Licensing Frameworks Team

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Supplier Licensing Review – Ongoing requirements and exit arrangements

Dear Sirs,

SmartestEnergy welcomes the opportunity to respond to Ofgem's consultation on the Supplier Licensing Review – Ongoing requirements and exit arrangements.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services, a supplier in the electricity retail market, serving large corporate and group organisations, and a wholesale market access provider for independent suppliers. It is in the light of these last two capacities that Ofgem may wish to take particular note of our response.

Please note that our response is not confidential.

We answer the questions below in the order in which they appear in the consultation document.

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

We understand that the proposals being put forward are intended to function together as a package and we agree that, as a whole, proposals to strengthen ongoing requirements ought to reduce the need for additional rules around exit arrangements. However, we do not think that this is the "ideal" package and should be significantly scaled back as we believe there will be considerable unintended consequences which we elaborate on further on in this response.

We note that Ofgem state that they should maintain proportionate oversight of suppliers. We interpret this to mean taking a risk-based approach. This leads us to conclude that, in general, measures should be targeted to those suppliers who present a greater risk with Ofgem reserving the right to request information/plans, for example, rather than imposing on all suppliers.

Question 2: Do you agree with the outputs of our impact assessment?
It is not clear to us what the "outputs" of the impact assessment are.

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

There is no real evidence provided by the Impact Assessment of the benefits to consumers of creating additional working capital for suppliers by not requiring all customer balances to be protected. We believe that there is a benefit to consumers because of the benefits of competition but in the interests of good process Ofgem should present some evidence as part of the Impact Assessment. For example, in the summer credit balances can be used by smaller suppliers to pay for collateral to buy ahead on the wholesale market and thus make their businesses more sustainable during the winter.

Additionally, there seems to be no science behind the 50% figure. It has not been demonstrated that this is any more optimal than say a 40% level of protection.

We understand that Ofgem are attempting to create a balance between protections for customers in general and promoting competition. However, this is not a matter of finding an optimum point on a scale because the two issues under consideration are not at either end of the same scale. If competition is important it should mean that these additional protections are not considered. Besides, mutualisation is the protection.

Question 4: Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? Please provide evidence to support further refinement.

Not only is there no evidence in the impact assessment of the benefit to consumers of living wills, nor is there any attempt to evaluate the costs to suppliers. It could be stated, however, that if the request to prepare a living will was only made to suppliers giving cause for concern then that in itself would be an incentive on suppliers to up their game and the thinking on these matters would be timely.

Question 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.

To clarify, Ofgem's preferred policy option is 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.

Ofgem have suggested the use of PCGs, third party guarantees or escrow accounts. However, if it is up to the supplier to choose the method it is clear that larger suppliers with access to PCGs will have a commercial advantage over smaller ones. As stated under Q3, the availability of this cash is good for competition.

Some suppliers offer interest on credit balances and it is also possible for customers to ask for their credit balances back. If Ofgem are concerned about the misuse of credit balances it would make more sense to make customers more aware of their rights.

We believe that smaller suppliers can have a variety of collateral structures in place with other suppliers providing them with access to market arrangements. Ofgem need to be careful of applying additional obligations on small suppliers which may be in conflict with such arrangements. This could affect the ability for the other suppliers to offer market access arrangements and hence affect competition.

We agree with the proposal to introduce a new principle-based requirement for suppliers to ensure they have, and can demonstrate that they have, the capability, processes and systems in place to enable them to effectively serve all their customers and comply with their regulatory obligations. However, in order not to be a regulatory burden, we believe that Ofgem should only request such demonstration if they have reason to believe that the licensee may not be compliant with the principle-based requirement.

Any further collateral requirements for policy costs would, in our view, present a significant hurdle for small suppliers, stifling competition and inhibiting growth and innovation.

Question 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?

We agree that it would be more proportionate at this time to focus milestone assessments and trigger points on domestic suppliers. However, the burden of proof at these milestones should not be so onerous that competition is stifled. We agree, therefore, only to a certain extent with the "introduction of new requirements for domestic suppliers to undergo milestone assessments conducted by Ofgem at certain customer number thresholds to ensure that they are adequately prepared and resourced for growth." We agree with the proposal that they should undergo additional assessments should they indicate signs of financial difficulty.

Question 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, you believe suppliers should assess in conducting checks?

We note the proposal to introduce an ongoing fit and proper licence requirement, where suppliers are required to have the processes and systems in place to ensure relevant persons are fit and proper, including background checks for past criminal convictions, director disqualifications, and previous involvement in company insolvencies or SoLR events. This is good practice at the time of start-up or a merger/take-over. Otherwise we feel it is an unnecessary on-going requirement.

It is also unclear from the proposals what a supplier is supposed to do if such a background check revealed a relatively minor, irrelevant or historic criminal offence. We would assume that the supplier would be allowed discretion in whether to ignore it. This, however, leads to another concern which is that if Ofgem are only expecting suppliers to have processes in place without being prescriptive as to the exact nature of the checks then there will be no consistency in how the obligation is applied. Clearly, suppliers already do the checks that they are comfortable with already.

We would not be uncomfortable with an overall principle-based requirement that suppliers are open and cooperative with Ofgem.

Question 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?

Ofgem consider that this requirement (setting out what would happen in the event of a supplier's failure, including risks of consumers incurring costs, risks of service disruption for its customers and how it would ensure compliance with any relevant licence conditions) should apply to all suppliers. We consider that this would be an unnecessary regulatory burden for the majority of well-run businesses. It would be more proportionate if this were a requirement of companies Ofgem is beginning to become concerned about. We are, however, slightly sceptical of the value of living wills as there is no way of ensuring that they would be implemented as written.

As we state in our answer to Q4, if the request to prepare a living will was only made to suppliers giving cause for concern then that in itself would be an incentive on suppliers to up their game.

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

Ofgem are proposing to introduce a new requirement to enable them to compel suppliers to undertake an independent audit, conducted by an external auditor, of their financial accounts and customer service systems and processes. This could be viewed as excessive regulatory interference. We would be less uncomfortable with this requirement if Ofgem only seek to use it in a proportionate way and in specific and defined circumstances such as when Ofgem have serious concerns about a supplier's financial resilience, they have reason to believe the supplier in question is preventing them from performing their statutory duties or specific technical or financial expertise is required to identify the root cause of customer service failures.

It is not unreasonable for Ofgem to require suppliers to report to them where there has been a change of control of the business. It should be made clear, however, that this is not in any way a requirement to seek Ofgem's permission.

Question 10: Do you agree with the near-term steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?

We are not convinced that the proposal to introduce a requirement for suppliers to include references in their contract terms and conditions that administrator activities relating to debt recovery will be executed as outlined in relevant licence conditions is workable/enforceable. A change in the law in this area would, however, be desirable.

Question 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 options? Are there any potential difficulties you can foresee?

We note that there have been instances of partial trade sales taking place just before failure, which has resulted in the SoLR selection process being less competitive and we can see why this may be deemed undesirable. However, we do not think this is an issue in the non-domestic market and it can help the credit position in respect of other parties to have the ability to liquidate all or part of the customer supply contracts to the extent that a struggling supplier may be able to once again become a solvent viable business. It may also prove useful for a struggling supplier to split out their domestic and non-domestic businesses in this way.

The document states that if a last-minute trade sale is being considered at a very late stage (ie where a SoLR process is otherwise imminent) it is likely Ofgem will take action to proceed with the SoLR process if they consider that will better protect customers. However, we are unclear of how Ofgem could guarantee that they would do this in a fair and proper manner and should not be seen to be interfering with commercial trades/relationships. Similarly, requiring suppliers to obtain Ofgem's approval before proceeding with customer book sales would, on the face of it, seem sensible, but implementing such a policy seems to us to put Ofgem in a difficult position and one which could, and should, be challengeable in court.

Question 12: Do you think our draft supply licence conditions reflect policy intent?

No comment.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
Head of Regulatory Affairs