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Dear Lesley

Supplier Licensing Consultation

Shell Energy Retail Limited - previously First Utility - welcomes the opportunity to respond to this consultation on changes to the supplier entry regime.

We broadly support Ofgem's proposed changes, with the following further suggestions:

- **A 3 rather than 2 year business plan should be considered.** As noted by many consultation respondents, the majority of recent supplier failures have occurred after 2 - 3 years in the market. We believe this is as a result of facing new challenges they were unprepared and unfinanced for: crossing the 200,000 policy cost threshold; facing a more diverse and costly customer mix (e.g. paper bills, prepay meters, more vulnerable customers); home-move (where new customers are inherited who may not even know they are on your supply) and increasing bad debt. Given the majority of investors require a 3 - 5 year business plan, we do not believe this is an onerous request.
- **An interview should be mandatory rather than only for Tier 2 once a certain risk score has been met as currently proposed.** Whilst we agree that it is not Ofgem's role to assess the viability of specific business plans, we feel it is Ofgem's role to assess the quality of the management, i.e. that they fully understand their licence obligations and have the capability and financial resources to meet them. An interview would play a critical part in this analysis.
- **Ofgem should have ready a broad sense of the financial and operational capabilities required to offer mass-market "vanilla" energy supply to compare proposals against,** using as a basis the information provided by suppliers under the Price Cap and to fulfill Citizens Advice and Ombudsman data requests.
- **The need to accrue for industry schemes should be made explicitly clear as a category in itself,** given the significant detriment such failure has created in the market.
- **We support the "fit and proper" requirements and agree that a SoLR event should not automatically be considered grounds for refusal of a licence. However, we would ask Ofgem ensures defaulting on industry schemes - for which other suppliers and their customers have had to pay - should result in an adverse finding here.**

We welcome this consultation's acknowledgement that the above measures should be considered as a package alongside ongoing monitoring, new rules on credit balances and changes to SoLR. These changes need to be made as soon as possible in order to address the very

real harm caused to the market and consumers by these serial failures (for which other suppliers and their customers pay).

In this respect we propose that Ofgem should:

- **Introduce a new licence requirement to demonstrate accrual towards industry schemes**, with monthly submissions from suppliers unless Government changes the ROC payment schedule from annually to monthly
- **Require an Annual Certificate of Adequacy**, with more frequent monitoring as required for those with riskier business models,
- **This should be complemented with a tougher enforcement regime**, with Ofgem introducing a faster and more formal “escalation” process, moving from enhanced monitoring through to tougher fines, licence suspension and revocation as appropriate.
- **Ofgem should also introduce fiscal responsibility rules - or ban altogether - the build-up of excessive credit balances**. This should be introduced immediately for new entrants and phased in over 12 - 24 months for existing suppliers. Ofgem should consult on an appropriate time period to phase in this requirement to minimise disruption to the market and customers.

Finally, we welcome changes Ofgem has made since the last consultation to make explicit suppliers should bear the appropriate degree of risk for their own operations. We ask that Ofgem considers this new principle in the round, i.e. across the whole suite of both legal and regulatory interventions, from mutualisation through to smart costs and the small supplier policy threshold put in place by Government.

We turn below to each question in more detail:

1: Do you agree we should extend our enhanced ‘fit and proper’ assessment questions to all licence application types, not just supply licence applications?

Yes, we agree that all licence holders, from supply to networks to shippers, should pass a “fit and proper” assessment. However, it is important licence creep does not happen between the domestic and non-domestic sectors without due course.

2: Do you agree that the proposed questions in section 12 will enable applicants for a gas or electricity supply licence to demonstrate that they meet the new supply licence application criteria?

No, we believe applicants should provide details of proposed funding arrangements for the first three year’s operation, not the first two years as proposed, although we agree a Certificate of Adequacy should only be provided for the first year

As noted by many consultation respondents, the majority of recent supplier failures have failed after 2 - 3 years operation in the market, as a result of facing new challenges they were unprepared and unfinanced for: crossing the 200,000 policy cost threshold; facing a more diverse and costly customer mix (e.g. paper bills, prepay meters, more vulnerable customers); home-move (where new customers are inherited who may not even know they are on your supply) and increasing bad debt.

Given the majority of investors require a 3 - 5 year business plan and, as Ofgem has made clear suppliers should no longer be relying on credit balances to fund growth so outside funding should effectively be expected, we would not expect this to be difficult to provide.

We welcome Ofgem's proposal to consider whether funding and operational plans appear to match the applicant's financial projections (including potential downside risks).

We broadly agree with the categories laid out in the Guidance, namely

- Core operational functions and processes
- Target customer base and expected rate of growth - However, Ofgem's Guidance should make it clear Ofgem expects suppliers to offer a range of payment options, including paper bills, and that this should be costed in to projects and tariffs as appropriate
- I.T. systems - we particularly welcome Ofgem's acknowledgement of switching, given the Guaranteed Standards Of Service will impose costs on both parties, even if one is not responsible
- Pricing strategy, tariffs and products - Ofgem should use information gleaned from the Price Cap model to determine if a new entrant is pricing significantly below cost and, if so, request additional proof of funding to ensure they are "good" for honouring those tariffs and will not go into SoLR and / or implement a risk-based enhanced monitoring approach.
- Projected volume of energy and purchasing / hedging strategy - If a supplier is planning to offer fixed price contracts, but is unable to explain how it will manage or finance its exposure to wholesale price variability, we would expect Ofgem to express concerns over the sustainability of their business model.
- Financial projections and risk management strategy, including paying industry charges - We broadly agree with the items in this category, however, Ofgem should pull out of this section and introduce a new, specific section in the guidance on accruing for industry schemes, given the high cost mutualisation has imposed (c.£100m in 2018/9 on ROCs and FiTs). This should be backed up by a new licence condition, see our answer to Question 6.

We agree that suppliers should provide their own stress tests, to avoid this becoming a tick-box exercise and to avoid stifling innovation, although we welcome the issues raised in the guidance (*i.e. "we would typically expect an applicant to show that they have considered how they expect to cope with market volatility, extreme winters, collateral/trading risks, and the impact of both slower or faster than anticipated growth. We expect an applicant to show that they have made reasonable assumptions based on potential levels of customer churn, and how they will manage potential downside risk."*)

We likewise agree that Ofgem should not mandate specific solvency requirements, as this will vary by business model.

We agree that Ofgem's role is not to assess the viability of specific business plans. However, we feel strongly it is Ofgem's role to assess the quality of the management, i.e. that they fully understand their licence obligations and have the capability and financial resources to meet them.

For this reason, we believe an interview should be mandatory rather than only in Tier 2 if a certain risk score has been met, as is the case with other regulators such as the FCA.

We support the proposed Statement of Customer Intent and agree with the categories outlined, namely

- Treating customers fairly



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- Customer service operations
- Vulnerability - including PSR
- Acquiring and transferring customers - including tariff comparability, sales techniques, and switching
- Customer communications - However, we believe this section must make clear Ofgem expects all suppliers to offer “front of shelf” all payment options, and a range of ways for their customers to contact them. A number of suppliers are not currently offering this; we would welcome Ofgem’s consideration of how this could also be tackled via proposals for Ongoing Monitoring.
- Payment, billing and credit balances
- Awareness of relevant price caps
- Smart metering - We welcome the acknowledgment that “suppliers are required to install and serve customers with smart meters in line with government plans”. - again, we note a number of suppliers are not currently offering smart meters, even larger ones, and note Avro was two years delayed paying into the DCC; we would therefore also welcome Ofgem’s consideration of how this could also be tackled via proposals for Ongoing Monitoring.
- Compliance reporting

3: Do you have any other comments on the proposed new regulations/application forms, including the updated tiered process or fees? Or, is there anything we have not included that you believe should be?

As stated in our response to Question 2, an interview should be mandatory for all candidates, with fees increased as required to cover this. Whilst Ofgem is not assessing the viability of a business plan, their role is to interrogate the financial and management capabilities of senior directors.

4: Do you have any comments or would you suggest any changes to the section on ‘Suitability to hold a licence’ (Chapter 3 of the draft guidance)?

We agree with the criteria laid out here, namely disclosures related to:

- Criminal convictions
- Director disqualifications
- Insolvency/bankruptcy/ debt judgements
- Supplier of Last Resort events: applicants must declare if they were connected to a company that triggered a SoLR event within the 12 months immediately preceding that SoLR event.
- Compliance/enforcement history
- Refusal/revocation/restriction/termination/disciplinary by any other body
- Competition infringements

We agree that “Involvement in a previously failed supply business will not automatically lead to rejection but, where – for example – the SoLR event was recent, material consumer or market detriment was caused, the failure was associated with serious compliance failings, and/or the individual(s) concerned were not co-operative with us during the SoLR process, this will be highly relevant to our decision on whether to grant a supply licence”



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5.: Do you have any comments or would you suggest any changes to Chapter 4 of the draft licence application guidance, relating to the new criteria and process for supply licence applications?

We agree with the three criteria set out in the Guidance namely

- The applicant has the appropriate resources for their proposal to enter the market
- The applicant understands their regulatory obligations and has appropriate plans in place to meet these
- The applicant is fit and proper to hold a supply licence

We support Ofgem's proposed principles for interrogating these criteria, above all the suppliers should adopt effective risk management, be adequately prepared and resourced for growth, and bear an appropriate share of their risk, and avoid overreliance on customer credit balances. Our strong preference is for Ofgem to ban excess credit balances without appropriate fiscal responsibility rules; new rules should be brought in immediately for new suppliers and phased in over 12 - 24 months for already active suppliers. Ofgem should consult on an appropriate time period to phase in the requirement to minimise disruption to the market and customers.

Whilst we agree with Ofgem there should be a positive duty on applicants to prove they satisfy these application criteria, Ofgem should also have ready a broad sense of the financial and operational capabilities required to offer mass-market "vanilla" energy supply to compare proposals against, using as a basis the information provided by supplier under the Price Cap and to fulfil Citizens Advice and Ombudsman data requests.

As set out earlier in this response, we believe an interview should be mandatory rather than only in Tier 2 if a certain risk score has been met. Whilst Ofgem's role is not to assess the viability of specific business plan, we feel very strongly it is Ofgem's role to assess the quality of the management, i.e. that they fully understand their licence obligations and have the capability and financial resources to meet them.

6: Do you have any other comments or would you suggest any other changes to any part of the draft guidance?

We welcome Ofgem's acknowledgement that these proposed licencing changes must be considered as part of a package of measures, including ongoing monitoring, action on credit balances and changes to the Supplier of Last Resort process.

To ensure suppliers "bear an appropriate share of risk", we propose Ofgem introduces:

1. Fiscal responsibility rules - or ban altogether - practices that promote the buildup of excessive credit balances. We consider that the most straightforward approach would be for Ofgem to ban practices deemed excessive, for example, preventing suppliers from taking payment for more than one month in advance of supply. If Ofgem wishes to allow this practice to continue, excess credit balances should be in some way protected, e.g. by a bond or Letter of Credit.

2. A new licence condition legally obliging suppliers to prove they are setting aside money towards all relevant industry schemes (including but not limited to ROCs). Ofgem could enforce this new condition by requiring all suppliers to provide monthly signed accounts demonstrating they are setting aside money in anticipation of the various industry scheme payment dates.

Government should also in parallel reform the structure of industry schemes to reduce the cost of mutualisation, e.g. requiring quarterly rather than annual payments under the Renewables Obligation. We would welcome Ofgem making a public request of Government in the working paper expected in May.

3. An Annual "Certificate of Adequacy." Where suppliers fail to prove solvency on an annual



basis or immediately when they fail to pay into an industry scheme, Ofgem should institute a formal “escalation” process, moving from enhanced monitoring through to tougher fines and licence suspension. It is important this process is rapid to prevent irresponsible suppliers continuing to incur increasing liabilities for the future.

We believe the changes suggested above, together with the recommendations in this letter for Ofgem to interrogate a 3 year rather than a 2 year business plan and automatically interviewing all applicants, will support a resilient and competitive energy market which delivers the best possible experience and value for domestic customers.