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Dear Lisa

**Supplier Licensing Review consultation**

Thank you for the opportunity to respond on the Supplier Licensing Review consultation.

We welcome this review and strongly agree that the requirements to enter the energy supply market need to be raised. At Green Network Energy we are committed to growing in a sustainable way. This means we expand our customer services in line with our growing customer base and invest in our technology and resource to continue to meet our changing customer needs. We price our tariffs fairly meaning that our customers have an attractive price while we can continue to operate a sustainable, viable business.

When suppliers exit the market, it causes great worry for the customers affected and damages consumer confidence in the market more widely. It is essential that standards for entry are raised as soon as possible, and that this is supported by ongoing monitoring and reporting to ensure that companies are growing in a sustainable way.

Our key areas of concern are the initial proposals for protecting customer account balances. Imposing maximum limits on credit balances and restricting suppliers from using credit balances as working capital will severely limit our and other suppliers' ability to operate. We use credit balances to buy energy in advance which allows us to offer customers fixed prices for their energy use. This benefits customers by mitigating the impact of wholesale market price changes and the likelihood of bill shock. Furthermore, spreading the cost of a customer's energy use over a year also helps to reduce bill shock by enabling customers to pay a consistent amount each month.

While a significant number of suppliers have exited the market recently creating additional costs to industry, the likelihood of these events occurring should decrease with the proposals under the licencing review. Consequently, these recent occurrences should not give reason to restrict the use of credit balances as working capital. We believe that Ofgem should instead consider other ways of recovering the cost of honouring account balances, such as through parent company guarantees or a general industry levy to create a sink fund for unexpected industry costs.

Once again, we very much welcome this review and believe it will help to build consumer confidence in new suppliers that are coming to market. We have set out our response to the consultation in Annex 1 below.

If you have any questions or wish to discuss any of our response in more detail, please contact Samuel Arnold on 07468 494 721 or S.Arnold@GreenNetwork.co.uk.

Yours sincerely

**Pietro Di Maria**

**Chief Operating Officer**

## Annex 1

## 2. The case for change and our aims

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

We broadly agree with the overarching principles but believe there could be some enhancements.

We consider that the first principle[1] could be strengthened by making a specific reference to companies having a prudent commercial strategy that enables them to be a going concern. This principle would then not only cover a company's customer service and risk oversight, but also that the company is pricing its products in a manner that enables it to operate sustainably.

For the third principle[2], while in the event of supplier failure customers need effective protection, we believe that this also needs to be proportionate. For certain new and innovative products, there should be some consideration for whether customers should accept the risk of trying new products. In these situations, the customer would bear some or all of the costs of these companies failing, rather than having these costs borne by industry. For instance, a couple of companies have recently released tariffs where the customer can pay for their entire usage upfront and receive interest payment on their credit balance. If these companies fail, there is potential for huge costs to industry in covering these customer's credit balances, and these costs are ultimately borne by customers. For products such as this, the customer who has made an informed choice to pay a year's cost upfront in return for a lower price and interest payments, should bear some of the risk should the supplier fail. We therefore believe that that this principle should include a proportionate element to the effective protections for consumers.

## 4. Entry criteria: policy options

**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 strongly agree that the requirements to enter the energy supply market need to be raised. Nine suppliers exited the market in 2018. While this is a natural part of a competitive market, it causes a great deal of worry to the customers affected and lowers consumer confidence in the market more widely.

There is a delicate balance between increasing the level of scrutiny at market entry and restricting the ability for new and innovative businesses to enter the market. While Ofgem prefers Option 2 as it appears to strike this balance, we believe that there is a need for further consideration of Option 3 and for companies to provide detailed information. In particular, a company should provide details of their long-term commercial strategy and their plans for pricing, hedging and how they plan to

[1] Principle 1 - suppliers should adopt effective risk management and be adequately prepared and resourced for growth.
[2] Principle 3 – we maintain proportionate oversight of suppliers, and effective protections for consumers exist in the event failure.

account for key industry costs such as the Renewables Obligation. This information will help to determine whether a company is planning to operate in a prudent way and not use aggressive pricing tactics to grow in an unsustainable manner. A prudent company should have long-term forecasts for its growth and finances in place. This would be coupled with the new proposed reporting requirements that will allow companies to revise their projections and enable Ofgem to challenge where there have been significant changes.

A concern of ours for increasing the level of scrutiny is how Ofgem will resource to monitor this activity. Review of business plans is a technical and time-consuming activity and will need staff that have a commercial background in order to challenge the viability of a prospective business. Similarly, there will be significant resourcing requirements for the proposed ongoing reporting obligations with over 70 suppliers currently operating in the market.

## 5. Entry criteria: initial proposals

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

We agree that these are appropriate.

**Criteria 1: Resources**

**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 believe that 12 months is too short, and this is evidenced by the fact that some of the failed suppliers this year were well established in the market. Further, the typical products sold by new suppliers (12 months fixed tariff with exit fees with Direct Debit paid in advance), during the first year of activity a supplier can be financially self-sustaining even with a poor commodity hedging, poor customer service and no long-term strategy. A prudent company should have long-term forecast for its growth and finances in place. We believe that a 3-5 year plan would be more appropriate. This wouldn't be a burden for most companies as this is something that they should have in place already. While any forward looking plan is speculative, this can be revised and adjusted on a regular basis, and can be combined with regular engagement with Ofgem to discuss how the plan has changed.

**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?**

We generally agree that this is the right information for applicants to provide.

We believe that it is essential that Ofgem thoroughly assesses the sales and trading strategy of a new company. We consider this to be the area of greatest significance when assessing market entry. While customer service and resources are important, these are symptoms of a poor commercial strategy that hasn't accounted for all the costs in running a sustainable energy business. If a company has an inadequate hedging strategy and an aggressive sales plan, the company will struggle from the outset to be sustainable in the long-term and this will then lead to failings in other areas such as customer services.

We also welcome proposal for parent company guarantees. When a supplier fails there are added costs for customers generally as the costs of honouring credit balances and other payments are mutualised across industry. Having guarantees in place from the parent company or financial backer will ensure that these costs aren't borne by industry and ultimately customers. We consider that Ofgem should also look at other ways the impacts of these costs are borne by industry such as increasing the frequency of payments such as the Renewable Obligation are made or the potential for an industry sink fund where suppliers regularly contribute into a pool for unplanned industry expenses.

Following these entry checks, we support the proposal for ongoing reporting. We believe that there is need to have these checks more frequently with new suppliers. This is because there is potential for a prospective supplier to game the application process by providing the sufficient information to attain a licence and then renege on the plans provided to Ofgem.

**Criteria 2: Regulatory obligations**

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

We agree that applicants should provide a narrative on how they plan to meet their regulatory requirements. However, this will only be effective if there are regular checks to ensure that a company is actioning its proposals as there is potential for suppliers to game the application by offering a plan for compliance without following it through. As stated in the consultation, previously some new suppliers have underestimated the cost of compliance. This means that while they rapidly attract new customers through low priced tariffs, there isn't enough margin for these companies to afford to meet all their obligations. Therefore, it is essential that Ofgem thoroughly assesses an applicant's trading and sales strategy to ensure these costs are adequately accounted for.

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

We agree with these general areas. One key regulatory area missing from this list is how suppliers plan to account for the switching obligations. This is essential with the Ofgem proposals for guaranteed standards for switching that are due to come in later this year. Under the proposals, poor switching behaviour by new suppliers could results in penalties for other suppliers even when the other supplier isn't at fault.

**Criteria 3: 'Fit and proper'**

**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 with these proposals.

We believe that there is a need to consider whether 12 months of being involved in a Supplier of Last Resort (SoLR) event is long enough, how will this be assessed and what staff it would apply to e.g. would it just apply to the board.

## 6. Timing of licensing: initial proposals

**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 agree with these proposals. There also needs to be greater restrictions on dormant licences as there currently 197 companies with a domestic licence of which less than half are active in the market.

## 7. Ongoing requirements

**Cyclical reporting**

**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 agree that suppliers should report on their financial and operational resilience on an ongoing basis.

However, it is important that this doesn't become unduly burdensome for suppliers to produce. For the certificate of adequacy, companies already make these sort of declarations as part of their annual financial reporting for Companies House and these declarations are audited. However, it takes a long time to produce these reports by which point the warning signs may have been missed e.g. for year ending in December, the accounts are usually produced by March/April and these are not published until November. If Ofgem where to require suppliers to produce this level of reporting out of sync with our current requirements, it would be unduly burdensome on suppliers owing to the massive replication of effort and costs.

In terms of the length of reporting, a six-month report may not be useful as the energy industry is affected by seasonality. Therefore, an annual report may be more appropriate.

As an initial view, we feel that there are two potential measures to help determine financial and operational resilience:

- Renewable Obligation Certificate reporting – quarterly report that forecasts a company's ability to meet its annual ROC payment.
- Asset Ratio reporting – a high-level report that assesses a company's liquidity ratio. On it's own, this metric is at a too high-level to give a sufficient view on company financial health.

However, when combined with the proposed ROC reporting, it would provide a good quick indicator of company financial health.

**Targeted/strategic reporting**

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

Targeted reporting appears to be a sensible approach to monitoring suppliers. We believe that there is a need for more frequent checks in the first year to ensure that company is sticking to the plans that it presented to Ofgem in the first instance. Furthermore, like some of the social and environmental schemes that have thresholds, there is a need to ensure that the milestones cover both customer numbers and total usage.

Ofgem should also consider the way in which a company is acquiring customers and should vary the need for reporting accordingly. For example, a company that rapidly gains a significant number of customers over its forecast plan through aggressive pricing should be considered a higher risk compared to a company that gains a significant number of customers through a collective switch.

**Prudential/financial requirements**

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

We are interested to know how the metrics will be used by Ofgem to determine what "good" looks like and whether these will be published so that we are able to see how we compare with the rest of industry.

We hold a strong belief that there shouldn't be any restrictions put in place on using credit balances. As a business we need to use credit balances as working capital and as such restrictions on credit balances would significantly prevent us from operating. Some alternative solutions would be:

- Capital guarantees – parent organisation or investors guarantees payment of customer credit balances and other payments in the event of supplier failure.
- Net credit balance ringfence – ringfence a proportion of net credit balance, rather than general credit balance. This would enable a company to continue to use credits as working capital while limiting the impact of the cost to industry in the event the supplier fails.
- Payment frequency – increase the frequency of payments such as the Renewable Obligation payment so that when a supplier fails, the cost will only be for perhaps one quarter rather than an entire year.
- General industry levy – a general levy could be added to each customer bill which is then put into a sink fund for unexpected industry expenses. This would mitigate the impact of there being unexpected costs to account for such as a SoLR Payment Claim.

**Suitability to hold a licence**

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

We agree with Ofgem's proposal to introduce an ongoing requirement to be 'fit and proper'. However, there needs to be great care over what is published. If a company is under review, is at risk of losing its licence, or Ofgem declares that the business is unsustainable, investors could restrict or remove funding to keep the company going.

## Credit Balances

We hold a strong belief that there shouldn't be any restrictions on using credit balances as working capital. Credit balances are a natural consequence of enabling customers to spread the payment of their contract over 12 months. This reduces the occurrence and impact of bill shock as they can pay a consistent amount each month. Similarly, suppliers can use the credit balances to purchase energy in advance to enable customers to have a fixed price for their energy for the duration of their contract, again reducing the likelihood of bill shock.

As the use of credit balances for working capital is an essential part of most energy businesses, we believe that there is a great need to review how these costs are mutualised across industry. Presently, the cost of failed companies that haven't paid the Renewables Obligation and the cost of honouring customer credit balances is paid for by the rest of industry and represents an unaccounted cost. Aforementioned, this issue could be reduced in several ways:

- Capital guarantees – parent organisation or investors guarantees payment of customer credit balances and other payments in the event of supplier failure.
- Net credit balance ringfence – ringfence a proportion of net credit balance, rather than general credit balance. This would enable a company to continue to use credits as working capital while limiting the impact of the cost to industry in the event the supplier fails.
- Payment frequency – increase the frequency of the Renewable Obligation payment so that when a supplier fails, the cost will be for only one quarter rather than an entire year.
- General industry levy – a general levy could be added to each customer bill which is then put into a sink fund for unexpected industry expenses. This would mitigate the impact there being unexpected costs to account for such as a SoLR Payment Claim.

While we understand that Ofgem is seeking to limit the cost of honouring credit balances in a SoLR event, we do not believe the current high-level proposals represent solutions at this stage. We have examined each of the potential options in the consultation below.

1. **Imposing maximum limits on credit balances, meaning suppliers would have to more regularly return credit balances**

It is important to consider the fact that credit balances are used to cover future energy use.

Imposing maximum limits on credit balances would be extremely hard to implement and would result in very poor customer outcomes. This is because it would create the situation where we'd automatically refund a customer credit accumulated over the summer and then increase their direct debit payments to cover their future winter usage. This creates a confusing situation for the customer and would very likely result in a higher number of customers going into debt. There would also be additional costs in setting up and managing these transactions in our systems.

An alternative to this is variable direct debit where the customer pays for their exact consumption each month. This would prevent the build-up of credit balances, but relies on the customer providing regular readings. It could also result in bill shock in the winter months and the customer may be less able to meet the higher winter payments so fall into debt.

Another alternative could be to only refund credit balances that are over the customer's estimated annual consumption e.g. a customer who is four months into a contract builds up £120 of credit, but we would have expected them to have £100, we would automatically refund them £20. However, this is difficult too as a new customer does not have sufficient historical data for us to build an accurate picture of their pattern of usage over a year. Therefore, in this example, if the customer used a higher than typical amount of energy in the winter, refunding them £20 would be an incorrect action and result in them going into debt in the winter.

Consequently, we believe that the current practice under the EnergyUK Billing Code of reassessing a customer's payment scheme at six months where there is an accurate meter readings remains the best method of ensuring the customer does not have too much credit accumulated on their account.

**2. Restricting suppliers from offering terms which incentivise customers to maintain credit balances;**

We agree that suppliers shouldn't offer terms that incentivise customers to maintain credit balances. However, it's essential that this proposal excludes having a price difference between direct debit and cash/cheque. This is because the price difference accounts for the higher cost to serve of cash/cheque customers, rather than acting as an incentive to build up a credit balance. Further, the purpose and customer benefit of having a credit is to reduce the likelihood of bill shock by enabling the customer to spread the cost of their energy usage over the course of a year.

This differs greatly from suppliers that are offering tariffs where they pay interest on credit balances. Here, there is a clear incentive for customers to maintain a credit balance with these suppliers. This is particularly true of some suppliers that are offering significant interest payments in return for customers paying their estimated annual cost upfront. If these suppliers fail, there would be a huge cost to industry as the size of the credit balance to be honoured is significantly higher than traditional monthly payments. Further, would there be an expectation that the interest payments be honoured too?

We believe that there is a great need for Ofgem to review these type of tariffs, especially as offering interest on payments could potentially be considered as a FCA regulated activity. Alternatively, just like when a customer makes an informed decision to invest in some financial products, customers who accept these tariffs should carry the risk if the supplier fails and should therefore only have a portion of their balance protected.

**3. Restricting suppliers from using credit balances as working capital, for example holding funds in separate ring-fenced accounts (or, requiring suppliers provide security cover for the value of consumer credit balances they expect to hold during the following year);**

As previously stated, restricting suppliers from using credit balances as working capital will make it extremely difficult for suppliers to operate. This is because this credit is used to forward purchase a customer's energy usage, so while the customer may have a credit balance at a point in time, there is still the unbilled amount that remains to be fulfilled through the rest of contract.

This option could be workable if the ringfenced amount was for a proportion of net credit balances, rather than total credit balance. This is because a supplier should be capable of immediately returning a credit balance to a customer that requests such an action, or closes their account. Not all customer's will require this though at the exact same time so not all credit balances need to be ringfenced. However, this would be a small amount and would not significantly reduce the SoLR Payment Claim for honouring credit balances.

Better options would be to have parent company/finance backer guarantees or a general industry levy to cover the cost of these credit balances. Further, the proposals for ongoing monitoring of supplier financial resilience potential negate the requirement for ringfencing, and allows the more efficient use of funding within suppliers to deliver lower bills to customers.

**4. Reducing the time suppliers have to issue final bills and return credit balances to former customers (noting the link to our recent proposals on switching automatic compensation).**

We agree that suppliers need to issue final bills and return credit balances in a timely manner. However, there needs to be clear exceptions in cases where a supplier's ability to do is limited e.g. where a supplier is not notified of a Change of Tenancy and there is no forwarding address.