

25 January 2019

Jeremy Adams-Strump
Industry Codes and Licensing
Ofgem
10 South Colonnade
London E14 3PU

Dear Jeremy,

Re: Supplier Licensing Review

Thank you for the opportunity to comment on the above consultation. Utilita is predominantly a smart prepay supplier and has viewed recent events of supplier failure with concern. We welcome Ofgem's action to review the position and urge prompt action.

Overall, we believe the proposals consider the right points, but it is important that stringent action is taken, to ensure customer confidence. This will also aid new entry, as suppliers can enter the market with greater confidence, and less risk of needing to bear the costs of other supplier failure.

We believe that not only is a more stringent entry process required, but some aspects should be monitored on an ongoing basis, and whenever a change of control applies. In addition, while we do not support the automatic protection of all credit balances on failure, we do consider that more controls on levels of credit balances and their use by suppliers could be appropriate. This in turn would provide greater protection to customers through an appropriate route.

In addition to the above, we would like to see Ofgem initiating an urgent review of the SoLR process to improve how it operates in the industry, allowing Ofgem more options when a SoLR does occur.

Finally, where high levels of protection are required for customers, such options are not without cost. If that is the requirement, then a scheme analogous to ABTA or the insurance industry could be considered. While this would require supplier payments into the scheme, these could be appropriately factored into price caps. The headroom available in the current caps is minimal, and is not sufficient, to accommodate risk of supplier failure.

The rest of this submission focuses on the specific questions raised in the consultation.

Chapter 2

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

We are in general support of the principles set out, but we believe strongly that in the interests of both present and future consumers, the interests of consumers and suppliers must be balanced in the case of failure.

Efficient suppliers, charging consumers the fairest price they can, will have little or no margin to absorb the costs imposed by supplier failure or mutualisation. Failure to weigh both sets of interests appropriately could lead to some customers (who may also be vulnerable), being required to cross subsidise the protection of others who may have already benefitted from below-cost, unsustainable prices.

As we noted in our introduction, we do not support the requirement for all credit balances to be automatically protected for this reason. However, as noted elsewhere in the consultation, we believe that there is room for consideration of other methods to improve management and scale of credit balances. If improvements are made, this will increase the protection of credit balances naturally.

All suppliers should be adopting effective and appropriate risk management strategies and we support this principle. The ability to manage regulatory compliance must be a part of this, and we welcome Ofgem stressing this requirement.

Chapter 3

There are no specific questions in these chapters. However, we agree that the current regime is not adequate and offers clear cause for concern. We have previously identified our concern to Ofgem over the reduction in requirements for a licence and the detrimental effect this has. While we understand the desire to encourage market entry and innovation, a licensing regime which leads to an off-the-shelf approach with only minimal scrutiny is not acceptable.

We strongly support an approach in which the intended licensee is the party who must apply for the licence. This party should demonstrate they have good quality arrangements and financing in place, and that they are a fit and proper person to operate an essential service to potentially vulnerable persons.

In this section, Ofgem also identifies the mismatch in market entry processes between gas and electricity. We agree this is a cause for concern, and that consideration should be given to ensuring the gas processes achieve the same quality of outcome as those in electricity. Finally, the changes should address the risks posed by off-the-shelf licensees; the new processes must require the actual licensed party to pass entry testing, preventing off-the-shelf licensees introducing risk.

Chapter 4

Question: 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 support proposals to introduce new, tougher entry requirements and increased scrutiny, however we are concerned that Ofgem's preferred option is not strong enough. For example, criteria should not just be transparent and objective, they should be measurable.

We also believe that minimum capital requirements would be a sensible approach. We agree that an assessment on entry represents only a point in time, however, combined with ongoing assessment, this would be a powerful protection for consumers.

Our view is most closely aligned to Option 3 – Detailed information, financial scrutiny and capital requirements, where Option 3 includes measurable criteria. While this is assessed by Ofgem as inflexible, we do not agree that it is a problem. The proposals to introduce tougher requirements and scrutiny cannot be achieved with information and qualitative assessments alone. High levels of protection, restoration of consumer confidence and equitable management of failure have a cost – Option 3 is that cost.

Chapter 5

Questions:

- 1) **Do you agree that our proposed assessment criteria for supply licences applications are appropriate?**
The criteria are not extensive enough and should be measurable. For example, few businesses would fail in the first 12 months, so while funding year 1 is important, in a supply business it is when growth increases that cost and risk rise. In addition, for stress-testing to be realistic, they must be carefully researched and consistent. Tests devised by the individual company may be helpful internally, but will not provide the necessary independence to give regulatory confidence.

2) **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 principles underpinning the criteria set out in 5.12 are good, but we are not convinced that they would be sufficient to deter. Parameters would be needed, and we suggest learning may be available from other sectors.

While applicants should be able to evidence the first year is funded, as above this mitigates only a small part of the risk, and additional measures or time would be needed.

3) **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?**

Please see comments elsewhere in this document. The principles are generally good but we consider this may still be too light touch.

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

Yes, a detailed narrative is required ensuring that the responsible party clearly understands their obligations. It may be that a panel-based approach would be beneficial, and a named, senior employee designated to have oversight of compliance. Ofgem could consider designation of a senior account manager to the new supplier to give advice and guidance.

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

Please see comments elsewhere in this document. The principles are generally good but we consider this may still be too light touch.

6) **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 consider that this is an essential part of the process. Further, ongoing assessment is required, detailed scrutiny of other corporate relationships or history, and a full re-assessment should be carried out on any change of control or ownership event.

Chapter 6

Question: 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?

Yes, this is essential. It must be carried out as close to market entry as possible and the licensing process must be limited to only those parties who will actually use the licence going forward. The off-the-shelf, pre-licensed supply ready company approach should be stopped.

Chapter 7

Questions:

1) **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 believe that this is an area which needs further work. While we can see benefits, for example of prescribed stress test scenarios, economic capital require to survive a 1 in X years event etc. consequences need to be clear and understood. If an issue arose, what would be the outcome. A second, major point is whether Ofgem has the appropriate skillset to manage this area, it is extremely specialist.

Ofgem also considers whether these assessments would be limited to certain suppliers. In our view, they should apply to all suppliers, and on all key events, such as change of control. We also suggest that when Ofgem and BEIS are considering policy options in future, it would be appropriate to include in their impact assessment the effect on such supplier measures.

We would be happy to participate in a workshop or further discussions on this topic.

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

No further comments

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

An assessment could be made of the riskiness of supplier activity, to calculate the economic capital requirements in the context of Ofgem's required confidence over a set time horizon. Such assessments would have to feed in to calculations such as price caps etc.

Other approaches here could also include the management and assessment of credit balances to increase consumer protection and reduce risk.

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

Yes, this is essential. The test should apply to all directors and be re-assessed on any change of directorships filed at Companies House. In addition, all such tests should be re-assessed on any event of change of control.

Chapter 8

While there are no specific questions in this section, we refer to our points elsewhere in this submission on credit balances. In considering the options put forward by Ofgem in 8.8, we have the following observations:

- a) Maximum limits on credit balances – this is a sensible and practical approach, it would need to be supported by robust and regular reporting, and possibly audit assurance.
- b) Restricting suppliers from offering terms – we do not support this approach. While we agree credit balances should be limited and managed, we see no reason why reasonable encouragement could not be offered to maintain modest balances to the benefit of both parties.
- c) Restricting use of credit balances as working capital – we think there would be merit in exploring this area further, security cover or an insurance product may be an option, if this can be achieved without being too onerous. It may also be possible to set a maximum percentage of working capital requirements, assessed in autumn.
- d) Reducing time to final bill and return balances – this may create difficulties in that the final bill process can have inherent issues which take time to resolve. This may be easier to monitor in aggregate.

We hope these comments have been helpful, and would be happy to meet to discuss any points in more detail.

Yours sincerely,

Alison Russell
Director of Policy and Regulatory Affairs.