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22 January 2019

Dear Lisa,

**RE: Supplier Licensing Review**

Thank you for the opportunity to respond to this consultation, the answers to your specific questions are enclosed. However as this is a subject I have strong views on, I thought I would send you a covering letter to explain the issues we see with the current licensing regime that we feel need to be addressed by any replacement.

There are 4 key issues we would like to highlight:

1. Who are you licencing?
2. The structure of business models in use
3. The safety net and credit balances
4. Stress testing

**Who are you licencing?**

There has been a fundamental shift in supplier entry through the mechanism of the 'supplier in a box' model, where software firms create shell companies which use their software, gain licence accreditation for the companies and then sell them in the market.

Ofgem are required to assess the suitability of new entrants to the energy market on the basis of a 'fit and proper people' test for any entrant using the conventional route to a licence.

It therefore follows that Ofgem should have the ability to assess the directors, the financial viability, structure, energy buying regime and business model of the proposed purchaser of a pre-licensed supply company.

We would therefore propose that the fit and proper test is applied to both new licensees and upon change of ownership and control.

White label suppliers will need to be policed in line with new requirements by their licence holder.

### **The structure of business models in use**

The structure of the business models in use by failed suppliers prior to cessation of trading have a common thread.

They are all seeking to be among the cheapest suppliers, and they are all taking upfront payments from consumers. They cannot all be the cheapest and without increasing customer numbers there is a diminishing cash pool to cover losses. So someone has to lose the race but it's the consumers credit balance that is at risk.

While losing money in a bid to secure market share is a business practice followed in many consumer industries (Amazon, Ocado) these must be backed by reserves, assets or funding. This has not been the case and the failures we have seen have been a direct result.

The costs associated with picking up the pieces are significant and fall on the rest of the industry and ultimately their customers. So it's not just the customers of these unsustainable business that are at risk, they are gambling everyone's money; no one has yet coined an expression to rival 'casino banking' but that is what we are talking about here!

Responding to the suggestions from Ofgem that 'it is for suppliers to manage the costs they face...' and that the SOLR process is a small cost that should be kept in perspective, we would point out that

- the costs that are being mutualised are completely outside the control of compliant suppliers
- the cost of individual failures taken in isolation can be thought of as small – that depends on the size of your own business!
- Ofgem don't have a business or any reserves, they collect the money from industry participants who in turn recover the costs from their customers.
- this is a risk business: the events of the last 12 months have shown that vividly.
- to operate in that environment you need to make a margin and you need risk capital.
- failed companies have been using customer credit balances as risk capital

### **The safety net and credit balances**

Prior to 2016 the SOLR process was geared to ensure continuity of supply. This worked well until the proliferation of new suppliers began taking up-front payments through Direct Debits.

This meant that customer money was being used as risk and working capital which meant in the event of failure their money became subject to unsecured creditor status.

In anticipation of supplier failures- however rare - Ofgem interpreted their mandate to protect consumers very widely and moved to protect their credit balances as well as continuity of supply.

Everything changed with the introduction of the Safety Net in 2016 to protect the credit balances of consumers of failed suppliers.

We met and corresponded at length with Ofgem at the time and the email dialogue is attached\*. The concerns expressed at that time are even more relevant today.

The truth of the licencing regime is that failed companies have been using customer credit balances as risk capital and the safety net provides no disincentive to do this or prevent recklessness in operating an energy company .

Perversely, the safety net, far from tightening regulation on an influx of new entrants, provides scant incentive to act prudently in what is a risk business. When you have nothing to lose and are playing with other people's money, the temptation to act recklessly might entice even a saint!

### **Stress testing**

Stress testing has been called for, for some time.

We feel the current suggestion that entrants need to show they can survive for 12 months is insufficient.

There's a belief that you can operate on-line only, collecting all monies by DD, and that there is no or little requirement for customer service staff and telephony, since this can be processed through the electronic media.

Our experience suggests the opposite and that these challenges do not materialise in the 12 month window currently proposed. We would suggest a 24 month period would be more appropriate.

Suppliers are not guaranteed to continue to collect by DD, because the licencing regime is designed to protect continuity of supply when there is churn in the market, be it as a result of switching or just moving home. Equally final bills are often not straightforward and require time and manpower to resolve.

Cheapest tariffs are operated by thinly staffed organisations, which when they get further down the line fail to have sufficient staff, or financial reserves to employ them, to handle the issues thrown up. It's a downward spiral!

There needs to be checks on funding and business practices, but over a longer time horizon

Quick fixes would be to examine the buying regimes; if suppliers are offering fixed term contracts they should be able to demonstrate they have the financial contracts, instruments and arrangements in place to deliver on the volumes and prices they are committed to.

Another would be to introduce a mandate on billing in arrears . This would prevent a build-up of customer money on the balance sheets of weak suppliers, other than seasonal variations, and it would remove the need for a safety net.

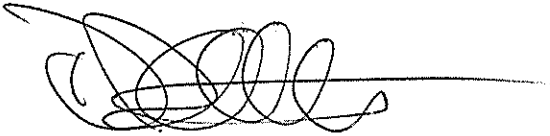
The safety net rewards recklessness and Ofgem should be given the power to peruse the directors for the money they have squandered.

It is accepted however, that introducing billing in arrears would need to be phased in, to prevent the policy precipitating the collapse of suppliers with insufficient capital in the event of the removal of customer deposits from working capital.

\* - Attached separately, please treat as confidential

But this could be managed over time, for instance when contracts come to an end. This would mean that going forward businesses would need to operate within the cashflows of trading rather than seeking prepayments.

This would introduce good working practices that would ensure a focus on cash flow and help eliminate the problem of industry payments such as RO and FITs

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Doug Stewart

**green energy**



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

Yes

**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 would suggest that the majority of new entrants are using the “supplier in a box” approach to entering the market. Whilst we recognise this route ensures that new entrants will have established accredited systems and ensure they can interact with the rest of the industry, we would like to propose that OFGEM have a requirement to carry out a “fit & proper” test both on the issue of a new licence and on the change of ownership and control. This would put a more robust test in place.

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

We would suggest that since OFGEM have carried out detailed work on the costs of supply to implement the price cap, they should be in a position to understand the true costs of supply and can therefore adequately challenge new entrants on their business plan assumptions.

**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?**

Experience would suggest that the period to build knowledge and grow their customer base looks to be a 24 month period rather than just the first 12 months.

**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?**

Yes

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

Yes

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

We would propose that the business plans for new entrants are tested by an independent auditor that would ensure that your role as regulator remains independent but that plans are robustly checked.

**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 also feel that any changes of ownership or control should be approved by Ofgem once a supplier is operating.

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

We would reiterate that the supplier should have an understanding of the requirements of proposed market entry so the closer checks are made the more valuable the scrutiny would be.

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

No

**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?**

We would propose that a licence condition be introduced that requires all suppliers must provide audited financial accounts and that on an annual basis the auditor confirms independently to OFGM that the business is a going concern. This would bring in a level of due diligence that would help protect against business failures and ensure that suppliers are financially challenged without the regulator becoming another auditor.

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

As above the use of established audit requirements would not create new burdens for established suppliers who should be happy to implement this change.

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

We are strong advocates that supply licences should prevent large upfront payments being collected from customers and used as the sole source of funding for the business. We would suggest that the practice of taking money in advance of supply be phased out and we believe very strongly that the first collection from a customer should be at the end of the first month of supply. This would have the additional benefit of ensuring the customer realises the cash saving as well and prevent the build up of consumer credit balances within suppliers. OFGEM would be seen in a very positive light if they supported this to the consumers benefit.

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

Yes, we would continue to propose that the "fit & proper" must be applied at any point in the future when ownership or control of a supplier takes place.