

**Attention**

Lisa Charlesworth  
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Dear Lisa and Jeremy,

**SUBJECT: Orbit Energy response to Supplier Licensing Review**

We welcome the chance to respond to the consultation on proposed changes to strengthen the criteria that Ofgem uses to assess supply licence applications. As a small energy supplier; one that has successfully entered in the past year; we have witnessed first-hand the repeated failings of our competitors and the consequences of these on both the industry and consumer.

In preparing this response we have not only considered our experience here in the UK; but also, other markets. Orbit Energy's current Co-Founder and CEO; Timothy Szakacs and Co-founder and Board Director Tom Gilpin have built and operated energy supply businesses in Australia and the United States; whose market and industry models are similar to that of the UK; and have deep experience in the different licensing models.

**Chapter 2: Do you agree with the principles we have set out to guide our reforms?**

We have commented on the four principles in turn:

*Suppliers should adopt effective risk management and be adequately prepared and resourced for growth.*

Effective risk management is a function of understanding the possible risk scenarios and having suitable plans and strategies for remediation. In energy supply this should include:

1. Ability to operate in the Commodity Markets. The wholesale energy market is a highly volatile commodity that when traded requires a deep understanding of financial and risk management. Organisations planning on entering the market should to be able to demonstrate that they understand these risks, through the development of suitable risk management policies, an understanding of the prudential and capital requirements, and access to financial resources. A number of

the recent supplier failures have occurred due to their inability to hedge against adverse wholesale volatility.

2. Market dynamics. Effective risk management will also model scenarios where the business strategy may be subject to changes in key business assumptions, market dynamics or public policy. Care should be taken not to assign too much credence to current customer behaviour when attempting to determine the risk landscape of the market and so the robustness of the supplier. The level of customer switching is not the key indicator of the market's health, as it can easily be driven by unrealistic tariffs prices that represent a significant negative gross margin. Instead the supplier should be able to demonstrate an ability to respond to all reasonable future market scenarios as they occur.

*Suppliers should maintain the capacity and capability to deliver a quality service to their customers, and foster an open/constructive dialogue with Ofgem.*

Compliance with the existing body of legislation is an essential part of any business plan when entering a new market. The vast majority of new licences are issued to supplier service management companies. The products and services provided seek to complete the accession process on behalf of the new supplier, and so the focus is on code and system accession, not supplier licence compliance. These means at accession the ultimate entity who will be delivering the regulatory obligations is not the licence holder and so Ofgem is currently blind to their suitability.

The emphasis should be on how prospective licence holders who are seeking to take control of an established licence will be able to provide such a service. There should also be a clear plan for maintaining that compliance during growth. Engagement with Ofgem is key but it must also be effective. Regular submission of data to the regulator will not necessarily give insight onto how the business is progressing; any engagement must be done by the regulator using personnel that understand the dynamics of commercial operations.

*We maintain proportionate oversight of suppliers, and effective protections for consumers exist in the event of failure.*

Proportional oversight is critical of existing suppliers. Even a supplier with a small portfolio will have a substantial turnover and represent a substantial asset. We believe that it is reasonable to expect that such businesses will already have in place reasonable oversight of the company's activities through trading updates, financial reports, Board meetings and annual general meetings for listed entities. These instruments could be utilised by Ofgem to understand the business performance, without creating additional burdens on existing suppliers. This would give understanding of the long-term viability of any business model, including the financial assumptions underpinning it. Building on this, Ofgem must be able

to engage with suppliers when the business model seems to be unsustainable in a way to ensure changes are made in that business to protect the rest of the market.

*Our licensing regime facilitates effective competition and enables innovation.*

We agree that Ofgem should take care to ensure that market entry can still occur, and innovative business plans are not unduly stifled, but any such innovation should place the risk on the investor, not the industry. All market offerings must be underpinned with a robust business model.

**Chapter 4: 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?**

Option 2 does not go far enough in ensuing protection to the market and will leave a potentially substantial level of risk on the market. Additional information will not provide any surety that the business model is either sustainable or does not place the risk on to the rest of the market if the planning assumptions are realistic. In order to attract investment a business must put together coherent and robust business plans with detailed financial modelling, so that investors can understand the risk that capital is subject to.

The current proposals are missing several key areas that need to be included in any future assessment of a licence applicant:

- It is important that Ofgem seek to undertake quantitative assessments of the financial capacity of that supplier.
- The Technical capability and capacity of the supplier must also be assessed to give an understanding of the ability of the supplier to adequately engage with customers at all points of the customer journey, as well as interface with central industry systems.
- A fit and proper test to ensure that only suitable individuals have significant control of supply businesses operations.

When granting licences, Ofgem is acting as the guardian of the industry and the risk it bears from that entity. There seems to be no reason why the business planning requirement, as set in Option 3, should not be shared with the regulator so it can truly understand the risk. This is not disproportionate considering the market's size. A supply business of just 5,000 dual fuel domestic customers represents a turnover of over £6m a year; these businesses are not microbusinesses and so Option 3 seems a reasonable way to protect the market.

**Chapter 5: Do you agree that our proposed assessment criteria for supply licences applications are appropriate? 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?**

The proposed risk criteria will improve the current situation, but will not provide the level of surety needed to effectively manage the risk that new entrants will represent. As stated above most licence applications are done by “supplier in a box” entities and so assessment should be done at the appropriate time. Any assessment should be done to ensure that the supplier licence holder can:

- Provide an indication of understanding the market.
- Having a realistic approach to risk management.
- A robust business and financial model.
- Demonstrate sufficient capital adequacy.

Being able to resource the resulting customer growth represents a basic requirement for any business at start up in the first 12 months, but gives no indication of how that business will expect to survive or grow once it commences operations. The failures we have seen recently have been of businesses that have generally been in the market for more than 12 months and so a requirement for providing initial funding and competency will not address the fundamental sustainability of any business that can only survive through acquisition at unrealistic prices. Any business plan should be tested for 3-5 years and we therefore disagree with Ofgem that business plans should not be assessed regarding their longer-term viability; this is essential as otherwise unsound businesses will continue to enter 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?**

As stated above, it is not unreasonable to expect new entrants to provide longer-term information on their business operations up to 3-5 years in advance, with detail on the expected evolution of the business in terms of customer numbers, staffing levels, margin, the likely capital investment to maintain the business during this period and an understanding of challenges and opportunities during that period. Such information should be routinely developed by companies to be provided to their investors so should not represent a significant burden.

**Do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence? Do you agree with the areas we would generally expect applicants to cover (in Appendix 1)? If not, why/what would you add?**

Any new business must be able to demonstrate to potential investors that will be able to comply with the legislative framework that applies to them. Licensees entering the energy market should be able to do this and whilst there is some value in providing such a

narrative, it should be as part of a coherent business plan (which should have a financial model as an intrinsic part) regarding compliance with all legislative requirements, not simply a subset of customer facing process.

**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 increasing the level of scrutiny of applicants for licences. These requirements should be extended to when a supply licence is to be transferred to ensure consistency.

**Chapter 6: 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?**

The timing of when a licence is issued will make little difference to the risk presented to the market. As stated above the current trend for licence granting is that it happens to support a “supplier in a box” offering, simply moving the date of licence granting will not solve the issue of Ofgem not knowing the identity or suitability of the proposed licence holder under this scenario. Licences should not be issued until Ofgem is fully aware of whom the ultimate licence holder will be and they have demonstrated they are a suitable licence holder as set out above.

**Chapter 7: 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?**

Ofgem needs to have an intimate understanding of the market and how suppliers are able to meet the challenges of that market, whilst continuing to operate in a sustainable fashion. Information that allows Ofgem to assess the resilience of suppliers will help aid that understanding. To that end, the information covered in Appendix 1, should be provided. This information however does not give the full picture, except when taken against the expected business development and so reporting against a fully developed business plan would also seem a reasonable step.

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

Ofgem needs to be able to engage with the supplier more closely when there is concern over its long-term viability. The additional level of engagement must be meaningful however and a supplier simply hitting a certain number of customers does not mean that the supplier is now suddenly unsustainable. Targeted engagement with the regulator should instead be based on key milestones in that supplier’s business plan so that the development of the business against its own requirements is clear to the regulator.

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

Care must be taken not to create an artificial requirement that will stifle business development. Suppliers are already subject to financial standards through the wholesale market via their counterparties and this should be recognised. If a supplier has in place credit arrangements with regard to its wholesale supply and has a proven track record of being able to meet its obligations with large counterparties, then that is an indicator that the business is able to meet one of its key operational requirements. By contrast a company that has no such arrangements should be further investigated by Ofgem to understand how that business will deal with market volatility.

So instead of creating a hard rule that suppliers must ring fence a certain proportion of their income, or place credit balances in escrow, Ofgem must utilise a more flexible approach, assessing a business on a case by case basis. If through investigation, Ofgem believe that the supplier is highly exposed, the regulator should have the ability, if warranted, to place additional financial obligations to protect the market. This will minimise the burden on suppliers, allow the market to regulate and allow Ofgem to take account of the circumstances of a particular business.

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

Yes. At present the regulator only seeks to verify an applicant’s suitability on limited grounds when a supply licence is applied for. Even if the current initial assessment criteria are expanded, in many cases the assessment will be meaningless as they will be for shell companies offered as part of a “supplier-in-a-box” market offering. These companies can be sold to any individual or entity without the suitability of that candidate being reassessed.

We agree with Ofgem that there should be a requirement for that suitability to be reassessed whenever there is a significant change in circumstances or when there is a significant change of control for all new and existing licences. Similarly we also would expect to see the fit and proper test extended to all existing licence holders to ensure that any organisation that is not meeting the standards expected in the market can have sanctions applied to them.

Your sincerely

Timothy Szakacs  
Chief Executive Officer  
**Orbit Energy Limited**