements. The first concerning the introduction of minimum capital requirements and the second concerning proposals around how it might introduce a process of ringfencing of customers credit balances.

UNISON is disappointed with the proposals and we do not believe they far enough to protect consumers and seem intent on artificially maintaining a dysfunctional market.

1 - Minimum Capital Requirements

As a result of the turmoil in the energy retail sector, Ofgem commissioned in Jan 2022 the consultants Oxera to review how Ofgem oversaw the regulation of energy retail supply. They produced a detailed report which contained several observations and explanations as to why the situation in the retail markets deteriorated so rapidly. In the executive summary Oxera stated that -

“Consistent with our understanding of supplier business models, we have identified that a number of suppliers that would go on to fail shared many of the following financial and operational characteristics: (i) negative equity balances in the years leading up to their failure; (ii) poor liquidity (current ratios and low levels of working capital); (iii) over-reliance on their customer credit balances to finance their operations; and (iv) either unhedged, or not substantively (i.e. more than 50% over nine months or more) hedged, positions”

UNISON, along with many others had already long before, pointed out the inherent instability in the energy retail market. For our members who work in this sector it was very clear. Poorly capitalised suppliers had suddenly sprung out of nowhere, and they operated not as energy suppliers providing an essential service to customers but as IT start ups. Realising a profit was not the objective measure they sought, but a growth in customer numbers in the hope they would be consumed at a profit by a larger entity. The lack of regulation and limited barriers to entry, ensured that this became an area of rapid growth that was inadequately monitored. This presented a systematic risk to the system and as wholesale prices become more unstable a large number of suppliers collapsed. This collapse created a cost pressure for all customers because of the policy of mutualised loss in which the losses are recouped via the energy bill. As a result, this cost pressure impacted those on low incomes hardest as energy bills are regressive by nature with the lowest income householders spending a greater share of their income on energy and by virtue of living in some of the poorest housing. This was and remains totally unacceptable and it goes against a key requirement of Ofgem to have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

The need to have minimum capital requirements is an essential barrier to entry which protects consumers over the medium to long term. It also ensures that new entrants act in a responsible manner (appropriate as this is an essential service) and understand that some rigour and oversight is applicable. A new entrant that cannot operate without an appropriate level of protected capital should not be eligible to operate and consumers would expect a regulator to prevent such entrants and see this as perfectly reasonable.

How you determine an appropriate level of capital requirements is not something that UNISON would seek to comment on. Rather UNISON is firmly of the belief that Ofgem has a responsibility to prevent poorly capitalised energy suppliers operating due to the inherent risks to consumers.

Ensuring a vibrant market is operating should not be the principal driver but rather, ensuring that customers are not exposed to the bad practices of rogue operators. UNISON believes that the too much focus has been put on ensuring a vibrant market at the expense of robust regulation (for fear this will put off new market entrants). This balance remains weighted against consumer protection and in favour of present and potential poorly capitalised operators who present a system risk.

UNISON would continue to argue for the most robust capital requirements for all energy suppliers necessary to prevent market collapse in the advent of volatile wholesale price and an end to the system of mutualised loss.

2 - Ringfencing of Customer Credit Balances

While recognising that Ofgem has sought to strengthen how customer credit balances are treated and is introducing some measures to ensure capital adequacy, we do not think the requirements go far enough.

UNISON remains firmly of the view that credit balances should be ring fenced and wholly allocated to the purchase of energy in the same way that would have transpired if people still paid for energy use via paper billing. The introduction of Direct Debits to pay for energy bills was promoted for the ease of transaction and reduced transactional costs. It was not, and never has been marketed as a means for suppliers to accumulate balances so they have additional working capital. We believe that the use of credit balances is not transparent or understood by consumers.

Many of the measures proposed, require a degree of monitoring and oversight which could be considered resource challenging to do properly via Ofgem and so a risk is present in that it relies on a degree of robust and honest self-reporting. This becomes problematic for business who may be struggling and when any disclosure of a problem could bring about further restrictions and the protection of credit balances, which may well force the wind down of a supplier.

UNISON would therefore strongly argue that creating the right conditions at the outset with the protection of credit balances at the forefront ensures that operators in this market are less likely to fail and will have more sustainable business models. Further, should they get into difficulty the net outcome is less likely to mean financial loss to customer in the broadest sense.

It is right that Ofgem have considered the protection of the Renewables Obligation and ring fenced this however we struggle to see how consumer credit balances should be any less deserving of protection.

Summary

UNISON would acknowledge that Ofgem has made some attempts to ensure the energy market is more stable and more robust going forward. We particularly welcome the protection of the Renewables Obligation payments. However, we do not believe the measures in this consultation go far enough and we do not think they will prevent further energy supply failures with the consequent loss of consumers money. This loss being most clearly felt by low income householders who are less likely to be able to switch into loss making energy supply deals (thus gaining from the profligacy of weak suppliers) and who use a greater share of household income on energy costs.

It is our expectation, and we believe that all energy consumers expect, that any energy retail supplier is effectively capitalised and stable. We would have wanted to see a more robust minimum capital requirement and a fit to operate licence for any senior individuals who have a significant stake or role to play in a supplier.

We believe that Ofgem has traded off greater protection for consumers, to encourage a more vibrant market when it clearly has already failed. Yes, it is more balanced, but we are still likely to witness reckless behaviour in what is an essential service to the public.

UNISON would reiterate its strong support for the protection of customer credit balances so that those balances cannot be used as working capital and thus put at risk from market failure. We do not believe that self-regulation works, nor do we have confidence that introducing a stricter regime as things deteriorate within a supplier is effective. In fact, it creates a further moral hazard which we have already witnessed in the past 18 months by which action by Ofgem might force the closure of supplier and thus is forced to consider this consequential impact over the protection of customers and the credit balances they may have.

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