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Industry Codes & Licensing  
Ofgem  
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London  
E14 4PU

21 January 2019

Dear Lisa and Jeremy,

### **Supplier Licensing Review – ESB Energy Response**

ESB Energy welcomes the opportunity to respond to this consultation. We took on our first customer in August 2017. This gives us a strong insight into the challenges suppliers face when entering the market. Our understanding of Ofgem's position is that while it would expect some suppliers to fail in any competitive market, it believes there are some prudent steps it could take to reduce the likelihood of this happening and so minimise the cost of such failures being borne by consumers when it does happen.

Ofgem has proposed a package of reforms, centring on supplier entry, ongoing monitoring of suppliers and protecting consumers from the cost of supplier failure. Our response will focus on each component of Ofgem's proposed package in turn. However, it's important to note that each component of the package will interact with the others. For example, a very comprehensive set of measures around supplier entry will reduce the likelihood of supplier exit and, therefore, the need for further interventions. ESB Energy believe that by focusing on supplier entry and exit, Ofgem can deliver the outcome it desires without the need for the additional burden of ongoing monitoring.

#### *Supplier Entry*

We're very supportive of the proposal to introduce tougher entry requirements, increase scrutiny of potential new entrants and undertake the licensing process closer to market entry.

Under the current market entry arrangements, there are a number of prescriptive and absolute requirements that suppliers may not become aware of until sometime after they have entered the market. This gives prospective new entrants a false impression that the barriers to entry into the market are lower than they actually are. The proposed approach provides an opportunity to make compliance with these prescriptive requirements a condition of entering the market. This will give potential new entrants a clearer understanding of what is needed to become an energy supplier and a more accurate view of the associated costs.

For example, a domestic supplier may not be aware that, although domestic supply is synonymous with single phase metering, a number of domestic premises have three phase electricity supply. A supplier could be operating in the market for several months and have thousands of customers before they become aware of this requirement. They will then have to quickly contract with a specialist three phase Meter Operator (MOP) in order to safely maintain three phase meters<sup>1</sup> or put controls in place to ensure three phase premises are identified and not acquired through change of supply. Either way, it represents an additional cost to the supplier over what they had planned for.

To be clear, making suppliers aware of existing barriers to entry to the market is not the same as introducing the barriers to entry into the market. We believe that ultimately new entrants will be thankful that Ofgem checks these arrangements prior to market entry. We recognise that many of these prescriptive requirements sit in legislation or industry codes rather than in the licence itself but they are needed in order to allow for the safe and efficient operation of the energy system. We would be happy to work with Ofgem to help identify which of these requirements should be preconditions for market entry.

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<sup>1</sup> Regulation 4 of the Electricity at Work Regulations 1989 require employers, employees and the self-employed to maintain electrical systems so as to prevent danger as far as reasonably practicable.

### *Ongoing Monitoring of Suppliers*

Monitoring is one of the key tools available to Ofgem so it makes sense to explore the possibility of using monitoring in the context of this review. However, we believe monitoring in this context introduces a great deal of cost and risk for little benefit.

Table 2 of the consultation sets out a cyclical or a targeted approach to monitoring in order to ensure the financial resilience of suppliers. Under both approaches, it's been suggested that if the reporting raised concerns, Ofgem could take action. It's difficult to understand how this would work in practise. If a company gets into financial difficulty it's not clear what sort of actions Ofgem could take to get them out of financial difficulty. If Ofgem is planning a more interventionist approach and intends to take steps to prevent companies getting into financial difficulties in the first place, it's difficult to see how it could future proof interventions to account for to new and innovative business models. It would be useful if Ofgem could provide concrete examples of the actions they might take in response to information they receive.

Arguably further monitoring could better prepare Ofgem for potential Supplier of Last Resort (SoLR) events. Our understanding of the market is that although nine suppliers have gone out of business in the last 12 months, many more have come close to bankruptcy, only to be sold or rescued by other providers. There is a risk that further monitoring beyond what Ofgem already does could lead to many more 'false alarms' where time and effort is invested in preparing for SoLR events that ultimately don't happen.

The consultation suggests that suppliers could submit an annual certificate of adequacy. We do not think this will be effective. There is an overwhelming incentive for directors to certify their companies as adequate in all but the most dire of circumstances. If a supplier certifies themselves as adequate and then subsequently goes bankrupt, it's difficult to see how Ofgem could pursue non-compliance. If they certify themselves as adequate and they don't go bankrupt then it's difficult to see how Ofgem can argue the supplier incorrectly certified themselves at the time.

The consultation also suggests an annual viability statement, a milestone assessment or the submission of information if supplier plans go outside of tolerance. All of these approaches sound incredibly onerous for both suppliers and Ofgem. There are 73 suppliers active in the domestic market and 90 suppliers active in the non-domestic market<sup>2</sup>. Eight have gone bankrupt in 2018. For the majority of energy suppliers who are financially prudent, you would be imposing substantial additional reporting requirements which lend no added benefit. Conversely, Ofgem has a duty of care to properly scrutinise the data it collects. It cannot just receive information and file it away. It will need to allocate resources to this work in perpetuity and we believe these resources could be put to better use helping consumers. This data is also likely to be highly commercially sensitive in nature. We know that Ofgem has controls in place but the more sensitive information it collects, the greater the possibility of a data breach. The safest way to protect commercially sensitive data would be to not collect it in the first place.

### *Protecting Consumers from the Costs of Supplier Failure*

We agree that supplier failure is something you would expect to see in any competitive market. We also agree that the cost of supplier failure should be borne by its investors, not consumers and vulnerable consumers. The current arrangements for protecting credit balances are not fit for purpose and a change is needed. It incentivises suppliers with financially risky funding models to enter the market. The consultation sets out a number options to help protect credit balances.

We believe that imposing maximum limits on credit balances or restricting terms around credit balances could create unintended consequences. Ofgem could set the limits too high or too low and the limits would need to be adjusted over time. Furthermore, domestic and non-domestic requirements would have to differ as these markets have very different characteristics. Finally, restrictions to supplier terms and conditions could inadvertently hinder new and innovative business models that may bring value to consumers. For all of these potential problems, these interventions still will not prevent the socialisation of credit balance costs in the event of a supplier going bust.

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<sup>2</sup> According to the State of the Energy Market report 2018

On the other hand, a letter of credit<sup>3</sup> from each supplier guaranteeing customer credit balances in the event they go bankrupt will achieve Ofgem's goals:

- Letters of credit will not be onerous or expensive for financially prudent suppliers.
- Less financially prudent suppliers will be incentivised to improve their financial resilience in order to obtain letters of credit at a competitive price. Where the risk warrants it, the financial institution may inspect a suppliers accounts and demand remedial action before the letter is issued or the letter may be issued on the condition that the supplier takes prescribed steps to reduce the chance of bankruptcy.
- Letters of credit will incentivise suppliers to proactively hand back credit balances in order to keep letters of credit costs down.
- In the event that a supplier does go bankrupt, the cost of protecting credit balances will not need to be socialised.

The consultation briefly touches on other costs arising from supplier failure. One relatively straightforward step that could be taken would be for the cost of government schemes to be collected more often than is currently the case. This would mean that a greater proportion of scheme costs would have collected in advance of supplier default and as a consequence it would reduce the likelihood of mutualisation being triggered.

Our understanding is that Ofgem wishes to proceed with introducing further requirements around supplier entry first and then to follow-up with the remainder of the remedies. This approach has merit but Ofgem should have a good understanding of how the overall package of remedies will work before proceeding with the first part. We would be more than happy to help you with getting this right. Please do not hesitate to get in touch.

Yours Sincerely,

Paul Fuller  
Regulation Manager

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<sup>3</sup> The letter of credit should not be from the supplier's parent company.