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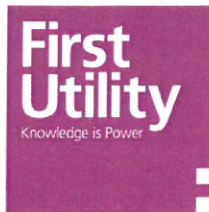
Dear Giulia

**Consultation on proposed approach to dealing with supplier insolvency and its consequences for consumers**

Thank you for your flexibility in allowing us a few extra days to respond to this important consultation.

By way of a summary, we agree that it is important “to have protections in place for consumers given that electricity and gas are essential services”. We think that overall, and subject to some specific concerns and suggestions which we set out below, the draft guidance on the Supplier of Last Resort (**SoLR**) process, reflecting Ofgem’s preferred option 1 as described at p. 5 of the 13 June letter), is sensible. The draft guidance retains flexibility where appropriate to enable Ofgem, and suppliers, to deal with the specific and different issues that may arise in the event of an impending or actual insolvency.

However, the SoLR process itself cannot address the potential disconnect, or lack of effective incentives, that arise more generally. Our concerns centre around the fact that consumers cannot realistically mitigate the risk of their supplier becoming insolvent and in our view, are also not likely realistically to bear the consequences of not doing so. It is unlikely, for example, that residential users check credit ratings and other measures to track this risk. We also think that notwithstanding the discretionary basis of the industry levy, it is not realistic to assume that such customers would not be held harmless, with the payment for this indemnity falling on customers generally through relevant charges incurred by their suppliers. Thus, those incurring the risks of their own supplier insolvency are not those paying the costs of those risks being realised. This is recognised in the distributional impacts consideration, but for the purpose of mitigation of these risks, at this point, it is effectively too late. This misalignment of potential incentives highlights a gap that the SoLR process itself cannot close, hence suggesting in this letter ongoing monitoring of risks and a review of those behaviours raising such risks, which we agree manifest around credit balances and payments in advance.



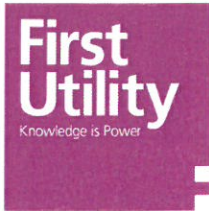
On that basis, we think it is extremely important that Ofgem itself considers how to track and analyse the level of risk being taken by all suppliers on an ongoing basis, which process could be started as part of, or in parallel with, the SoLR consultation process. Ofgem has rightly identified that a key risk within this process for consumers is around

credit balances and the challenges to recovering balances or where relevant, payments made in advance.

Taking this into account, our main concerns are as follows:

- As noted, the adverse risk to customers of badly managed credit balances and/or payments in advance does not realistically sit with customers and is difficult to address in the SoLR process, nor can the consequences of any underlying company solvency or other challenges - Ofgem may be able to make the connection between a company making losses and its payment and credit balance practices and what this means for its solvency or otherwise but we do not think that the customers (in credit or who have paid in advance or more generally) would;
- That the status of credit balances and the advance payment situation does not appear to be amongst the data provided to potential SoLR (Appendix 1 - information from failing supplier, at p. 26 of the draft guidance), which makes it difficult to assess scale of issue, level of risk and potential cost for inclusion in the SoLR response;
- That the difficulties noted above taken together may act as a disincentive for finding voluntary SsoLR, particularly noting that Ofgem prefers such suppliers to waive the making of a claim for last resort supply payments (paragraph 3.5 of the draft guidance refers) which itself feels unrealistic in anything but the smallest scale insolvency situations;
- That there are indeed distributional impacts (as we highlight above and Ofgem notes at paragraph 25 of the 13 June letter) as between the customers who may be losing their credit balance on an insolvency event and those potentially funding any last resort supplier costs. This should also specifically include the impacts as between customers who have been persuaded to pay in advance and those who would fund any potential levy payments. We think that Ofgem needs to give further thought to how e.g. any discounts or interest payments given for payment in advance could weigh in the balance, any incentive effect of addressing this, and whether this means that prepayment puts customers at more possible risk of non-recovery as a result, although as noted above, we struggle to see how realistic it is that the levy could not be called upon to hold customers harmless. Please note that this concern does not of itself count against a conclusion at this stage that option 1 is not appropriate;
- Taking this into account, it is not clear at this stage whether customers should in fact be informed of the risks of this possible situation (noting the incentive issues discussed earlier and the previous potential point on partial recovery above) when considering whether any measure offered alongside advance payment is discussed at point of sale, e.g. discount or interest payment. Thus, this is not to recommend at



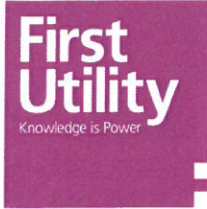


this stage the provision of specific information to be provided to prepayment customers (paragraph 45 of the Appendix to the 13 June letter refers) on the risk but assuming that the explanation implied for prepayments (innovative means of financing and advance purchase of power) holds, an explanation of the advantages as well as the disadvantages for customers is important;

- We are aware of Ofgem's concerns around credit balances and that suppliers are appropriately managing these. This is a matter that has been raised more generally, participants have been able to comment, and information is being sought to understand the issues across industry and per supplier. We think that a similar approach should be taken to payments in advance, which we think raise different issues to those of credit balances, and certainly different trade-offs of benefit and burden, incentives, costs and risk as between supplier and customer (and in the case of insolvency, customers generally and other suppliers). It seems to us that an equivalent level of concern for these mechanisms as for credit balances is justified; and
- In our view, warnings as to upcoming capacity constraints, the publicised costs of addressing these, seasonal weather risk, and the challenges of marginal pricing, amongst other things, do raise supplier financeability challenges in the coming winter. Press coverage is likely to deal with this given that this is not only a risk to the customers adversely affected but a political risk. Balanced and appropriate communications to help customers understand the possible risks may be needed in any event, from suppliers and from trusted sources. Tracking this risk is therefore vital: it will also allow Ofgem to review the SoLR process internally against an awareness of system and regulatory risk, and financeability risk and verify (we hope in theory but worst case, in practice) the approach underpinning the updated SoLR process. Without that tracking, it is difficult fully to validate the underlying approach to SoLR.

In light of the above, we think it is appropriate to consider what more can be done to support all customers generally, and vulnerable customers in particular, in the event of supplier insolvency. This could start with an Ofgem information-gathering programme, asking suppliers about their risk management policies and approaches, in addition to the RFI on credit balances on a regular basis (period to be defined). As Ofgem notes at paragraph 8 of the Appendix to the 13 June letter, "inappropriate hedging strategies" can put a supplier at risk. Whilst Ofgem may have interpreted its duties as not requiring the tracking of the financial health of supplier licensees following licence grant, we do think it is appropriate to monitor the approach to risk taken by supplier licensees, including but not limited to hedging and other risk management strategies. This is particularly the case approaching winter-time and taking into account where changes to the regulatory or industry environment may themselves pose specific challenges, for example, around sharper marginal prices within the new cash-out regime.

This assumes that Ofgem would be prepared to track supplier risk in general terms, which would have costs attached, but we think that the approach and information obtained could be designed to minimise the information collection, review and



assessment costs. Ofgem has previously indicated that they recognise the cost to suppliers of RFIs and where possible, have focused on information already gathered and provided e.g. to the CMA. These areas, e.g. risk management and hedging, as well as prepayment and other strategies and issues around financing, have formed the basis of information requests from the CMA so our assumption is that the costs of meeting further such requests would be manageable. Further, we note Ofgem's own monitoring programme following on from the P305 changes. We do not therefore think that the costs of providing further data will be material, although this would need to be tested with suppliers and Ofgem's own costs of collection, etc., assessed.

As also set out above, we are concerned that payment in advance raises different risks, trade-offs and distributional impacts to those of credit balances and suggest that Ofgem commence an information-gathering and assessment programme to provide a basis from which to further explore any differences, and what this may mean for the SoLR process, the incentives on SsoLR where this approach has been used by the failing supplier and the issues that may be raised specifically around assessing costs of meeting any such payments on a voluntary basis or otherwise.

As you will have gleaned from the above, we think that payments in advance, and poorly managed or misused credit balances, are serious issues. Ofgem is already looking closely into the latter and whether any particular supplier practices raise concerns about that supplier or more generally, industry practices: we think it's essential that Ofgem starts to look more closely into the former, taking into account the financial health (or worst case, ill-health) of suppliers as well. We would be happy to discuss any of the matters raised in this letter further if that would be helpful.

With best regards



**Natasha Hobday**  
**Group Policy and Regulation Director**

