

23 January 2019

Co-op Energy response to Ofgem's Supplier Licensing Review

Dear Lisa and Jeremy

Thank you for the opportunity to respond to [this](#) consultation.

Introduction to Co-op Energy

One of the biggest differences between Co-op Energy and other energy suppliers is that we're a co-operative, which means we're owned and run by our members. Most big energy suppliers are owned by shareholders, so any profit they make goes back to their shareholders, rather than customers. When we make a profit it's our members, and our community who see the benefits.

Established in 2010, Co-op Energy has 380,000 domestic customers and is committed to sustainability. We stopped buying electricity from coal in 2016. All our electricity tariffs are now sourced from 100% renewably generated electricity as standard.

We launched our Community Energy Strategy in March 2017 and we are helping to expand community energy in Great Britain and to be recognised as the GB's leading supporter of locally-generated low-carbon energy. Via Power Purchase Agreements (PPAs) we are enabling a fair market access for community energy, with projects including wind, solar-PV and hydroelectric technologies. The number of PPAs with community energy groups now stands at 68 compared to the nine we had at the end of 2014.

We secured Fair Tax Accreditation for the 3rd consecutive year and won the Queens Award for Enterprise 2015 in recognition of our ongoing commitment to social responsibility.

Summary of our views

We agree new arrangements should be brought forward urgently to introduce new checks on new entrants. In addition activity to provide assurance on the financial and operational stability of **existing** suppliers should be undertaken urgently.

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Our overarching view is Ofgem's proposed way forward does not strike the right balance between protecting consumers and allowing new suppliers to enter the market. We do not think Ofgem's preferred option (2) will provide sufficient protection for consumers. It is estimated recent supplier failures could cost consumers £80m or more. A rigorous and robust assessment of new entrants as outlined in option 3 provides a level of consumer protection commensurate with the materiality of the risk.

We look forward to hearing more about Ofgem's approach for existing suppliers in the new year. While it is important entry criteria for new entrants are made more robust, it appears we may have reached 'peak supplier' in terms of absolute supplier numbers. It is our view there may be a high level of consumer risk posed by suppliers already in the market and intervention by Ofgem could help mitigate some of these risks.

We are supportive of your intent to remove the 'loophole' which allows companies to provide 'off the shelf' companies without appropriate scrutiny.

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

We agree with the overarching principles set out in 2.11. In particular, we agree an overreliance on customer credit balances as a source of working capital can be unsustainable and shifts the costs of failure to the market and consumers.

We think particular attention needs to be given to suppliers who take payment in advance, particularly for extended periods. Without further safeguards, we think this represents an unacceptable risk of shifting costs onto consumers. A mechanism for this risk to be borne by the supplier rather than underwritten by the SoLR process is needed. This could be some form of insurance product or funds held in escrow.

However, a tariff where consumers pay upfront for their entire annual energy will clearly only be an option for wealthier consumers and could 'lock out' poor and more vulnerable consumers. This risks exacerbating an existing feature of the market, where some suppliers effectively 'cherry pick' lower cost to serve customer by only offer DD, 'online only' tariffs, sometimes without offering a telephone contact number. Such an approach is making it harder for suppliers seeking to serve all consumers.

We agree suppliers should maintain a capacity and capability to deliver a quality service to their customers and maintain a constructive relationship with Ofgem. This should include regular DD reviews, plans for PPM support (when over 50k customers) and support for vulnerable customers.

We also agree Ofgem's reform should seek to minimise the wider market impacts of failure.

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We agree the licensing regime should also support effective competition and allow innovation to take place. However, we suggest that when assessing the benefits of innovation Ofgem should also consider the distributional impacts of any benefits compared to the distribution of risk. For example, a supplier taking payments in advance will offer tariff that will benefit more wealthy consumers. However, in the event of such a supplier's failure, the cost of this failure is socialised across all consumers, including a disproportionate burden by lower income households and the fuel poor.¹

Do you agree with our proposal to introduce new tougher entry requirements and increase scrutiny of supply licence applicants?

Yes. These should be brought forward without undue delay.

It can be argued that if the proposals has been brought in earlier, this could have protected the market and consumers from the material impacts of recent spate of Supplier of Last Resorts (SoLR) and mutualisation of Renewable Obligation Certificates (ROCs). Some observers have estimated the costs to consumer could be £80m, or about £3 per household.²

Do you agree this can be achieved with increased information requirements and qualitative assessment criteria?

No. We do not think the risk-based qualitative approach outlined in option 2 provides sufficient protection for consumers. It is our considered opinion Option 3 appears a proportionate approach in the light of recent multiple supplier failures and the failure of several suppliers to pay ROC bills on time, and the material impact this has on consumers.

Ofgem states the requirement to require full business proposals and accounts and projections (possibly for 5 years) is a disproportionate resource effort, although it is not clear on whom this disproportionate burden falls.

We think any credible new entrant should have already prepared these items as part of their business planning. We would be very concerned if they had not so therefore this does not appear a disproportionate burden on new entrants.

It seems logical to conclude Ofgem's concern relates to the disproportionate nature of its own resourcing in relation to performing more comprehensive assessments of new entrants. Give the

¹ An estimated 11.1% of household in England are in fuel poverty, BEIS, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/719106/Fuel_Poverty_Statistics_Report_2018.pdf, page 3

² <https://www.theguardian.com/money/2018/dec/16/uk-householders-pick-up-bill-for-bust-energy-firms>

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materiality of recent failures, this appears unlikely, however it is impossible to determine since no cost information for option 3 (or the other options) is provided in the consultation. We think this would be a helpful addition to enable stakeholders to provide more informed views.

We think the application of a fee to cover some/all of Ofgem's costs for assessing new entrants could remove some of the resourcing concerns.

Evidence from recent SoLRs should inform the discussion of appropriate options, given Ofgem's insight into these failures. For example, which, if any, failure would have been prevented if option 2 or 3 had been in force when the failed suppliers entered the market?

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

We agree with the criteria in 5.1, covering appropriate resources (criteria 1); understanding of regulatory obligations and plans in place to meet them (criteria 2); and the applicant if fit and proper to hold a license.

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?

Yes as a minimum, applicants should provide evidence of their first 12 months. However, we do not think this approach provides adequate protection for consumers after the first 12 months of business.

A credible business will have financial plans beyond the first 12 months of operation which could be shared with Ofgem. We think Ofgem should be well qualified to sense check both existing and future business models, particularly if expertise from its Innovation Link³ is used. Ofgem could monitor how the supplier performs against these initial plans on an ongoing which could provide early warning of financial distress and we would hope this is explored in Ofgem's work in 2019 looking at ongoing requirements for suppliers already in the market.

Do you agree with the specific information we would generally expect applicants to provide (in Appendix 1)? If not, why/what would you add or change?

When assessing applicant's resources (criteria 1), Ofgem's proposals state it will be necessary for the applicant to provide financial data in respect of the applicant's projections. However, Ofgem does not propose to 'check their working'. It's not clear what specific validation of the financial data would occur,

³ Ofgem's Innovation Link is a 'one stop shop' offering support on energy regulation to businesses looking to launch new products, services or business models.

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and how this would protect consumers. We think there is a role for some financial 'sense checking' by Ofgem to ensure applicant's financial planning is sound.

While a 'signed declaration of adequacy' may provide a route for sanction (and hence produce a deterrent effect) for blatant false statements by directors, it does not appear to be an effective route to deter 'overly optimistic' statements, which we think will be more likely than outright false statements.

We think a suppliers plans for completing their smart meter rollout should be specifically looked at as a condition of entry, given the importance of smart metering for consumers. The most straightforward route would be for new suppliers to submit annual rollout plans using Ofgem's template as part of the licensing regime. This will reduce potential gaps in new suppliers' smart preparedness as we approach the completion of the smart rollout.

Criteria 2: Regulatory obligations

We agree Ofgem should not prescribe the manner in which a supply entrant must approach compliance and agree with the table of relevant obligations which could be grounds for refusing a licence.

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

Yes as a minimum.

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

Yes – see earlier answer.

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

Yes.

We think consumers would be better protected if there was clearer guidance on the bar for disqualification, rather than judging each application on a case by case basis. For example, this should include barring directors of previously failed suppliers which have resulted in SoLR where there is evidence of poor/high risk management approach. It could also include enforcement activity where a fine, or consumer detriment exceeded a certain threshold. This approach would also ensure applicants are clear on the expectations before applying.

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Do you agree that Ofgem's licensing process should be undertaken closer to proposed market entry?

Yes. We agree with Ofgem's rationale. It is important the current 'off the shelf' model is reformed and the assessment of the applicant is made on the people/entity who will actually operate the business rather than the managed service providers who are licensing the company for onward sale.

Do you identify any barriers to this approach or any adverse impacts of this change?

No.

Ongoing requirements

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?

Yes.

Close attention should be paid how credit balances are being used to provide cash flow and fund growth. Clearly if credit balances are being used unsustainably to fund growth this should be a trigger for further investigation.

Other metrics which could be tracked:

- % of account subject to DD review annually
- Review of operational approach to managing vulnerability and investigation of any SoR outliers
- Approach to managing debt

A Certificate of Adequacy, which declares that the supply business combined with an Annual viability statement seems prudent.

We do not agree these reporting requirements should only apply to suppliers of a certain size. Recent history shows multiple supplier failures in quick succession are possible and it is the combined impact of these failures that is ultimately paid by consumers. Therefore, all suppliers should be required to provide reassurance of their soundness. If Ofgem is still minded to introduce a threshold, this should be no more than 50,000 customers.

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

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We agree both a threshold check should be introduced (including when triggered by being appointed a SoLR) and when growth or other metrical are materially different to expectations.

We agree this provides an appropriate level of protection for consumers from paying for the cost of supplier failures.

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

We agree it is sensible to include prudential/financial requirements on suppliers, for example parent company guarantees or other form of cover. This will help protect consumer for the costs incurred from supplier failure.

We think suppliers whose business model results in holding a greater level of credit balances should be subject to greater scrutiny.

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

Yes we agree a 'fit and proper' person test should apply to individuals named in the licence application and on an ongoing basis.

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