

Supplier Licensing Review: Ongoing requirements and exit arrangements

Ofgem Policy Consultation

A Response by Utility Warehouse

This document sets out the views of Utility Warehouse regarding the Ofgem Policy Consultation “*Supplier Licensing Review: Ongoing requirements and exit arrangements*” published by Ofgem on 22 October 2019.

Utility Warehouse previously welcomed Ofgem reviewing their approach to licensing suppliers and felt it was particularly timely given the status of the GB retail energy market. We are therefore fully supportive of the new entry requirements which came into effect in July 2019 which focus on more rigorous stress testing of a new supplier’s ability to operate before they can commence the provision of energy supply to domestic customers. While competition is imperative in the sector, companies who operate in the market must take their responsibilities incredibly seriously and have the appropriate infrastructure in place, from financing, ability to hedge and the necessary operating systems and staffing levels to support.

It is unfair to ask customers who haven’t switched supplier, or those who have switched to a responsible supplier, to pay for the losses incurred by those who have benefitted from an artificially cheap price operated by an undercapitalised and under resourced supplier, which if other suppliers are asked to fund these losses, needs to be recovered from their customers through even higher prices. It is therefore imperative to review the ongoing requirements for existing suppliers in the market.

We have provided comments below to some of the specific questions raised by Ofgem in the consultation and have listed the chapter titles as appropriate.

Promoting better risk management

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.

We consider that the financial adequacy of suppliers is intrinsically linked to how they manage customer credit balances given some undercapitalised suppliers utilise this as working capital to fund their operation. There have been extreme examples of some suppliers encouraging customers to build up large credit balances by offering preferential terms such as interest rates or requesting customers to pay their annual usage upfront. We are not an advocate of such arrangements as we feel it is fundamentally unsustainable and presents a major risk to the stability of the market. Further, there is evidence to suggest some suppliers do not forecast the costs of operating in the market, not least those amounts owed under compliance with government schemes.

We therefore encourage and support Ofgem seeking to put in place arrangements to minimise the extent to which suppliers build up large, unsettled costs that then need to be mutualised across other parties in the event of their failure, such as customer credit balances and government scheme costs. We feel Ofgem’s proposals that suppliers must protect a minimum of 50% of customer credit balances is the minimum that would be appropriate as a standard

for all suppliers to adhere to, and the scope of protection should also include at least 50% of government schemes, including but not limited to the Renewables Obligation. We feel Ofgem could put in place additional safeguards using a risk-based approach, for example, requiring the protection of 100% of both customer credit balances and government scheme costs where the supplier has a low equity base.

As a more general comment, for cost mutualisation protection to deliver real benefit to the market it is critical Ofgem closely monitor the delivery options being used by all suppliers to ensure these are fit for purpose. Should a supplier subsequently fail and their cost protection not be adequate in preventing mutualisation, this presents the risk of significant reputational damage.

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 are broadly in favour of milestone assessments for suppliers, particularly at lower customer number thresholds. These assessments could consider if a supplier is performing in accordance with the business plan they set out as part of the entry assessments or if the supplier is prepared to comply with necessary regulatory obligations such as the Warm Home Discount.

We have concerns with the value and rationale of a supplier assessment at customer number threshold between 500,000 to 800,000. Our basis behind this position is as follows:

- a) Ofgem already collects a wide range of information from larger suppliers through regular reporting and RFIs.
- b) As Ofgem recognise in the consultation no additional supplier obligations begin at this level; and
- c) There has been no supplier failure of this size or above to date.

We therefore feel Ofgem should instead continue to use a dynamic approach of assessing larger suppliers using the existing information available to them rather than conducting a review at a specific customer number threshold.

Increased market oversight

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

Ofgem currently have the mechanism of using a direction to instruct a supplier to undertake an independent audit so we feel this proposal risks duplication of existing powers. In addition, there is clear disparity between the language used within the body of consultation document itself which states Ofgem would use audits "sparingly" in a "proportionate" way, compared with the current drafting of the proposed license condition which does not include such precautions. If Ofgem were to consider that this proposal does not duplicate existing powers, as a minimum the scope of the license condition must be reflective of the intent and only used in exceptional circumstances.