**By email:**
Vlada Petuchaite
Licensing Frameworks
Ofgem

03 December 2019

Dear Vlada,

**Supplier Licensing Review: Ongoing requirements and exit arrangements policy consultation**

Thank you for the opportunity to respond to this policy consultation.

We fully support the aims and objectives that underpin this consultation, as we have long held that regulatory intervention is required to ensure that suppliers operate in a way that is financially responsible, without excessive reliance on customer credit balances and/or non-payment of government scheme costs as a means of working capital with which to run their business or, worse, a source of dividend and remuneration.

Firstly, we think that Ofgem is on the right track in terms of recognising cost mutualisation as a high priority area which the industry needs to fundamentally address. These costs fall disproportionately on vulnerable consumers. However, we feel that Ofgem has not sufficiently explored the various options that have been put forward and we can see some critical limitations of those options. Unless these issues are sufficiently addressed, it is likely that customers may not be materially better off than under the status quo. We also believe that in respect of the Renewables Obligation (RO) an additional solution would be to open up the legislation in order to require suppliers to make more frequent payments under the scheme, as this will encourage suppliers to make more timely payments and allow Ofgem to interject earlier in the process where suppliers are deficient on their RO liabilities. We stress however that Ofgem could have done very much more even with the existing legislation.

Secondly, with the exception of the proposals around the cost mutualisation protections and the milestone and dynamic assessments by Ofgem, we feel that the other proposals do not add any material benefits to mitigate the negative impact arising from supplier failures and disorderly exits from the market. Those proposals seem to overlap with existing supplier obligations and/or powers that Ofgem can exercise to intervene where it deems necessary, whilst potentially adding significant burdens for suppliers to comply with.

Thirdly, we find it disappointing that both the policy consultation and impact assessment papers fail to address the impact of these proposals on the price cap. The transaction and operational costs potentially posed by the package of measures could be material, and we believe that the price cap headroom allowance for opex and obligation costs would need to be revisited once the final package of measures has been implemented.

Please find attached our detailed comments on the proposals.

Yours sincerely,

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**Overarching question:**

**1. Do you think the proposed package of reforms will help to reduce the likelihood of disorderly market exits, and the disruption caused for consumers and the wider market when suppliers fail?**

*Somewhat, but they are no reason to continue to delay use of current powers.*

**Are there other actions you consider we should take to help achieve these aims?**

*Yes.*

We think that the cost mutualisation protections piece is a key focus area that, if implemented correctly, will help assist in reducing the likelihood of disorderly market exits and the disruption caused for customers and to wider market. Those reforms should also assist in fostering behavioural changes within suppliers so that they do not overly rely on customer credit balance and funds that should be earmarked for payment of their government scheme obligations as a source of working capital, dividends or remuneration. These changes should prompt suppliers to revisit their operating models. We do feel that these proposals need further refinement, and we have provided further commentary in our response to question 5 below.

With the exception of the proposals around the cost mutualisation protections and the milestone and dynamic assessments to be conducted by Ofgem, we feel that the other proposals:

(i) overlap with existing supplier obligations and powers that Ofgem can exercise to intervene where it deems necessary; and/or

(ii) would be ineffective in achieving the policy aims and objectives.

Further commentary on each proposal is set out below, but we believe that whilst potentially adding significant burdens for suppliers to comply with they would not materially add any benefits to mitigate the negative impacts arising from supplier failures and disorderly exits from the market.

In our view, Ofgem should only add further licence conditions where there is a genuine need for them and where the implementation of them is proportionate to the risks that it is seeking to mitigate. If existing powers are not used then further powers are not warranted. We feel that Ofgem has not made out the case for the need for the implementation of those other proposals, especially where those obligations or powers duplicate what is already set out in licence or other regulatory requirements. We submit that Ofgem should focus on exercising the powers it already has in order to swiftly address concerns with supplier non-compliance, rather than to add to this by duplicating obligations and powers already available to Ofgem.

**Questions for the impact assessment:**

**2. Do you agree with the outputs of our impact assessment?**

*Broadly.*

In principle we agree with the outputs of the impact assessment. In particular, we welcome the analysis around moral hazard, adverse selection and the consequences of poor supplier behaviour.

However, it is difficult to provide commentary on the detail of the impact assessment given that many of the proposals require either further development and/or clarification before they can be meaningfully considered and commented upon.

We also believe that Ofgem has not necessarily based the proposals on a strong and varied evidence base. Taking the cost mutualisation protections as an example, Ofgem has based its view of the third party guarantor option on research of a single provider in the market. There is no substantive consideration of whether the commercial terms would vary dependent on the risk that each supplier may pose (e.g. established players vs new entrants) and whether the cost would escalate as there are further supplier failures. Similarly, with the option of insurance schemes, there is no consideration of whether such schemes exist, on what terms and how price sensitive the premiums are to developments in the market (such as the increasing rate of supplier failures). Similarly, Ofgem assumes that parent company guarantees would be readily available for suppliers with parent companies and that the only costs would be of the legal and administrative variety – there is no consideration of the existing credit collateral cover that suppliers have in place due to current requirements and whether there might be a larger cumulative impact of adding further credit cover requirements.

It is essential not to create disproportionate entry barriers. Very small entry poses little industry wide mutualisation risk, it is growth in excess of financial stability that creates the problem that flows to consumers.

**3. What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?**

We have no further quantitative data at this time – please see our response to question 2 above.

However, our view remains that all of the defaults experienced to date could have been avoided by prompt and effective action by Ofgem. The figures have not fully been revealed but they are well in excess of £100m and probably £200m and rising.

**4. Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? If not, please provide evidence to support further refinement.**

In terms of assumptions around costs, it is difficult to meaningfully comment as many of the proposed measures need further refinement and additional detail to be provided. With reference to purported benefits, we believe that several of the proposals would be ineffective so as to render no determinable benefit – please see below our answers to the various consultation questions.

The package of proposals set out by Ofgem in this consultation will result in increased costs for suppliers, where some additional costs may be incurred on a cyclical basis (e.g. the cost of arranging cost mutualisation protections) or ad hoc basis (e.g. the cost of independent audits). Within the consultation documentation, Ofgem has made the assumption that costs associated with its policy proposals are passed from suppliers to customers through higher tariff prices.

However, what has not been addressed is the issue of whether Ofgem will adjust the regulated price caps to take account of the additional burdens and costs that will be incurred by suppliers as a result of these proposals. Our view remains that the 'headroom' opex allowances for suppliers under the caps are currently insufficient and do not necessarily reflect full cost recovery.

Depending on where the final proposals land, and if these were to materially increase operating costs, we would look to Ofgem to reopen the opex allowance under the caps.

**Promoting better risk management:**

**5. Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible any evidence, to support your position.**

As a matter of principle, we agree that mutualisation of costs/defaults should be mitigated and protected against, especially as the impact is borne by suppliers that operate in a more financially responsible manner and, ultimately, by customers of those suppliers. We have long held that mutualisation presents a moral hazard and results in some customers (typically those on sustainable tariffs) cross subsidising other customers (typically on unsustainable tariffs) and corporate adventurers when suppliers become illiquid and fail without making adequate provision for their obligations.

Furthermore, the costs of default by market participants being mutualised across the other, remaining participants (with customers of the latter picking up the tab) is not a mechanism that commonly exists in other markets. The Financial Services Compensation Scheme is enshrined in primary and secondary legislation, but there is no similar legislative grounding for the mutualisation of credit balances as licence condition 9.4 covers only the cost of supply for the gaining Supplier of Last Resort (supply would cover installation, operation and billing of the meter), and therefore to include credit balances here is taking an overly expansive view of 'supply' in this context.

Therefore, we welcome Ofgem's recognition that regulatory intervention is required in this area to help protect against the mutualisation of supply defaults on credit balances and government scheme costs. It is of paramount importance that the policy design here is robust and fit for purpose, and that this flows through into the supply licence condition obligations that are formulated to give effect to the policy intent. We cannot afford for the measures introduced under this initiative to be substandard or open to abuse. We comment further on the specifics below.

Ofgem's proposal, as set out in the policy consultation document, is "to introduce a requirement for suppliers to put in place arrangements to protect a minimum of 50% of their customer credit balances in the event of their failure". This was seemingly limited to credit balances, omitting protection against the mutualisation of government scheme costs. However, Ofgem later sent a note to suppliers explaining that this was an error in the drafting of the consultation and clarified that the proposal was to "introduce a requirement for suppliers to put in place arrangements to protect a minimum of 50% of their customer credit balances and a proportion of government scheme costs in the event of their failure". We fully agree that any mechanisms that protect against cost mutualisation must cover not only credit balances but also government scheme costs.

*Protection of credit balances*

We agree that all suppliers should be required to protect a proportion of their credit balances. The proportion should be uniform across all suppliers and should be set at a level of 50% or more.

However, as with the other measures the principal answer is effective regulation. It appears that suppliers may have taken money directly from customer bank accounts, that was not owed, and not paid it back. This has been was widely reported. We remain confused about why little action was taken then and apparently none now.

At a practical level, Ofgem would need to provide an appropriate definition in licence of what would constitute a credit balance for the purposes of any proposed licence condition designed to implement this proposal. The correct positioning of this licence condition definition will not only provide uniformity of approach across all suppliers but it will also help suppliers ensure that the right amount of credit balances are protected.

In particular, as it relates to customers who pay via a periodic fixed direct debit, the licence definition would need to be clear on whether it relates to credit balances accumulated by direct debits collected and: (i) billed to customer accounts; (ii) not billed to customer accounts; or (iii) both. Depending on the point in time at which the credit balance is calculated (due to seasonal variance) and the time at which accounts are billed, there could be a sizeable variance between the billed and unbilled credit balances.

A closely related issue pertains to the time period during which the credit balance position is calculated to arrive at the baseline. The value of credit balances held by suppliers fluctuates throughout the year. The time at which a percentage is applied to supplier credit balances (e.g. 50% as Ofgem is currently proposing), in order to calculate what value needs to be protected, should be consistent for all suppliers. If this is not achieved, and suppliers are left to choose when they apply the percentage for the purposes of the calculation, then suppliers may pick the point in time during which their credit balances held are at their lowest level and then use that reference point. This would not be in keeping with the policy objective of adequately protecting against cost mutualisation.

As mentioned above, credit balances held by suppliers do fluctuate over the course of the year. Ofgem should consider whether the percentage applied to work out the value of credit balances to be protected would be carried out once annually, or more than once. Requiring this exercise to be carried out only once during the year would have the advantage of posing lower burden, but it may not assist the policy object objective of protecting against cost mutualisation where, for example, the supplier later accumulates larger credit balances during the year (for example, through acquiring significant volumes of customers or increasing customers fixed direct debits). Further reassessment points during the year may assist in ensuring that suppliers have the correct level of cover (particularly where the protection will be obtained through an insurance scheme). Whilst this may potentially add a level of further burden to suppliers, the benefit to customers and the wider market would manifest itself in the form of ensuring that suppliers have the appropriate level of cover in place.

*Protection of government scheme costs*

We agree that it is a priority to try to implement measures that have the effect of reducing the amount of cost mutualisation of government schemes that occurs as a result of supplier failure. This is as much of a priority as is the protection of credit balances, if not more so. We welcome Ofgem's recent increased commitment to take more timely action to prevent suppliers failure to comply with their obligations, and we are encouraged to see Ofgem's letters to suppliers in this regard reminding them of their payment obligations. We note that apparently some suppliers had stated that they would pay in line with their obligations but later did not. It is not a criminal offence for suppliers to change their mind or for their financial circumstances to change, but it is a criminal offence to mislead the regulator. We await the outcome of the relevant investigations.

Whilst we welcome the proposals Ofgem has made to try and mitigate the mutualisation of government scheme costs, and we comment on those proposals below, we firmly believe that

there is more Ofgem can do with its existing framework of powers, and Ofgem should act sooner rather than to wait for this consultation exercise to run its course through to the implementation stages. For example, with the Renewables Obligation (RO) scheme the statute is clear that a supplier's licence should be revoked where the relevant payment has not been received by the end of the Late Payment Window. Further, while enforcement may not commence during the Late Payment Window, the statute is clear that this is a default situation (and therefore arguably a breach) and the window should not be treated as a source of cheap working capital. Therefore, it is clear that Ofgem can act in these scenarios even under the current framework. If Ofgem's approach is to not automatically revoke licences in these circumstances, it would be helpful if Ofgem can detail the process it would usually follow in these scenarios. Suppliers seem to be using the Late Payment Window in RO as a financing vehicle and we believe that Ofgem can and should do more to act earlier within the existing framework.

At a high level, we agree that all suppliers should be required to protect a proportion of their government scheme costs. The proportion should be uniform across all suppliers and should be set at a minimum level of 50% of the payment obligations or more.

The issue of defaults against the RO is perhaps the largest issue to tackle here, due to the scale of the defaults. In terms of the practical difficulties with this proposal, it is difficult to envisage how suppliers would correctly calculate the level of the payment obligation in order to determine how much of it they would need to protect. Whereas with credit balances it is within the gift of the supplier to calculate at any given time what their (i) total credit balance held figure is and (ii) how much of that they would need to protect at any given time, the position for RO is more complex. With a RO, there is a lag in suppliers knowing what their RO liabilities for the period are going to be, and therefore it would be difficult for suppliers to apply the relevant percentage figure and accurately determine what level of funds they would need to protect.

Aside from this practical consideration there is the more fundamental point that suppliers, particularly at the smaller end of the market, use RO funds as a capital/cash flow with which to run their business. Suppliers' business models should be such that they should not overly rely on RO funds to operate their business, and Ofgem has recognised the need for suppliers to adopt more sensible and robust business models. The focus here should be to promote more timely payment of RO obligations. For suppliers at the smaller end of the market, particularly those without parent companies, going to market to secure coverage for their RO obligations may prove to be relatively expensive and could further affect their cash-flow. We firmly believe that the payment of RO obligations needs to move to more regular intervals such as quarterly (or even monthly), and this would bring the RO scheme more in line with the Feed-in Tariff (FiT) scheme. This would remediate the underlying issues of delayed or non-payment of RO obligation, as it would encourage suppliers to revisit their business models to make more timely RO payments rather than to finance some sort of insurance or guarantor cover (the cost of the latter ultimately falling on customers).

We recognise that changing the payment intervals of the RO obligation will require the opening up of the RO legislation, but we believe that in the long term it is more beneficial for the market than requiring suppliers to merely arrange for protection of the sums. We believe that more than 20 suppliers were either late in discharging or failed to discharge their latest RO payment obligations. This is a significant number and highlights a much wider problem. We believe that for RO, Ofgem should work with Government and the industry to revisit the RO legislation to look at a more sustainable solution rather than to pursue the more substandard licence based solution that is currently being proposed.

*Options for protections against mutualisation of costs*

We believe that any licence requirement adopted that requires suppliers to protect a proportion of their credit balances and government scheme costs should allow suppliers the flexibility to utilise different ways of protecting those funds. Therefore, we do support the adoption of a menu of options from which suppliers can choose the type of protection that best fits their business model and requirements. In order for the policy objectives to be met, it is crucial that each option is credible, viable and fit for purpose. Therefore, we would expect that Ofgem investigates each option rigorously and forms a robust evidence base prior to issuing any final proposals, so that suppliers can properly consider the options and comment on them.

In the consultation paper, Ofgem has proposed several different methods of protecting against mutualisation of costs. However, we think that several of the options on the table have some significant limitations and drawbacks which have not been addressed in the consultation paper and generally the detail is quite light on how Ofgem sees the options functioning in practice. For those reasons, we strongly feel that additional detail should be provided by Ofgem on how it views each option working in practice and suppliers should be afforded further time to scrutinise the menu of options ahead of Ofgem making any final decision.

We have the following observations on the various methods of protection that Ofgem has proposed as part of the cost mutualisation policy proposal.

***Parent company guarantees***

We generally agree with this as a method of protection against the mutualisation of costs. Most of the larger suppliers already have parent companies capable of providing parent company guarantees (PCG) as do some medium and smaller suppliers. However, Ofgem must be cognisant of the fact that even parent companies have limits as to what level of PCG they will provide to their energy supplier subsidiary, as the parent may not necessarily overstretch in this way. Collateral cover requirements may already prove voluminous for parent companies in many cases, e.g. for TNUOS charges cover.

Clearly, a PCG is only as strong as the financial health of the parent company. In the case of smaller suppliers, it is possible for the entire group to run into financial difficulties at or around the same sort of time period, and in that scenario the PCG may provide limited or no effective recourse.

***Third party guarantees***

Third party guarantees (TPG) potentially have value here, where the third party guarantor is an entity that is financially strong and where the guarantee itself provides sufficient coverage for credit balances and government scheme costs.

However, Ofgem does not set out in the policy consultation its thinking on what kind of TPG would be acceptable as an adequate protection against cost mutualisation. The impact assessment that accompanies the policy consultation does reference the possibility of a TPG being provided by a ‘well-known high-street bank’. Whilst we accept that a TPG from a recognised high-street bank may provide a level of adequate security against cost mutualisation, this is the sole example advanced by Ofgem and it appears that Ofgem only investigated this option with a single banking institution.

What is not clear is what other entities and organisations Ofgem would deem as being adequate and suitable to provide a TPG to suppliers. The risk is that supplier procures a 'paper' TPG from a guarantor that is not properly capitalised to cover the costs in the event of the supplier failure. We suggest that a little more prescription would be required from Ofgem here to help flesh out what is acceptable and what is not. This would help achieve the desired policy aims and objectives and mitigate against suppliers potentially putting in place inadequate TPG that will not meet the stated policy objectives.

***Insurance schemes***

We note that Ofgem has not provided much in the way of detail on this proposal, including whether such insurance scheme products are readily available in the market and whether they provide adequate coverage and at premiums that represent commercially reasonable costs.

Were such schemes to exist in the market, any premiums would be extremely sensitive to market movements such as suppliers entering into credit default or other breaches of obligations, compliance investigations into suppliers and, of course, supplier failures. This option could prove extremely costly for suppliers, especially where they could not avail themselves of the PCG or TPG options.

Insurance schemes have merit in principle because they drives the right behaviours but great care should be taken not to erect disproportionate entry barriers.

***Principles-based cost mutualisation protections***

It is not at all clear, from either the policy consultation or the impact assessment, what is meant by this option. However, we would echo our other comments in response to this question on cost mutualisation that there needs to be an element of prescription as it relates to the methods by which cost mutualisation protections are employed by suppliers. This is to ensure a level of consistency and robustness to ensure that the stated policy aims and objectives are realised i.e. the mitigation and minimisation of cost mutualisation across the industry.

***Requirement to set aside funds in an escrow account***

Typically, a transaction using escrow occurs with two (or more) transacting counterparties with a third party acting as the escrow agent. The escrow agent would receive, hold and then distribute the money amongst the transacting parties once the parties had discharged their respective obligations under the terms of the transaction (and, where applicable, consent to such a release of monies).

It is not evident from the policy consultation or the impact assessment how Ofgem envisages the escrow option to work in practice for protecting against cost mutualisation.

Firstly, there is no counterparty to the supplier here that would either perform obligations and/or consent to the release of the funds from the escrow (as is typical in many escrow arrangements). The proposal could potentially work if the supplier and, for example, Ofgem were the two counterparties with a solicitor acting as the escrow-agent who could only release funds to the supplier following Ofgem rendering an approval. We note that it appears from the consultation paper that Ofgem has not suggested that this is the way in which the escrow solution would work. Where Ofgem makes payments to suppliers that are deficient or likely to become so for other obligations or the same obligation in a different time period (for example annual Feed-In Tariff

levelisation which follows periodic levelisation) we believe that it would have been possible for Ofgem to protect consumers by intelligent use of escrow payments.

Secondly, whilst the consultation documents do make reference to 'solicitor-controlled escrow accounts' there is no detail beyond that. We assume that what is meant by this is that the solicitor would be the escrow agent and, further, that the solicitor would be instructed by the supplier seeking to protect their funds (a proportion of credit balances plus government scheme costs). We fail to see how this would effectively protect the relevant funds. A solicitor appointed by the supplier as the escrow holder will act in accordance with the instructions of the supplier, their client, and so would release the funds from the escrow account upon client instructions do so (particularly without the presence of a counterparty). If it is being suggested that the solicitor-controlled escrow would only release funds held in escrow (e.g. if the supplier requires the funds to settle government scheme costs, or has lowered the overall amount of credit balances it holds) only upon compliance with specific terms, then there are questions around who would set those terms, who would assess them for adequacy and how.

In the absence of clarification on the aforementioned points on how safeguards would be employed in the utilisation of escrow accounts, the current view is that the supplier employing the escrow account solution could seemingly withdraw the funds at will, the risk of which would increase as the supplier moves towards failure. Therefore, in the absence of firm commentary from Ofgem about (a) how it sees escrow accounts working effectively for the stated purposes and (b) what safeguards would be employed, this is not an option that we would support at this time.

***Other mechanisms***

It is indicated in the consultation document that, as well as potentially allowing suppliers to choose from a 'menu' of options to protect against mutualised costs, Ofgem would be open to suppliers proposing other, alternative mechanisms to them for review and Ofgem would then assess the appropriateness of those options.

We support the concept of a menu of options being available for suppliers to select the method of protection that is most suited to their particular business model and corporate and commercial arrangements. Each of the options should be properly assessed and consulted upon to ensure they offer appropriate security against cost mutualisation (including addressing the points raised in this response). We firmly believe the menu of options available should be set out in licence, essentially a prescriptive licence condition rather than a principles-based one.

In terms of suppliers being able to suggest alternative methods of protection, we support this provided that those alternative methods are (a) suitable to achieve the policy aims of regulation here and (b) are put to the industry to consider as part of a consultative process. We do not support any suggestion that suppliers would be able to bilaterally engage with Ofgem to obtain ratification of proposed solutions on a case-by-case basis. This will ensure that there is a level playing field and that any methods of protection are appropriate and fit for purpose.

*Monitoring and enforcement*

The impact assessment document makes reference to suppliers being required to submit an annual assurance report. We believe that reporting on and monitoring of this requirement will be crucial and we are keen to understand in further detail Ofgem's thought process here and what safeguards will be employed, as this will be key to ensuring that suppliers have appropriate coverage for cost mutualisation protections. If the annual reporting requirement asked suppliers to

report to Ofgem, for example, by 01 April of each year this may not be adequate where a supplier's coverage under a TPG or insurance scheme will need to be renewed on 01 May, but the supplier chooses not to renew and later in the year becomes insolvent. In that sort of case, credit balances and government scheme costs for that supplier would be unprotected and this would not mitigate the impact of cost mutualisation. Therefore, we believe that any licence condition for this proposal should not only provide for cyclical reporting, but also for Ofgem to request an ad hoc report of this kind on a risk-based approach, the latter to be exercised where Ofgem has reason to be concerned about the compliance and/or financial position of a supplier. This would be in keeping with the stated policy objectives and also some of the other proposals Ofgem has made.

We note that Ofgem has recognised that suppliers funds may be protected by third parties (e.g. insurance scheme providers, third party guarantors and solicitors controlling escrow accounts) and that consequently Ofgem may not have direct regulatory oversight and reach over those third parties. Ofgem further acknowledges that it still needs to consider how, in the case of credit balances, funds will be recovered by customers from those third parties. We believe that these issues need to fully addressed prior to adopting the measures that Ofgem is proposing.

***Implementation period***

We believe that an implementation period of 9-12 months would be more appropriate. This would more adequately take into account not only the fairly significant corporate, financial and operational changes that may be required within suppliers, but it will also allow suppliers sufficient time to properly consider which of the methods of protection would be more suitable for their business models and to go to market to contract for solutions where the method of protection against cost mutualisation will be provided by a third party (such as a TPG or insurance scheme).

**6. Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider to help us to identify where suppliers' may be in financial difficulty?**

*Yes, we agree with the proposal to introduce new milestone assessments for suppliers.*

Whilst Ofgem already ostensibly monitors supplier growth, we welcome the formalisation of this process in the manner suggested in the consultation document as that should help deliver more transparency across the supply market. We believe that the suitable implementation of this proposal and robust practical application of it by Ofgem should help guard against supplier growth that is too rapid and/or unsustainable, as this presents significant risks to customers and the wider industry.

The consultation presents four customer thresholds which will trigger milestone assessments (50,000, 150,000, 250,000 and 500,000-800,000). Whilst we agree that these threshold triggers are suitable, we believe that there would be value in adding an additional threshold trigger point at around 1m-1.5m customers. Rapid growth to medium sized supplier status can pose risks to customers and the wider industry, and therefore we would advocate a further final milestone check at that point.

In addition to the customer milestone assessments, we also support the additional risk-based or 'dynamic' assessments that Ofgem may conduct upon suppliers that either deviate from their entry plans or where suppliers exhibit signs of financial challenge or difficulty. The latter is particularly important as it works hand-in-hand with the proposal around protection against cost mutualisation.

Ofgem has a responsibility to step in and engage with suppliers at the earliest signs that a supplier may be in difficulty (and an appropriate example of where Ofgem should intervene is where suppliers have payments outstanding in respect of government scheme or industry payment obligations).

The consultation document proposes that if the aforementioned assessments reveal concerns about supply businesses, then Ofgem would act to impose, via directions, measures that could include limiting the supplier's ability to make changes to payment collection patterns (such as increasing direct debits without proper justification) or limit their ability to take on customers. These measures are crucial to the healthy functioning of the market, and they serve to act as deterrents against other suppliers engaging in similar conduct. Regarding these measures that Ofgem could impose, there is one matter that Ofgem should clarify as part of this consultation process. At an Ofgem workshop held on 26 November 2019 to discuss these proposals, Ofgem reconfirmed the position set out in the consultation documents that a supplier not passing a milestone assessment might be barred from acquiring new customers. However, Ofgem went on to comment that suppliers in those scenarios may possibly be given an exemption for the purposes of taking on customers if this was pursuant to them being appointed as a Supplier of Last Resort (SoLR). We have considerable concerns with this position, as we believe that a supplier failing these milestone assessments should be barred from any and all customer take-on, with no exemption for SoLR activity. If anything, a supplier taking on a bulk transfer of customers through the SoLR process may present even greater risk than the supplier taking on customers organically through its sales channels. We note that there have been recent examples of SoLR being awarded to suppliers that were deficient on their financial obligations (e.g. with their RO and Energy Companies Obligation), and one of those suppliers itself failed soon thereafter.

Ofgem states in the consultation document that it is not minded to fix a set of criteria that would help determine whether a dynamic assessment may be triggered. This is on the basis that there are an array of indicators that could give rise to concerns about a supplier's financial health. However, we believe that Ofgem should publish a non-exhaustive list of factors that may trigger such an assessment, as this will help focus the minds of suppliers as to the matters that Ofgem might deem to be relevant for the purposes of triggering an investigation.

In terms of other factors that Ofgem should use as a trigger to consider whether a supplier may be in financial difficulty, we submit that Ofgem should give due consideration to: (i) the pricing behaviour of suppliers, particularly where products/tariffs are priced at below the cost of supply; (ii) instances where any information might suggest suppliers have not hedged appropriately; and (iii) where suppliers sharply increase and accumulate customer direct debits without reasonable justification.

The consultation notes that the milestone checks themselves would be similar in nature to Ofgem's new entry checks, e.g. checks of supplier IT systems and how that IT is integrated with the business and growth strategy. We assume that Ofgem, in conducting these assessments, would have the requisite expertise in order to assess what an adequate or good business looks like in order to achieve consistent outcome across different suppliers that may undergo those assessments, whilst allowing for the variance of business models. On the latter point, Ofgem should not be been seen to be laying down prescription as to how good innovation is defined, as there are different ways of achieving a stable growth.

**More responsible governance and increased accountability:**

**7. Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?**

In principle, we agree with the introduction of an ongoing fit and proper requirement, as we feel this could potentially have benefits across the industry, particularly where the same actors that are responsible for supplier failures then go on to become involved with other suppliers in the future.

We do believe that where current directors have been directors of companies exited in default, that this merits an amount of scrutiny. There is no evidence that this has happened. The key here is less to mistrust everyone but to target attention of those whose prior activities give cause for concern.

However, we think that the proposal, as currently set out in the draft licence condition, is far too wide, onerous and could prove to be disproportionately burdensome and costly for suppliers to implement and adhere to.

Firstly, the obligation would apply to individuals either being considered for or occupying a role with Significant Managerial Responsibility or Influence, which is defined as meaning "where a person plays a role in (a) the making of decisions about how the whole or a substantial part of an undertaking's activities are to be managed or organised, or (b) the actual managing or organising of the whole or a substantial part of those activities". We believe this definition is far too wide, and could capture any number of individuals, particularly within a large supplier. Applying a similar definition as part of entry requirements may seem more reasonable and proportionate given the limited number of personnel at start-up, but as the organisation grows to the size of a large supplier this definition would have the effect of potentially applying to dozens of employees who make decisions over and/or manage discrete areas of responsibility that may themselves constitute substantial parts of the undertaking's activities. Given the requirement to carry out periodic assessments on whether relevant persons are fit and proper, this would likely be highly onerous to manage. We feel that the definition should be curtailed to apply only to director level employees, as they are ultimately responsible for performance within their areas of responsibility and this would enable suppliers to not only more easily identify those individuals for the purpose of the licence condition, but would also be more manageable in ensuring periodic assessments are carried out.

Secondly, the headline obligation is that the "1.1 The licensee must not employ a person in a position of Significant Managerial Responsibility or Influence who is not a fit and proper person to occupy that role". The words 'must not' effectively render this obligation to be one of strict liability. We feel that the obligation here should only require suppliers to take reasonable steps to employ a person (in the relevant position) that is fit and proper. For example, a situation could arise where a candidate could apply to a supplier for a relevant role and on their application documentation they may not disclose their involvement in a previous supplier (e.g. this could be shown as a period of unemployment). In reality, unless the candidate held a director role within the previous supplier and/or there was information readily available in the public domain, the hiring supplier would have no reasonable means of becoming aware of that the candidate held a role in the previous supplier. Recruiting suppliers should be able to rely on information provided to them by candidates for roles and may be required to undertake proportionate enquiries and background checks, but an unequivocal obligation seems unreasonable and disproportionate.

Thirdly, the following proposed licence conditions also prove to be difficult to apply in practice:

- “1.3 In complying with paragraphs 1.1 and 1.2, the licensee must have regard to whether the individual is of good character, and whether he or she has been responsible for, contributed to, or facilitated any serious misconduct or mismanagement (whether unlawful or not) in the course of carrying out a regulated activity (or, providing a service elsewhere which, if provided in Great Britain, would be a regulated activity).”
- “1.4 In complying with paragraphs 1.1 to 1.3, the licensee must have regard to and take account all relevant matters including, but not limited to, whether the individual has: … d. Been a person with significant management responsibility or influence at a current or former Gas Supplier or Electricity Supplier which triggered a Supplier of Last Resort Event”
- “1.5 The licensee must give particular regard to cases where the relevant person has a background in the energy sector in Great Britain and the previous actions of that individual resulted in or contributed towards significant consumer or market detriment.”

Again, suppliers can only make reasonable and proportionate enquiries in this regard. At sub-director level, it may not be within the gift of suppliers to ascertain whether the candidate for or incumbent in the role meets the above criteria. Short of the information being available in the public domain, a supplier would only become aware that a candidate or role incumbent fell short of the aforementioned standards if either the candidate/incumbent offered up that information or their former employer did (e.g. as part of a reference). The latter scenario is unlikely to occur because the former employer may be insolvent and/or they may choose not to disclose much information beyond a standard reference due to their human resources policy and procedure (which would be influenced by their interpretation of employment law). At best, suppliers should only be expected to have to regard to and take into account information that either is or might reasonably be available to the supplier.

One potential solution would be for Ofgem to maintain a register or database (not dissimilar to a ‘watch list’) which would collate information relating to individuals as being of high risk and, therefore, actually or potentially not fit and proper to operate within a supplier at the relevant level. Ofgem is involved in not only SoLR events but, more widely, compliance engagement with suppliers and would therefore be privy to information that suppliers at large may not. Recruiting suppliers could then use this register or database as a point of reference.

Further, the proposed licence condition is drafted in a way that suggests that it only applies to persons employed by suppliers: “1.1 The licensee must not employ a person in…”. This apparent restriction to employees arguably does not extend to contractors that suppliers may engage or contract in relevant roles or positions. We would submit that the definition be widened to include contractors, otherwise suppliers could potentially circumvent the licence condition by taking an individual on as a contractor rather than employing them.

Finally, the licence condition should not have retrospective effect – it should only be forward looking. That is to say that any employees or contactors already engaged at the point of the licence condition going live, and the expiry of the implementation period, would not be subject to the assessments. The proposed licence condition is fairly prescriptive in some respects, including draft licence condition 1.4, therefore it could transpire that suppliers already have individuals employed or contracted that would be caught by the proposed licence condition. It potentially may not be feasible from contractual or employment law perspective to take action against that individual. It would be useful to have clarification on this point.

With reference to implementation periods, were this proposal to be implemented we believe this would require significantly more than the statutory 56 day implementation timeframe. This is due to the time we expect it would take to adequately formulate policies and procedures around this and

to amend processes and training. We think that a period of 6 months would be required to implement this proposal.

**Increased market oversight:**

**8. Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?**

*No, we do not support the proposal to require all suppliers to produce living wills.*

Whilst we understand the intent here, this proposal to create and maintain a living will seems disproportionate, inappropriate and ineffective for the energy industry. We believe living wills are more suited for public contractors, such as Carillion (now in liquidation), but less so for energy suppliers.

Firstly, a living will would have no binding legal force in the event of a supplier failing. It would not bind the administrator in any way. Further, the living will would almost certainly be out of date given the fluidity of the market/industry and that as a supplier goes through the phases of financial difficulty, the need to update the living will would invariably rank low in their order of priorities. We therefore do not believe that a living will would serve any value in the administration of the failed suppliers affairs.

Secondly, in the event that a large supplier were to fail, the administration of the company's affairs would be handled via the statutory Energy Supply Company Administration process. A supplier going through this process would not go through the standard administration and SoLR process, and therefore we believe that the management of the company's affairs in this scenario would not be assisted or aided by a living will (which, again, would almost certainly be out of date). The intended items of content of the living will, as set out in paragraph 4.11 of the consultation document, seem more appropriate and relevant in cases where a supplier enters into the standard liquidation/administration process.

If Ofgem deems there to be significant efficacy and value in the production of a living will, such that the benefits proportionately outweigh the burdens they would impose on suppliers, it may be that Ofgem tailors the requirement such that it only applies to suppliers that would go through the standard administration SoLR process (i.e. not the large energy suppliers). Alternatively, it may be prudent to impose the requirement to produce a living will using a risk-based approach (i.e. as set out in option 2 of paragraph 5.3 of the impact assessment document), possibly in conjunction with the exercise of Ofgem's proposed power to conduct dynamic assessments in scenarios where Ofgem deems a supplier may be in financial difficulty. This would represent a more proportionate and principles-based approach, while reducing undue burdens on suppliers generally.

Were this proposal to be taken forward, we do not believe that any parts of the living will should be required to be made public, regardless of the proposal to redact the commercially sensitive information and to only publish the non-commercially sensitive information. We feel that this information could be used and presented unfairly by price comparison websites (and possibly other industry participants).

Further, if Ofgem were to take this proposal further, we disagree with the implementation timeframe as set out in the consultation paper. We believe that, depending on the minimum informational requirements, any meaningful living wills would need significantly more time than the

proposed 1-2 month period following Ofgem's final decision. An implementation period of six months would be more appropriate.

**9. Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.**

*In principle, we agree that Ofgem should require suppliers to commission independent audits as and where it is deemed necessary, but Ofgem should not ignore the cost of these audits.*

However, in our view, we believe that Ofgem already has a range of powers at its disposal with which it could require supplies to carry out independent audits (such as via issuing a direction). For example, Ofgem can require audits to be carried out under environmental programmes (e.g. FiT and Warm Home Discount schemes), it has in the past compelled suppliers to carry out independent audits into their complaints performance, as well as part of any compliance engagement. On that basis, we do not believe that Ofgem has set out the case that supports the addition of a further licence condition for the stated purpose.

If Ofgem deems that it requires further, more specific powers set out in the licence conditions, then we generally support this but we would also maintain that the effectiveness of this proposal will be in Ofgem's willingness to exercise the powers in the appropriate circumstances and earlier in the process. In particular, where a supplier appears to be at risk of not complying with their obligations (not just their financial obligation, but also matters such as complaints performance, service standards and compliance) Ofgem must be ready to step in sooner rather than later as this would likely assist the turnaround of the supplier in question or at least mitigate some of the risks around their failure.

We think that the proposed draft licence condition is far too wide in application, as it indicates that Ofgem could require an independent audit to be carried out "if it may reasonably require or that it considers may be necessary to enable it to perform any functions given or transferred to it by or under any legislation, including any functions conferred on the Authority by or under the Regulation". It should reflect the policy intent as set out in the policy consultation where Ofgem indicate that it would exercise the power "only where [it] had significant concerns about a supplier's financial resilience or customer service arrangements", or alternatively Ofgem could reflect the purposes set out in paragraph 4.19 of the consultation document in setting out when it would exercise the power to require an independent audit. Ofgem should only utilise this licence condition to require independent audits to be carried out in a way that is proportionate, as such audits can be costly and ultimately the cost of these audits is borne by customers.

**Exit arrangements:**

**10. Do you agree with the near terms steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?**

*The administration process*

We note that, as alluded to in the consultation document, Ofgem has recently published a document setting out its expectations of administrators. Whilst we are encouraged to see Ofgem acknowledging that there is a problem with administrators and the wider administration process, we do not think this letter, in and of itself, will have much of an impact. As Ofgem acknowledges, in both the consultation document and the aforementioned letter, there are examples of administrators acting responsibly and providing good customer outcomes and there are examples

of administrators engaging poor practices which impact customers. We do not believe that the Ofgem open letter will appreciably alter this position. It may prove more fruitful if Ofgem were to follow up its open letter by proactively engaging with the relevant regulatory and supervisory bodies for the providers of insolvency services to try and secure behavioural changes and adherence to a minimum set of standards.

With reference to other steps that we think Ofgem should take as part of the supplier exit arrangements and the administration process, we have been very clear on this is the past. We strongly believe that increased transparency is required around how the administration process works in terms of debt recovery by the administrator and how that debt is redistributed. Ofgem has a *statutory* duty to be transparent. Currently, the administration process is very opaque and suppliers are unaware as to how debt recovered is redistributed.

Where, for example, the customer of the failed supplier owes a debt to that supplier, post-failure this debt will be owed to the administrator. The administrator may asking the appointed SoLR to collect the debt on their behalf. However, the administrator can take an expedient view and come to some other arrangement with the SoLR, for example (i) that a haircut will applied where the SoLR will owe to the administrator a percentage of the overall debt owed irrespective of what percentage of the debt is actually recovered, (ii) a pari passu agreement which sees the SoLR remitting a defined percentage of all payments to the administrator until the debt is paid or finally abandoned, or (iii) the SoLR will pay to the administrator a maximum percentage of the debt recovered.

The final credit owed by the failed supplier to its customers should be paid by the administrator (possibly via the SoLR). The issue here is that if the administrator has fallen short by subordination of the final debt (in the ways described above), then the amount of final credit available to be distributed is reduced. This has the effect of a direct increase on the claim on the levy made by the SoLR (where it is successful in making such a claim). The levy claim feeds through to distribution charges which feeds through to an increase in the SVT price cap, keeping in mind that Ofgem and CMA both state that SVT is disproportionately represented by disadvantaged consumers.

Furthermore, if the SoLR has purchased the debt from the administrator at a reduced rate (and we suspect there can be significant reductions or factorisation) and then it later over-recovers against that outlay, this has the effect of creating a windfall for the SoLR. In theory, this should be netted off against the credit balances honoured by the SoLR and thereby reducing their levy claim by the commensurate amount. However, we have seen no evidence of such a practice.

Despite numerous supplier failures we are not aware of monies having been redistributed after recovery. Therefore, this is both a consumer protection issue and a matter of public interest, and so we believe Ofgem should be transparent about what is going on with the administrators on matters of collection of final debt and distribution of final credit, as these go hand in hand with the cost mutualisation protections that Ofgem is consulting on.

*The proposal to update supplier terms and conditions*

We do not support this proposal, as we do not believe that the adoption of the proposal would meet the intended policy objectives.

Ofgem has proposed to introduce a requirement for suppliers to include references in their contract terms and conditions that activities relating to debt recovery will be executed as outlined in relevant

licence conditions. Ofgem believes this will provide some backstop protections for consumers in the sense that it will provide customers concrete contractual terms to point to should the appointed administrator's practices fall short of what Ofgem would expect of a licensed supplier. Ofgem further believes these contractual terms may also be helpful to the consumer should there be a legal dispute with the administrator.

We disagree with Ofgem's rationale here. Supply terms and conditions, as between supplier and customer, would not necessarily bind administrators where said supplier has failed. The administrator takes control of the company and their primary duty is to the creditors of the company. In the course of performing their functions, an administrator has wide-reaching powers and can do anything that is deemed necessary or expedient for the management of the affairs and property of the company. This includes the ability to set aside terms of a contract if he or she thinks that on balance non-performance may help them achieve the purpose of the administration. Therefore, we do not think that the proposals would improve customer interactions with administrators – the primary duty of the latter to work in the interests of creditors of the failed business would remain unchanged, as would their powers to set aside terms that interfere with that purpose.

Thereafter, we are not convinced that the proposed licence condition drafting meets Ofgem's stated policy objectives, and we offer the following points for consideration.

One of Ofgem's primary concerns with respect to the practices of administrators, as set out in the consultation document, was the significant delays final bills being issued to customers. However, the proposal licence condition only requires "paragraphs 5 to 8 of standard condition 27 (inclusive)" to be included in supplier terms, and so this would not include the final bill rules (which are set out in paragraphs 17 to 18 of standard condition 27 (inclusive)). However, even if the drafting were updated to include reference to final bills, the obligation is to "take all reasonable steps to send a final Bill or statement of account of the Domestic Customer's account within 6 weeks". An administrator could simply argue that it was not reasonable to expect it to issue final bills within 6 weeks as it needed to get to grips with the failed suppliers affairs, acquire and make sense of the data, work out the billing position and validate it etc.

Furthermore, several aspects of paragraphs 5 to 8 of standard condition 27 (inclusive) simply could not be complied with by the administrator, and examples include the duties there to offer fuel direct and prepayment as payment methods and to offer energy efficiency advice to customers. Ofgem's stated aim here is that "reflecting these requirements in contract terms may also be helpful to the consumer should there be a legal dispute with the administrator". We believe that inclusion of terms and conditions that cannot necessarily be exercised by the customer against the administrator does not meet the policy objectives set out in the consultation.

**11. Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?**

*Portfolio splitting*

In principle, we agree that there may be benefits in splitting the customer portfolio of the failed supplier and awarding parts of the customer portfolio to two or more suppliers of last resort where this is deemed appropriate in the circumstances. This may particularly assist where the portfolio of the failed supplier is fairly substantial and it may not be expedient for one supplier of last resort to take on the entire portfolio. This would assist in securing better outcomes both for a more

competitive market and for customers, whilst also ensuring that appointed suppliers are better placed to discharge duties as a supplier of last resort.

However, as we understand it, there may be excessive cost and complexity associated with making this is a reality, particularly from an industry and systems perspective, in addition to any other barriers. We note that Ofgem will shortly commence engagement with Elexon, Xoserve and the DCC, before expanding this engaging to the wider industry. We would be interested in seeing the output of how those conversation progress and we would also feed in at the relevant time.

It goes without saying that Ofgem should conduct a robust feasibility and impact assessment exercise here, and should only proceed if the benefits clearly and demonstrably exceed the costs (and any risks) of launching an intervention here.

*Trade sales*

We support Ofgem's attention in this area. Clearly Ofgem should not block genuine trade sales that might have the effect of putting suppliers out of business and negatively impacting customers of affected suppliers. Also, Ofgem should carefully consider its vires to act in this area.

Subject to the above, we think Ofgem should address two particular issues.

Firstly, there is the scenario where a supplier acquires the assets of another supplier where it has the look and feel of what is commonly known as a pre-pack liquidation. The acquiring supplier potentially will have had greater information (about the supplier that would be selling its assets) than other suppliers who may have participated in the supplier of last resort bid. This information asymmetry is unfair on those other suppliers, who would likely only beat the acquiring supplier in the supplier of last resort bid by effectively overpaying (the so-called 'winner's curse').

Secondly, the acquiring supplier should not be permitted to purchase the assets of another supplier under a trade sale if at the time it was deficient in its financial obligations, for example the Renewables Obligation. If the acquiring supplier is in financial trouble or is otherwise using any late payment facility (under government scheme obligations) as a cheap source of working capital, then it should not be permitted to acquire the assets of another supplier.

We believe that both of the scenarios above may have occurred with a recent trade sale between OVO and Spark Energy. This is a matter of public interest and deserves a great deal more transparency than the information provided so far by Ofgem. The Solarplicity sale to Toto invites numerous questions. We await the outcome of Ofgem's enquiries. It is clearly inappropriate to make a trade sale of customers whilst leaving debts and obligations associated with those customers behind. Examples of obligations are DCC fees, Ombudsman fees and of course financial obligations, levelisation and mutualisations.

Further, there appears to be an emerging market feature in which companies sell parts of their business and/or sell parts of their customer portfolios, and abandon the rest in default (and Ofgem's impact assessment does touch on some of these issues). We believe that this is another area that Ofgem should address. The term "stamping out sharp practice" is used frequently by Ofgem. These suppliers have effectively taken customer money on account, spent it on other things, and not returned it. Since this practice has occurred then we must conclude: (i) that it was not considered sharp practice; (ii) that it was considered sharp practice but it is not being pursued; or (iii) that it is being pursued but out of public view. None of these seem satisfactory.

**12. Do you think our draft supply licence conditions reflect policy intent?**

As it relates to the draft licence conditions on the ongoing 'fit and proper' requirement, independent audits and customers in debt proposals, please see above questions 7, 9 and 10 respectively. We have set out in those responses how the drafting of the relevant licence conditions should be amended to reflect the policy intent. With regards to the remaining draft licence conditions, our comments on them are as follows.

*Operational capability*

Whilst we support the move towards principles-based regulation, we do not believe that Ofgem's proposals on operational capability add to the existing regulatory framework in a material or meaningful way. This proposal would seem to add unnecessary licence conditions whereas the general direction of travel should be to further simplify the rulebook.

The operational, process and systems capabilities of suppliers can already be assessed against existing regulatory requirements, such as under the Standards of Conduct, The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 and the requirement to adhere to industry arrangements (as well as other legal and regulatory requirements). Further, Ofgem already has extensive powers available under current legislative and regulatory provisions that would enable it to assess any operational capability issues that suppliers may be experiencing (for example, by issuing a request for information and issuing provisional/final orders to secure compliance). Therefore, we believe there is considerable overlap between existing regulatory obligations of suppliers and powers that Ofgem currently has available, and the current proposals as indicated in the draft licence conditions. We do not believe that Ofgem has demonstrated that there is a gap in the current legislative and regulatory framework that would necessitate the proposed licence conditions in order for Ofgem to take the requisite action against suppliers that are not adequately serving their customers and/or are at risk of not meeting their legislative and regulatory obligations.

We are also not clear on how Ofgem will, in the event that that they exercise the proposed powers, achieve consistent outcomes in this area. It would appear, from the way in which the proposals are described in the consultation paper, that the information that Ofgem may request (and receive) could include information that is very complex and technical, such as financial, accounting and IT systems information. Whereas in the event of a compliance breach Ofgem may be well positioned to adjudge whether a supplier has actually breached its obligations or not, we think it may be relatively more difficult for Ofgem to assess whether a supplier has any issues in terms of its operational capability. So we think Ofgem should provide further detail on how information received under these powers would be evaluated, and also Ofgem's assurances that it will have (or procure) the relevant expertise to be able to scrutinise any information received in a meaningful way. This proposal also seems to have considerable overlap with the proposals on milestone and dynamic assessments and independent audits, and the demarcations between those distinct activities is not clear.

If Ofgem decides to proceed with the implementation of this proposal, then it must be prepared to use this licence condition to open compliance or enforcement engagement with suppliers at the earliest possible indications that suppliers may be at risk of not adequately serving their customers and/or not meeting their legislative and regulatory obligations. Ahead of this licence condition being implemented, Ofgem should still use the existing arrangements to intervene where suppliers are not meeting their obligations.

With respect to the drafting of the licence condition, we believe that the term “sufficient operational capability” needs to be aligned to the policy intent set out in the consultation paper. We have understood the policy intent to mean that Ofgem will use its powers to step in where it deems that a supplier may be struggling with its obligations and may be at risk of supplier failure in the future, however, the way that the licence condition is drafted could conceivably allow Ofgem more generally to make enquiries of and monitor suppliers. For that reason, we believe the policy intent should be clearer here and this should be reflecting in the drafting of the licence condition.

*Principle to be open and cooperative with the regulator*

Whilst we support the notion that suppliers should have strong, constructive relationships with the regulator, we think that the licence condition as currently drafted is far too wide and vague. To that extent, we believe that the licence condition drafting does not meet the policy intent.

Firstly, the term “open and cooperative” is extremely loose. For example, if a supplier were to not support the regulator’s proposals for a licence change or chose not to provide a response to a voluntary request for information, that could potentially be construed as not being cooperative. Therefore, the scope here is too broad.

Secondly, there requirement to “disclose to the Authority appropriately anything relating to the licensee of which the Authority would reasonably expect notice” is excessive in reach and scope. Due to the looseness of the wording, there are potential scenarios where the regulator may ex post decide that it should have had notice of matters when the supplier might have reasonably, at the time, deemed it as something that would not necessarily require disclosure to Ofgem.

Following on from the above points, it must be borne in mind that Ofgem is a regulator and should become get overly concerned by operational and business as usual matters, but the drafting indicates that many matters that should properly be within the sole remit of suppliers may be caught by the provisions. This has the potential to overly burdensome on both suppliers and Ofgem.

To better reflect the policy intent set out in the consultation document, it would be far more optimal to frame these obligations as coming into effect where a supplier is experiencing financial difficulty or where they are at material risk of non-compliance and there is an actual or potential risk of detriment to customers and/or the market.

*General monitoring and reporting*

We agree with Ofgem’s suggested approach of adopting a risk-based approach to monitoring supplier compliance with the new rules that are introduced as part of the Supplier Licensing Review.

Further, we have no objection to the proposed new licence condition requiring suppliers to issue ‘Change of control’ notifications to Ofgem. Naturally, we would expect all suppliers to have had proactive discussions with the regulator during any merger or acquisition activities, and arguably the requirement should bite in the lead up to the change of control negotiations rather than post-event.

With reference to the drafting of the ‘Change of control’ licence condition, the term ‘Relevant Merger Situation’ is used and is presented as a defined term but it is not defined either in the existing licence conditions or the proposed new licence condition.