Citizens Advice Response to Ofgem's Supplier Licensing Review

Introduction

The Citizens Advice service provides free, independent, confidential and impartial advice to everyone on their rights and responsibilities. It values diversity, promotes equality and challenges discrimination. Since 1 April 2014, the Citizens Advice service took on the powers of Consumer Futures to become the statutory representative for energy consumers across Great Britain.

The service aims:

- To provide the advice people need for the problems they face
- To improve the policies and practices that affect people's lives.

The Citizens Advice service is a network of nearly 300 independent advice centres that provide free, impartial advice from more than 2,900 locations in England and Wales, including GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particularly dispersed groups.

In 2017, Citizens Advice Service helped fix 163,000 energy problems through our local network and 61,000 through our Consumer Service Helpline. Our Extra Help Unit specialist case handling unit resolved 8,367 cases on behalf of consumers in vulnerable circumstances, and their Ask the Adviser telephone service handled 2,593 calls from other advice providers in need of specialist energy advice.

Since April 2012 we have also operated the Citizens Advice Consumer Service, formerly run as Consumer Direct by the Office for Fair Trading (OFT). This telephone helpline covers Great Britain and provides free, confidential and impartial advice on all consumer issues.

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Summary

Citizens Advice welcomes the opportunity to respond to Ofgem's consultation on supplier licensing. We have been calling for a review of the supplier licensing since 2013.[1] In 2016 Ofgem first set out plans to keep the arrangements for licensing under review[2], but almost two years passed until the publication of these initial proposals to change the licensing approach. Given the scale of the recent problems in the market, we think this review is clearly overdue.

While new entrants in the energy market over recent years have had some positive impacts - such as greater consumer choice and increased competition - we have also long been concerned that the current licensing regime is not fit for purpose. This has allowed insufficiently prepared suppliers to enter the market, and resulted in acute customer service issues and financial instability at these suppliers, culminating in a recent spate of supplier bankruptcies. We estimate that over 800,000 consumers have been been affected by the failure of ten suppliers through the Supplier of Last Resort (SoLR) process in the last 12 months alone.

These failures have negatively affected all consumers. The customers of failed suppliers have often had to suffer poor customer service from their old supplier, followed by the hassle and stress of being switched to another energy provider that they haven't chosen. Some have had delayed access to credit they are owed, while others have had to pay back energy debts to the administrator, losing the consumer protections they had when they owed this debt to a licensed supplier.

Indirectly, all consumers are affected as they bear the socialised costs of supplier failures, including the Safety Net (which includes the costs of managing SoLR transfers and protecting credit balances) and wider costs, such unpaid bills for renewables subsidies. The frequency of the failures also risks undermining

[1] For example, in private correspondence to Ofgem from Consumer Futures (17th October 2013 & 29th November 2013), our response to Ofgem's Draft Forward Work Programme 2017/18 (2017), and our Utility Week blog (2018).
[2] Ofgem, Draft Forward Work Programme 2017/18

trust in the industry, and could discourage some consumers from engaging in the market.

It is vital that Ofgem takes action to prevent these issues recurring in future. We agree with Ofgem that in a competitive and well-functioning market some suppliers will fail. And we support regulatory measures to protect both consumers and renewable generators when energy suppliers fail. But the socialised cost of these protections mean there is a clear impetus for Ofgem to take more robust action to reduce - but not eliminate - the risk of energy supplier bankruptcies.

The review seeks views on the rules related to supplier entry, ongoing monitoring, and managing supplier exit. While new entry criteria cannot mitigate the risks that some licensed suppliers are currently placing on the market, they could prevent such suppliers from entering in the future. We therefore support Ofgem's proposed changes to the licensing requirements, including detailed information requests and fit and proper requirements for applicants.

We also support proposed changes to require the licence application to be completed by the leadership team that will be running the company. Many existing suppliers have come into the market through 'supplier-in-a-box' companies, which apply for the licence and set up the company, before handing it over to another entity. These companies have reduced barriers to entering the market, and can be a vital support to companies as they enter the market. However, the current licensing sequencing does not permit Ofgem to assess the appropriateness the actual management team of the new supplier, and must be amended.

We think Ofgem should rapidly establish more effective ongoing supplier monitoring. This would help Ofgem identify suppliers that are failing to provide an acceptable service or have insufficient financial resilience. Strategic monitoring could complement this, by increasing scrutiny in periods when suppliers are at particular risk, for example, when growing rapidly or when passing regulatory thresholds.

Better monitoring needs to be backed up by more timely regulatory action than has been the case in the past. Over two years ago, Ofgem opened separate investigations into two of the largest of the recently failed suppliers, but neither had been completed at the point the suppliers closed. Similarly, provisional orders to prevent suppliers from taking on new customers have been deployed

by Ofgem in the past few years to tackle poor practice, but only following the most severe customer service failures. We think that swifter investigations and earlier regulatory interventions could have better protected consumers and minimised the costs of supplier failures.

The consultation sets out some early thinking on arrangements for supplier exits from the market. Based on our experience of recent supplier failures, we think this is an area that Ofgem should consider more urgently. We think there are some consumer protection gaps in the SoLR process that should be addressed, including administration of customer debt, transfer of smart prepayment meters, and protection of micro-business credit balances. Given the rate of recent failures[3] and ongoing market turbulence, we also believe Ofgem should take immediate action to protect consumers from excessive socialised costs of failure, by considering changes to rules on credit balances and how renewable energy subsidies are paid.

[3] Seven suppliers have failed between September 2018 and January 2019

Response

Section 2: Aims

Q1: Do you agree with the principles we have set out to guide our reforms?

We broadly support the overarching principles. The first principle indicates that suppliers should be adequately prepared and resourced for growth. We agree, but think that suppliers should also be prepared and resourced for other exogenous factors. Many recently failed suppliers have, at least partly, blamed rising wholesale costs for their failure[4], but this is a change in market conditions that should have been considered and accounted for by prudent companies.

We think that the third principle should encompass the protection of directly affected customers of failed suppliers - but also all energy consumers, who pay the socialised costs of supplier failures.

We think that the second and third principles should apply equally to micro-businesses as they do to domestic consumers. This would lead to better protections for micro-business consumers, who currently have fewer protections during the SoLR process.

Section 4: Entry criteria: Policy options

Q2: Do you agree with our proposal to introduce new tougher entry requirements and increase scrutiny of supply licence applicants? Do you agree this can be achieved with increased information requirements and qualitative assessment criteria?

We agree with the proposal to introduce tougher entry requirements and increase the scrutiny of supply licence applicants. As stated in the proposal, Ofgem's awarding of a licence should not be equated with Ofgem's approval of a supplier's business plan, nor should it prevent Ofgem from taking action against a supplier which fails to meet its responsibilities to consumers after it has received a licence.

[4] The Guardian, Spark Energy goes bust and leaves 290,000 without a supplier, 2018.

We think that the suitability of the proposed entry requirements can only be assessed alongside the framework for monitoring suppliers once they enter the market. If Ofgem pursues a less onerous monitoring framework there may be cause to counterbalance this with more detailed information requirements upon supplier entry. If sufficient ongoing and strategic monitoring is in place, we generally agree that Ofgem's proposal for increased information requirements for new applicants should ensure they are prepared, while being proportionate and flexible to different business models.

At a minimum the increased information requirements should include detailed information on the company's business proposal, their plan to deliver an acceptable service including to vulnerable consumers, as well as their accounts and financial projections. Factors such as a company's financial status should not immediately disqualify an applicant from supplying energy, however they are important to consider prior to granting a license, alongside the approach they plan to take.

Suppliers with riskier business models - or that plan to target more vulnerable customers - should have to supply more information to demonstrate how they will mitigate the potential risks. More detailed information requirements and/or a minimum capital requirement could be appropriate tools in some circumstances, dependent on Ofgem's initial assessment of a company's business model and their target market.

Section 5: Entry criteria: Initial proposals

Q3: Do you agree that our proposed assessment criteria for supply licences applications are appropriate?

We agree that the proposed assessment criteria are appropriate. Specifically, we feel that it is necessary to request that applicants submit:

(1) An entry proposal describing their business plan

(2) A source and proof of funds to match their business plan, with regard for aspects of the plan such as customer type and payment methods accepted

(3) A statement of intent which demonstrates that the applicant understands and can meet their obligations to consumers, in particular how to meet the needs of vulnerable consumers and handle consumer complaints

(4) Information demonstrating how the applicant meets fit and proper requirements

Q4: Do you agree that applicants should provide evidence of their ability to fund their activities for the first 12 months, and provide a declaration of adequacy?

We agree that applicants should provide evidence that they have sufficient resources to fund their activities, but we think this should be provided for a period of at least two years. A two year business plan would generally ensure a company is resourced for an entire cycle of taking on customers and closing their accounts after a 12 or 18-month contract, and to pay industry costs, such as renewable subsidies, that fall due in the period. It is particularly important to include loss of customers in these business plans because, in our experience, struggling suppliers often fail to close accounts and refund leaving customers in a timely manner.

A two year timeframe is also more likely to cover the riskiest period of supplier growth, as we know from recent supplier failures that happened in the second, rather than first, year of operation (Figure 1).

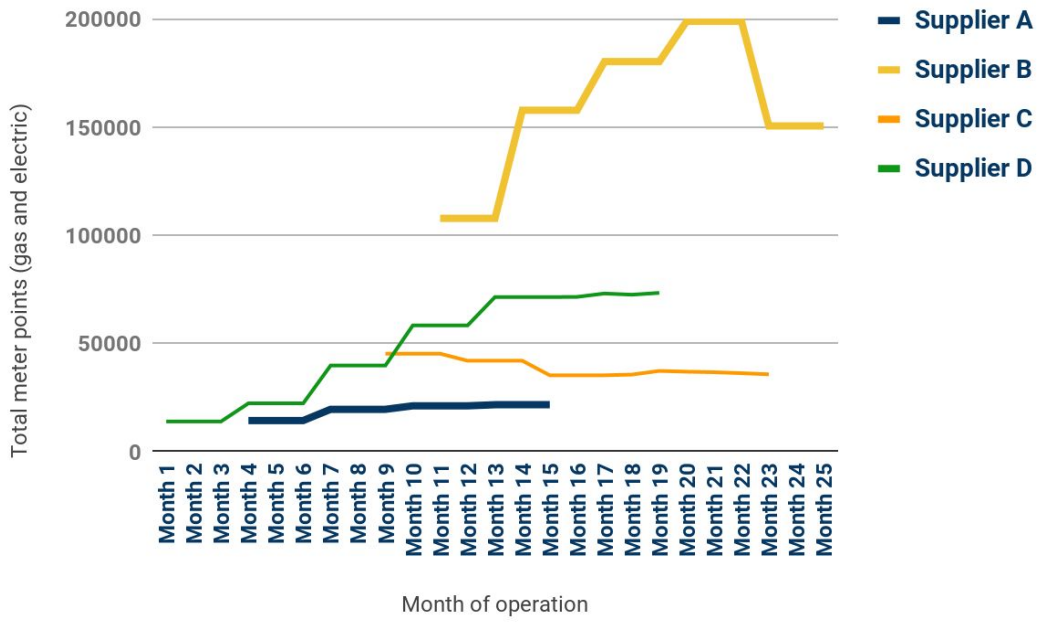

Fig 1. Period of operation for recently failed suppliers, measured from when Citizens Advice first became aware of the supplier. The lines begin when we first received customer number data from the supplier, and end when the supplier failed.

A declaration of adequacy could also be a reasonable part of the entry process, but Ofgem should be clearer about the legal weight it would hold, what additional value it contributes that the other requirements do not, and what the repercussions would be for companies that are later found to have falsified their declaration.

Q6: Do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence?

We strongly agree that applicants should be aware of their key customer-related obligations and licence conditions. In our initial discussions with new energy suppliers, Citizens Advice sometimes receives questions from suppliers that, had they reviewed

their licence conditions and other rules, they should have been well aware of in advance. These include questions around treatment of customers with prepayment meters, the requirements for complaints handling, and when debt-blocking is allowed.[5] We have been alarmed that some companies remain unaware of basic rules, or fail to have a dedicated regulation manager, even once they have tens - or even hundreds - of thousands of customers.

A narrative may help ensure that applicants familiarise themselves with industry rules. In their narrative, applicants should describe how they will meet the customer outcomes defined in key Standard Licence Condition principles, including the Standards of Conduct, informed choices and customer communications principles. This narrative should be scrutinised by Ofgem to ensure that a supplier's plans to meet their obligations are feasible. The relevant industry codes should also be reviewed and understood by applicants prior to receiving a licence.

A key area where suppliers should present their plans is how they will identify vulnerable consumers and address their needs. Applicants should be required to outline their plans to establish and maintain a priority services register[6], and what customised services these consumers will receive. As part of this narrative, suppliers should also demonstrate an understanding of appropriate signposting for vulnerable consumers[7] as well as consumers with general queries or complaints[8].

In recent years we have been aware of non-compliance with prepayment meter requirements by some new entrant suppliers.[9] We think the narrative should include a description of plans for offering prepayment to customers in payment difficulties, and how applicants expect to offer a prepayment meter tariff to all new customers once they pass the threshold to do so. Information on whether companies plan to sign up to relevant voluntary commitments, such as the prepayment meter principles, should also be included in the narrative[10].

When Ofgem assesses these narratives, it is important to establish that the applicant's leadership teams have considered these issues and how they interact with their business plan for themselves, rather than obtaining an off-the-shelf statement from a consulting company or already licensed supplier. Ofgem could require applicants that they think pose a higher risk to explain their narrative at an interview, in addition to the written narrative. An interview requirement aligns with practices in other sectors. For example, to ensure that financial firms are effectively governed by individuals with the appropriate skills, the Financial Conduct Authority assesses individuals with significant influence functions in high-impact firms via an interview where they can demonstrate

[5] Evidenced in correspondence between Citizens Advice and suppliers
[6] Ofgem, Vulnerable consumers in the energy market, 2018.
[7] Citizens Advice, Good practice guide: how energy suppliers can signpost and refer vulnerable consumers to the right source of help, 2017.
[8] Citizens Advice, Domestic Complaints Signposting Guide, 2017.
[9] Ofgem, Decision to close compliance engagement with Bulb on SLC 27, 2018.
[10] Energy UK, Prepayment meter principles, 2016.

their competence in the function they are applying to carry out.[11] Interviews would also align with the approach Ofgem takes to assessing supplier performance in the Social Obligations Reporting, where it requires some suppliers to attend interviews to explain their performance and how they intend to improve.

Q7: Do you agree with the areas we would generally expect applicants to cover (in Appendix 1)? If not, why/what would you add?

The areas in Appendix 1 appear to be comprehensive, however many of them warrant further elaboration. For example, Criteria 1 requires applicants to develop a pricing model based on reasonable assumptions and plans for realistic growth. However, it may be challenging to predict realistic growth - in our experience many new entrants have grown more slowly than they initially predicted. To properly assess if companies are adequately resourced, these plans may require stress testing. Stress testing should ensure that companies can fund activities beyond their initial expected growth, or in the event of changes to market conditions which a company could reasonably be expected to prepare for, such as an increase in wholesale prices.

We would also expect a supplier to prepare for regulatory changes which have been clearly signalled by Ofgem and/or government (for example, a supplier entering the market in early 2018 could have been expected to prepare for the introduction of a price cap on default tariffs). We think applicants could reasonably be expected to plan this for up to two years of operation.

While we think these requirements would be appropriate for a majority of applicants, Ofgem may need to ensure the criteria are flexible enough to fairly assess the financial adequacy of companies with radically different business models; for example, a company which requires much longer contracts with consumers, or upfront payments for products and services.

Furthermore, when companies are required to demonstrate an understanding of their risks, this should reflect their particular business model. For example a company primarily taking on prepayment meter customers may face different risks and therefore require longer opening hours than a company primarily serving customers who pay by direct debit.

In Criteria 3, the fit and proper requirements apply to any “person with significant management responsibility or influence”. It is important for Ofgem to take a broad approach to this and ensure that all individuals who are involved in senior-level decision making are assessed to be fit and proper. We have noticed a trend of senior directors and leaders moving from one failed energy company to a different company, or establishing a new supplier. We have shared specific concerns with Ofgem via the tripartite process.

[11] Financial Conduct Authority, Significant influence functions, 2015.

Q8: Do you agree that we should ask additional 'fit and proper' questions as part of the application process (as set out in Appendix 1)?

We agree that fit and proper questions should be asked as part of the application process. Ofgem should require an outline of the applicant company's structure to identify the roles various individuals are undertaking, to assess which are senior enough to meet the fit and proper requirement. Similarly, Ofgem should consider which individuals at any white label companies related to the supplier must also be assessed to be fit and proper.

Any significant changes in company ownership or senior management during the application process should be reported to Ofgem and, where appropriate, should trigger a re-assessment of the fit and proper criteria.

Section 6: Timing of licensing: initial proposals

Q9: Do you agree that Ofgem's licensing process should be undertaken closer to proposed market entry? Do you identify any barriers to this approach or any adverse impacts of this change?

We broadly agree with Ofgem's proposal to move licensing closer to proposed market entry. Ofgem should outline clearly how the timeline will differ for dual fuel applicants versus gas-only supplier applicants, and whether suppliers wishing to switch from single to dual fuel must repeat the entire process.

Some companies may raise concerns that the changed timeline will impose additional costs or risks that might act as a barrier to entry. Ofgem could reduce this risk by allowing companies to contact them in advance of their application, if the company has specific questions or concerns about their likelihood of eventually becoming licensed. This could operate similarly to Ofgem's Innovation Link, in that it would consist of an informal steer rather than official advice. Ofgem should also consider how it could share lessons-learned from the licensing process with would-be applicants, similar to its approach to sharing lessons-learned from compliance and enforcement cases.

It is also important to note that the new licensing requirements are not a replacement for Ofgem's Innovation Link and regulatory sandbox as a mechanism of risk management for non-traditional business models. We support the ongoing operation of the sandbox as a way to enable positive innovation for consumers, which should operate alongside stronger licensing and monitoring requirements.

Section 7: Ongoing requirements

Q10: Do you consider that suppliers should report on their financial and operational resilience on an ongoing basis? If so, do you have any initial views on the content of these reports/statements?

Ongoing monitoring of suppliers already exists in many areas. Monitoring by Citizens Advice and Ombudsman Services: Energy can identify when issues arise that affect consumers. For example, we consistently raised concerns about suppliers like Iresa and Economy Energy through the tripartite process, based on cases we were seeing through our advice services. Suppliers are also required to report to Ofgem on an ongoing basis through its complaints monitoring and Social Obligations Reporting, and to Citizens Advice in order to provide data for our energy supplier rating.[12]

Our star rating has shown a strong correlation between customer service and financial resilience.[13] Suppliers performing poorly in the rating have subsequently faced investigations and/or provisional orders, and many of the worst performers have gone on to fail (figure 2).

Figure 2. Citizens Advice supplier rating showing the final rating received by recently failed suppliers, alongside the mean average rating in that same release. The supplier's ranking is shown in brackets.

However, this data can only identify certain issues, and can be a lagging indicator. For example, some companies with financial issues have subsequently taken steps to inappropriately maintain high credit balances, prevent refunds to customers, or take high one-off direct debit payments. Ongoing monitoring of financial resilience could have identified these financial issues at an early stage, and triggered appropriate

[12] Some of this reporting is required for suppliers with a certain number of customers.
[13] Citizens Advice, Supplier Rating, 2019

mitigations, before consumers were negatively affected. Similarly, operational resilience could be monitored through additional customer service measures that aren't currently included in the star rating or other existing monitoring.

Collection of financial performance data is not unprecedented - Ofgem already requires detailed information about financial performance from the largest energy suppliers, in the form of Consolidated Segmental Statements. While this approach would not be proportionate for smaller suppliers, we strongly believe that Ofgem should require all suppliers to report on their financial and operational resilience on an ongoing, regular basis. This should include provision of information regarding financial changes, such as major changes to a company's assets or new, significant loans.

Ofgem should augment this, and other backward-looking indicators of operational and financial resilience, with a requirement for forward-looking plans from suppliers through a viability statement or certificate of adequacy. This should include a requirement to provide assurance that bills for industry payments, such as renewables subsidies, can be paid. The supplier should also assess their current operational and customer service capabilities, and set out how any deficiencies will be improved.

Ongoing supplier monitoring may require some additional resources from Ofgem. But if it is done in a proportional and effective way it should result in less resources required to manage supplier failures, and lower socialised costs for consumers resulting from these failures. As we elaborate in our response to question 11 below, we think that ongoing monitoring could be tailored to reduce the burden on Ofgem and suppliers. The frequency and intensity of ongoing monitoring could be connected to the level of risk a supplier presents to its customers and the wider market. For example, more frequent monitoring may be required for suppliers that are new, growing rapidly, or where other intelligence suggests they may represent a higher risk.

Q11: Do you have any initial views on the potential introduction of targeted or strategic monitoring/requirements on active suppliers?

We strongly support targeted monitoring, alongside ongoing monitoring. We agree that this should be designed to encourage companies to proactively flag issues to Ofgem, for example if they are likely to deviate from their previously submitted plans or statements.

We also agree that targeted monitoring could be related to approaching particular regulatory thresholds. We have previously seen some suppliers struggle, particularly when they have crossed thresholds requiring them to offer ECO or Warm Home Discount. In some instances, targeted monitoring could take the form of more frequent ongoing monitoring, while in others it may be appropriate to require additional information. We strongly support the proposal that some thresholds should trigger additional requirements, such as the appointment of a Compliance Officer. We have

previously had serious concerns about companies that have grown to a significant scale without having an appropriate regulatory compliance function.

To be effective, ongoing and targeted monitoring should be accompanied by prompt action by Ofgem when a problem is identified. Citizens Advice works closely with both Ofgem and energy suppliers in order to monitor issues as they arise, using data and insight from our Consumer Service and the Extra Help Unit. When we have serious concerns we share these as soon as possible so they can be addressed before the severity escalates.

When problems are identified, we support Ofgem's approach of working closely with poorly-performing suppliers and giving them an opportunity to improve. However, we feel there have been opportunities in the past where Ofgem should have proceeded with further action, such as imposing a provisional order, at an earlier stage. We think this is particularly the case where the scale of consumer risk from poor service was very high, or where the financial and organisational situation of the company was such that a credible recovery programme was unlikely to succeed in a timely fashion.

We have also been concerned by the slow pace of some investigations by Ofgem, including those into energy suppliers that have subsequently failed. For example, Ofgem opened an investigation into Economy Energy's compliance with sales and marketing rules in September 2016[14], which was still open 28 months later when the company failed in January 2019.

Similarly, in July 2016 Ofgem opened an investigation into Extra Energy relating to 'treating customers fairly, frequency of billing, timely provision of final bills, provision of annual statements, return of credit balances, handling meter readings appropriately, transfer blocking, and complaints and call handling'.[15] This investigation was still open 29 months later when the company failed in December 2018.

If these investigations had been concluded and followed by action, such as a significant fine, the companies would have had limited scope to take on new customers, reducing the socialised costs of their eventual failures. Such action would also have acted as a warning to other companies that unacceptable behaviour would be swiftly and appropriately dealt with. Ins

We are concerned that the closure of these cases at the point the suppliers failed removes the possibility of using any initial findings to share lessons learned with other suppliers. Ofgem should endeavour to share whatever information it is able to about these closed cases as part of its Enforcement Overview report 2018/19. Ofgem should also retain any information on the personal responsibility of senior management at

[14] Ofgem, Investigation into Economy Energy's compliance under the gas and electricity supply licences (Standard Licence Condition 25), 2016.
[15] Ofgem, Investigation into Extra Energy Supply Ltd and its compliance with its obligations under the gas and electricity supply licences (SLC 7B, 14, 21B, 25C, 27, 31A) and with the Consumer Complaints Handling Standards Regulations, 2008.

these suppliers for any issues, and consider this as part of any future 'fit and proper' assessment if these staff join the leadership teams of another supplier.

It is vital that any new monitoring regime is accompanied by sufficient regulatory powers to intervene - and the appetite to use them. Ofgem should explore whether its current enforcement remedies are appropriate, and whether more intermediate actions are needed to tackle issues as they emerge. For example, if a supplier is struggling to cope with growth, a potential corrective action could be to restrict, rather than completely prohibit, acquisition of new customers.

Ofgem should also be more transparent about its willingness to revoke a licence, and the threshold for taking such a step. We note that the recent provisional orders prohibiting Iresa and Economy Energy taking on new customers were followed in short order by the failure of these suppliers. We supported these orders, which were put in place to protect consumers, but given the precarious financial situation of these firms at the time, this action was clearly likely to make it difficult for these suppliers to survive. If Ofgem considers that some companies are not fit to be in the market we think it should stand ready to remove their licence to operate.

Q12: Do you have any initial views on the potential introduction of prudential/financial requirements on active suppliers?

We strongly support the introduction of prudential/financial requirements on active suppliers. While we support the regulations that Ofgem has in place to protect consumers and renewable generators in case of supplier failures, these introduce an element of moral hazard to the market - for example, incentivising suppliers to increase credit balances, knowing that these will be protected if they fail.

The protections socialise the costs of supplier failures across all consumers. This means that active switchers moving to newer companies benefit from lower tariffs and have their credit balances protected if the company fails, with this cost paid by all other consumers, including loyal customers of incumbent, low risk suppliers, who already are on more expensive default tariffs. Ofgem therefore has a duty to minimise the costs on consumers much as possible.

Ongoing financial reporting requirements, as we propose above, as well as reporting of key financial data by troubled suppliers could allow Ofgem to better track performance, particularly of failing suppliers, and take appropriate action to mitigate the impact of the failure on consumers. A key area where we think that Ofgem could intervene is on credit balances. There are also steps that could be taken to reduce the wider costs of supplier failures. We discuss this in more detail below.

As Ofgem develops prudential and financial requirements, it should review the circumstances of previous supplier failures to identify key criteria for future assessments and monitoring.

Q13: Do you consider that Ofgem should introduce a new ongoing requirement on suppliers to be 'fit and proper' to hold a licence?

We strongly believe that Ofgem should introduce an ongoing requirement on suppliers to be 'fit and proper' to hold a licence. We have noticed that individuals who have had significant leadership and responsibility in a failed supplier have later been involved in managing other energy supply companies. Individuals who have significantly contributed to companies that had acute failures in customer service, broke industry rules, or had reckless strategies in place, should have no place running an energy company again.

Section 8: Exit arrangements: managing supplier failure

Almost 1 million consumers have been directly affected by the failure of a supplier since GB Energy's failure in November 2016. For example, Co-op Energy claimed £14 million to recover their costs for taking on failed GB Energy's customers. Recovering this fee ended up costing consumers £0.52 per household[16], a seemingly small price which nonetheless adds up when considering the quantity of failed suppliers since then. More recently Octopus has also made a claim for nearly £14 million[17] in 2018 for taking on customers following the failure of Iresa Energy.

We accept that in a competitive market suppliers must be allowed to fail. But given the recent spate of supplier failures, we think Ofgem should urgently consider introducing rules that could limit the socialised cost of these failures on the market. This should look widely at the cost of failures - including the mutualisation of renewables subsidies and the cost of protecting closed credit balances.

We also think there are clear consumer protection gaps in the SoLR process, that mean the current arrangements are not fit for purpose.

Protecting customer account balances

This is clearly an area where Ofgem should act. We are aware of a number of suppliers that have taken inappropriate action to increase the credit balances of their customers, by either increasing direct debits, delaying refunds or taking one-off payments. We have also seen tariffs emerging that require the payment of significant credit upfront[18]. The impact larger credit balances have on SoLR claims is clear. We estimate that when Iresa

[16] Citizens Advice, When energy suppliers go bust, it costs everyone, 2018.
[17] Citizens Advice, Response to Last Resort Supplier Payment Claim from Octopus Energy Limited, 2019.
[18] For instance, Eversmart's "Family Saver Club tariff" whereby the consumer pays for a year's energy upfront. This tariff was withdrawn by Eversmart in January 2019.

failed in 2018 its customers had an average credit balance of £128, whereas there was an average credit balance of £69 per customer when GB Energy failed in 2016.

Capping the level of credit balances could be one way of limiting the costs of supplier failures. This could be done by imposing an absolute restriction on the credit balance that can be held for a single customer. Such a cap would need to be set appropriately to both prevent suppliers from unnecessarily increasing credit balances to meet the maximum level allowed, while also protecting consumers who may have higher consumption patterns and may prefer to keep a higher credit balance to manage their costs appropriately across the year.

Some of the six largest energy suppliers previously put in place automatic refunded direct debit customers at a set level - in effect a form of cap on credit balances. The most common approach was to refund any balance of £5 or more when consumer accounts were reviewed.[19] However, we are aware that some suppliers have since increased this to a higher level following customer complaints about these refunds. Through our advice services we have also seen detrimental effects for consumers whose credit balances are prematurely refunded at a time when their energy expenditure is expected to rise, thereby placing them in debt or creating additional hassle of making new payments. This demonstrates the complexity of setting an absolute cap at an appropriate level.

An alternative approach would be to set a credit limit that is relative to a customer's estimated consumption, so that a higher balance can be held if a consumer is expected to use more energy. This would provide a more appropriate 'buffer' for consumers to manage changes in expected consumption, limiting the risk of the account going into debit and the need for additional payments. However, this could also mean that less affluent consumers, who tend to consume less energy and have lower credit balances, end up paying to protect the larger credit balances more affluent consumers, who tend to consume more energy.

As the energy market offers more varied products and services to consumers with a range of needs, higher credit balances may be a feature of some new offerings. An approach which could allow more innovation by suppliers, while also making protection of credit balances more progressive, would be to only protect credit balances to a certain level. Any credit held above this level would be at risk if the supplier failed, although the consumer could attempt to get this refunded from the administrator. This would mirror the approach taken by the Financial Services Compensation Scheme for financial services which, for example, only protects the first £85,000 held in a bank account.[20] Careful consideration would need to be given to the level at which protection was removed, and consumers would need to be protected, with clear information and opportunity to take action to prevent their credit being put at risk, for example by requiring opt-in consent from the credit balance to go over the limit of the cap.

[19] Ofgem, Direct Debits: What you need to know, 2016.
[20] Financial Services Compensation Scheme

While limits on credit balances are one approach to minimising the costs of SoLR events, we strongly agree with Ofgem's view that suppliers should bear their share of the risk of failure. Several models have been proposed for credit balance protection, including requiring a letter of credit of a guarantee from a parent company or creditor. Another option includes the potential to protect customer credit balances by either keeping them in a separate escrow or segregated cash account. This type of model is currently used by the Public Utility Commission of Texas[21]. These methods could allow suppliers flexibility over the level of credit balances while protecting consumers in the event of a failure, and have the significant benefit of reducing or entirely removing this element of cost from the SoLR process. However, further work would be needed to understand the impact such changes would have on supplier costs and barriers to entry, and whether they could inadvertently increase the risk of supplier failure.

Ofgem should also consider whether controls on credit balances should be imposed on all suppliers, or selectively using a risk-based approach. The latter could take account of ongoing financial monitoring, and impose controls if this showed suppliers were becoming financially unstable. Controls could also be applied based on factors such as how long the supplier has been in the market. This approach would need to be applied cautiously, to ensure that the controls themselves do not inadvertently cause struggling suppliers to fail during a short term financial issue that they that might otherwise have survived.

As the retail market develops, we think the current Safety Net approach may no longer be appropriate. The recently announced joint Ofgem/BEIS retail market review should consider how to protect credit balances in any post-supplier hub market design. Alternative approaches that have been suggested include an insurance-based scheme, in which premiums would appropriately assess the risk-level of a particular business, and cover the cost of a SoLR process.[22]

Regardless of whether a cap or other action is taken to protect balances, it is vital that consumers are given prompt refunds by suppliers when they request them (as already required by SLC 27.16). We have also seen cases where consumers with high credit balances (sometimes over 3 months worth of credit) are not promptly refunded, putting them at risk of financial distress. This practice also restricts competition, by preventing consumers from switching to another supplier if they cannot afford to make energy payments to a new supplier while their deposit is being held by their current supplier. While this credit is protected if the supplier fails, this process can take time and further delay the return of the consumer's money. Ofgem should take swift enforcement against any suppliers that intentionally delay refunds to their customers.

We support Ofgem's recent action to formally include closed account balances in the Safety Net, but this also increases the risk of higher socialised costs of failure if suppliers

[21] Public Utility Commission of Texas. Electric Substantive Rules. Chapter 25: Rules, Chapter E: Certification, Licensing and Registration.
[22] Laura Sandys, Dr Jeff Hardy, Professor Richard Green, Dr Aidan Rhodes ReDesigning Regulation: Powering from the future, 2018.

retain these funds rather than refunding them quickly. We think the introduction of a Guaranteed Standard for refunding credit balances at the end of a contract is a welcome step to tackle this risk.[23] Ofgem's planned future Guaranteed Standard on final bills should reduce this risk even further.

Tackling wider costs of supplier failure

The initial costs of supplier failure, including managing the SoLR process and covering the cost consumer credit balances, are a burden that is spread across all domestic consumers.

However, supplier failures also result in other socialised costs, through mutualisation of payments to the Renewables Obligation scheme and the Feed-in Tariffs scheme. Ofgem identified a shortfall of £58.6m in the Renewables Obligation scheme for 2017/18. Many companies which contributed to the shortfall subsequently failed, including Economy Energy, Extra Energy, and Spark Energy[24]. It seems likely, based on the supplier failures so far this financial year, that mutualisation will be required again for the 2018/19 scheme year.

Improvements in supplier monitoring and intervention to ensure financial resilience could help reduce the risk of these costs accumulating. But changes to the when scheme payments are made could reduce these risks further. Moving to quarterly, rather than annual payment would reduce the amount owed that the point a supplier failed. Alternatively there could be a requirement to ring-fence these funds which could ensure that suppliers do not use them as working capital. As with a requirement to ring-fence credit balances, appropriate consideration would need to be given to whether this was likely to increase supplier costs or introduce inappropriate barriers to entry.

While of a smaller order of magnitude than funding for renewable levies, there are also a range of other unpaid costs when suppliers fail, including unpaid bills for services like the Energy Ombudsman and deficits at the Balancing and Settlement and Smart Energy Codes. These costs will also need to be recouped, and are likely to ultimately be paid for by consumers. All participants in the industry should consider how to limit these risks, through appropriate credit cover and other arrangements.

Ensuring all consumers are protected in supplier failures

We are concerned that some consumers are not adequately protected during the current SoLR process. Consumers who are in debt with their energy supplier at the point that it fails are particularly at risk. In these cases, the debt has often been left with the administrator, rather than moving to the new supplier. Because the administrator is

[23] Citizens Advice, Response to Ofgem's decision on the way forward on Switching Compensation for Supplier Guaranteed Standards of Performance, 2019.
[24] Ofgem, Renewables Obligation Late Payment Distribution 2017 - 2018.

not a licensed entity they do not have to consider ability to pay when collecting debt, and any arrangements to repay that the consumer had previously agreed with their supplier will be void. With recent supplier failures taking place during winter months, these consumers may face much higher costs than they expected for their energy at the coldest time of the year.

In some SoLR events the new supplier purchased customer debt from the administrator, allowing them to continue collecting the outstanding debt from customers in line with Ofgem rules. We prefer this approach, as we think it secures the best outcomes for consumers. Where this has not happened, we are aware of some cases of good practice where the new supplier and the administrator have worked together to help consumers who are particularly at risk of detriment. Ofgem should consider what further action in can take to protect consumers with energy debt going through the SoLR process. We would expect that a fair outcome for these consumers would include honouring any existing arrangements to repay, and setting up new repayment arrangements in line with the requirements in the supply licence.[25]

In recent SoLRs where the losing supplier had been using SMETS1 smart prepayment meters, we identified risks to consumers if the meters are not compatible with the new supplier appointed by Ofgem. Consumers may struggle to top-up during the interim period while Ofgem is selecting a new supplier. And if a non-compatible supplier is selected, prepayment consumers may be placed in credit mode for a significant period of time, placing them at risk of building up an energy debt. This risk should reduce once SMETS1 meter enrollment and adoption has completed, but until then Ofgem should ensure that these risks are appropriately accounted for as part of its internal SoLR process.

Micro-businesses are not currently formally protected by the Safety Net. This may arise from a view that these customers should be better able to manage this risk, or that they are less deserving of protection. However, many micro-businesses have no formal training before starting their business[26], and issues reported through our consumer service often finds the lines blurred between their understanding of their rights and responsibilities of their business and domestic supply.[27] We are also aware that domestic consumers can be living in premises covered by a non-domestic contract - for example, in flats above shops and pubs. We therefore believe that the both micro-business and domestic consumers should have their credit balances protected, with the cost of a Safety Net for small business customers ring-fenced within the micro-business market segment.

There already appears to be some informal protection for these customers by Ofgem. Following the collapse of Extra Energy in November 2018, ScottishPower agreed to cover the cost of credit balances for Extra Energy's micro-business customers in its SoLR

[25] Citizens Advice, Proposed modifications to SoLR supply licence conditions, 2018.
[26] Money Advice Trust - Supporting small businesses with energy debt, 2018.
[27] Citizens Advice, Good Practice Guide - Recovering energy debt from the smallest businesses, 2018.

bid, while also using the Safety Net to cover part of the cost of protecting domestic credit balances.[28] While we support an outcome that protects microbusinesses, this could be seen as an implicit use of the Safety Net to protect non-domestic credit balances. In future, Ofgem should automatically protect micro-businesses with a Safety Net of their own, rather than relying on SoLR bidders including this in their offer.

We also have concerns about the transparency of Ofgem's process for selecting SoLR providers. In some cases it has appeared that suppliers that were seeking to claim more funds from the Safety Net were chosen over others that were seeking less. We think that minimising socialised costs should be given more weight in any SoLR decision than other factors, such as securing a cheaper replacement tariff for customers of the failed supplier. Similarly, we would like a better understanding of the regard that Ofgem gives to customer service levels at the new supplier when assessing bids. It is important that consumers are well supported through the SoLR process, especially since they are likely to experienced poor customer service with their failed supplier. Ofgem should provide more detail on the bids it receives in future, to allow for better scrutiny of its decision making process.

There is a risk that the recent supplier failures reduce consumer confidence in switching, particularly to smaller suppliers with less established reputations. In its ongoing work to monitor consumer attitudes and experiences, Ofgem should improve its understanding of experiences of those directly affected consumers who have been through the SoLR process, to understand if it has impacted their perceptions of and willingness to engage in the market. It may also be useful to understand wider consumer attitudes towards the socialisation of costs.

[28] Ofgem, Ofgem appoints Scottish Power to take on customers of Extra Energy, 2018.