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By email only

Dear Rob,

Re: Supplier Insolvency and its consequences for consumers -- Consultation response

Thank you for the opportunity to comment on Ofgem's consultation on its proposed approach to dealing with supplier insolvency and its consequences for consumers. We welcome this initiative because we consider it highly likely that the risk of supplier insolvency has increased given the sharp rise in the number of suppliers in recent years – not all suppliers will succeed. We have made some general observations first, and then addressed the specific questions raised in the consultation.

Utilita is a leading smart prepayment supplier, the vast majority of our portfolio is prepayment and most of the customers have smart meters fitted. This gives us a unique perspective and highlights some particular issues with the SoLR process. There are currently in excess of 4 million prepayment households and increasing: it is essential to consider such customers in designing industry processes. It is also important to factor in that the industry in engaging in smart roll out, though given the delays in the smart metering programme, the timing is uncertain. In terms of smart roll out, we also believe that by either choice or necessity, some customers will retain legacy prepayment meters. The SoLR process must therefore support such meters on an ongoing basis.

General observations

The first line of defence against supplier insolvency is profitability. That is, a well-functioning energy supply industry, and a sensible competitive and regulatory environment, affords suppliers the best opportunity to generate positive earnings. A high degree of regulatory certainty helps suppliers to better manage the risks that they face.

Even so, we believe that over time there will be incidence of supplier failure, sometimes for reasons beyond the norm. It is the responsibility of both the regulator and the industry to ensure that the customer should not have to worry about the risk to either their finances, or energy supply, from an insolvency.

We agree that a trade sale is typically the best solution for a supplier whose independent future may be in doubt. This is the case both for the industry as a whole but also the individual supplier. A successful trade sale is an indication of low industry risk, that the industry will not suffer reputational damage which may reduce the availability of capital, and avoids a dis-orderly impact on customers and supplier staff. Of course, a poorly managed trade sale may weaken the buyer but that is their commercial choice.

We acknowledge that there may be circumstances when a trade sale cannot happen or be possible. Examples might include severe corporate governance failings suddenly coming to light or a supplier suffering from a sudden and rapid deterioration in its financial position. What matters, most especially when the risk of insolvency builds quickly and the regulator needs to act quickly to protect customers, is the ability of Ofgem to react in a timely manner. We therefore agree it is good practice for Ofgem to know that there are several firms which have demonstrated in advance that they are both willing and able to step into the breach, rather than the current ad hoc approach.

We didn't find any evidence in the Consultation of plans for a co-ordinated industry approach in the event of more than one supplier failing at the same time, i.e. severe market disruption. This is a plausible scenario for any industry and lessons can be learnt from the 2008 financial crisis. In these circumstances one can imagine that no supplier, even those on the Supplier of Last Resort (SoLR) list, would remain willing to step into the breach. Even if a solution is found, the impact of an industry levy on suppliers' financial profile, at a time when all suppliers are likely to be weakened, needs to be acknowledged. This would especially be the case in the event of an insolvency of a larger supplier. The regulator and the industry also need to factor in the impact of a 'flight to quality' – as multiple supplier insolvencies will doubtless garner much media attention -- as there will likely be increased switching requests and higher call centre volumes.

We agree that it is wise not to impose up-front costs upon suppliers. The energy supply competitive landscape is rapidly changing, including the increased market penetration of a number of new suppliers. As one of those suppliers we naturally believe that imposing an up-front cost might impinge upon our ability to compete. We also believe that in the event of a levy being imposed, following a supplier insolvency, it is important that the costs do not weigh too heavily upon the smaller suppliers. We observe from the banking industry that the Financial Services Compensation Scheme (FSCS) has led to a higher degree of consumer confidence (and less need to panic) compared to the very low level of depositor protection that was in place at the time of the 'run on the bank' on Northern Rock in 2007. However, we note that the FSCS charge has become a permanent cost of doing banking business and disproportionately impacts smaller lenders. Similar principles apply to the energy supply industry. If any approach of this type is adopted, it will be essential to ensure that it does not result in suppliers adopting a less prudent approach or one that might lead to freeloading. If this is not the case, the costs of any such scheme will ultimately impact customers.

We agree with the initiatives to protect vulnerable customers that may arise from a supplier insolvency. This is especially relevant for prepayment customers.

Finally, we note the other options which you laid out in paragraphs 44-47 of your covering letter. We agree that it would make sense to make it a requirement for suppliers to remind customers that their customer balances are not protected. However, it is important that the wording does not alarm customers unduly. Customers should be made aware that there is a very high probability that their credit balances are not at risk, and while protection of their credit balances cannot be guaranteed, in the event of a supplier insolvency there is a clear SoLR process from which they will benefit.

Response to consultation questions

Q1: Do you agree with the approach to SoLR and energy administration set out in our revised guidance?

Overall we generally agree with the approach. However, we note the following:

- We disagree with the wording of Ofgem's preference to prioritise those suppliers who state up-front that they will not make a claim. Having to make this decision up front is likely to prejudice against smaller suppliers because they would be less likely to make this advance decision at a time when their business models and financial profiles are evolving rapidly.
- We think there could be merit in a segmented SoLR register. That is, some suppliers might be more willing and able to sign up to be on the SoLR register if they are able to state that they are only interested in taking on a certain number of customers and/or a certain customer base. A segmented register may also make insolvency solutions easier for Ofgem to administer if they have greater flexibility to use more than one supplier. It may offer a better solution for customers if they are taken on by a supplier that really wants them, rather than being bundled into a broad supplier rescue.
- We believe it should be made clear that suppliers are not stigmatised if they temporarily step-off the SoLR register. This may happen for perfectly valid reasons. For example, if the supplier was going through corporate change such as M&A. Use of a segmented SoLR register may help in this respect.
- We consider it would be better to separate the issues around supplier claims for costs into two constituent parts:
    - Costs associated with SoLR administration; and
    - Costs associated with reinstating consumer credit balances.

  In the case of the former, it should be emphasised that the rules around claims are stringent and will require full evidence, to ensure incentives remain on suppliers to maximise efficiency. However, it is possible that under some circumstances, the costs to suppliers of a SoLR may be higher than others – for example at times of wholesale instability. It may be better to consider allowing a claim for some limited and temporary aspects of such costs (which are then borne by the generality of consumers), rather than such costs being passed to a much smaller group of customers in the form of a higher deemed contract price.
- On the second point, in those cases where it may be in customers' interest to be taken on by a smaller SoLR, it may be reasonable for those suppliers to be able to make a claim in respect of significant credit balances. We suggest that such claims should be auditable.
- We disagree with the suggestion to provide details on suppliers' financial viability to customers. There is no one simple measure of a company's financial health which could be explained to a broad customer audience. Further, there will be issues with the consistency of the data across the sector and whether the data relates to the same time period. It should also

be remembered that a company could approach insolvency even if its most recent financial metrics appeared to be healthy.

- That said, we do believe that suppliers should be encouraged by the regulator to do more to make publicly available, via their own website, details of financial performance, reflecting their statutory annual report and accounts. Small energy suppliers seriously lag the disclosure of small banks, for example. Customers that are interested in this type of information have the right to know and suppliers should have nothing to hide from improving their investor relations; after all their accounts can be obtained from Companies House. It may be possible to provide a limited summary that should apply to all suppliers, as some may not have previously published full accounts.

Q2: Do you agree with our preferred approach (option 1 - no further action, i.e. case by case use of SoLR powers) to protect consumer credit balances? We would be particularly interested in hearing your views on the following factors in relation to each option: effects on innovation and potential barriers to entry, increased regulatory burdens, impact on customer behaviour, proportionality.

We note that while the options put forward seek to address the issues experienced in a SoLR process, they would not of themselves address underlying issues such as how significant credit balances may be built up in the first place.

Overall we agree with the preference for <u>Option 1</u>.

The key issue is the ability of the SoLR to have arrangements in place to i) be able to interact with their new customer base in a timely and effective manner, and ii) source the additional energy required.

We don't agree with the variation to Option 1 (paragraph 29 of your covering letter), which implies that a levy will be applied in all circumstances. We concur with your stated view that it may encourage weaker supplier behaviour.

We are against <u>Option 2</u>. Under Option 2, working capital, which arises from customer credit balances, may become ring-fenced which could reduce the financial flexibility of the supplier. We also believe that Option 2 may be hard to enforce. For example, there would need to be a daily allocation of excess customer cash balances, which may be impractical. The supplier therefore starts to look more like a regulated bank. Finally, we also disagree with the suggestion to only provide protection to a restricted category, such as vulnerable customers. We see no value to customers from this approach.

While we do not support Option 2 as proposed, it may be that with further work, a modified version might be viable in limited form. For example, restrictions on levels of credit balances could be set related to annual expenditure, and specific treatment prescribed for balances in excess of this level.

We are against <u>Option 3</u>. The additional up-front costs would be unwise. We note that Ofgem's previous iterations of SoLR, for example in 2001, have considered this option. Having considered the potential impact on customers and on competition Ofgem chose to set the level of security cover to zero.

Q3: Do you consider that there is other information which would help you decide whether to volunteer to be a SoLR and on specific terms? If so, what is this information and from whom should it be sought?

In addition to the point raised in this letter above, on having a dynamic and sectional SoLR register, we would like greater clarity on the impact of being added to the SoLR register and how supplier status could be easily updated. For example, once a supplier has been added to the register, are they obliged to respond to any SoLR request.

It would also be helpful to include additional information on the potential process if Ofgem was to issue a Last Resort Direction where the supplier had not volunteered to be a SoLR, and how any resulting impact on the supplier might be managed.

As noted in our covering letter to the recent request for information on credit balances, we believe that there are a number of issues that affect prepayment customers in particular. The consultation in our view does not fully explore the impacts on prepayment customers. We have therefore attached a short appendix setting out some of our thoughts in this area.

We hope that these comments have been helpful. If you would like to discuss any points raised in more detail, we would be happy to help.

Yours sincerely,

By email

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