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## Summary of responses to the Supplier Licensing Review: Ongoing requirements and exit arrangements consultation

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Ofgem's consultation on the Supplier Licensing Review: Ongoing requirements and exit arrangements, published on 22 October 2019, sought stakeholder views on our proposals to ensure appropriate protections are in place against poor customer services and financial instability. This consultation closed on 3 December 2019 and we received 45 non-confidential responses from suppliers, consumer groups and other interested parties.

This document summarises some of the key themes contained in the responses to our consultation. It does not represent the views of Ofgem.

We will use these responses, as well as our ongoing engagement, to assist us with our policy development.

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## Contents

<b>Responses to questions.....</b>	<b>4</b>
Overall package .....	4
Impact assessment.....	5
Cost mutualisation protections .....	6
Milestone assessments.....	9
Dynamic assessments.....	10
Ongoing fit and proper requirement.....	11
Living wills .....	12
Independent audits.....	13
Customer interactions with administrators .....	14
Operational capability and open and cooperative principles.....	15
Portfolio splitting .....	15
Trade sales.....	16
<b>Consultation respondents .....</b>	<b>17</b>

## Responses to questions

Following the introduction of our new supplier entry requirements,<sup>1</sup> we have progressed with the next stage of our Supplier Licensing Review (SLR) considering ongoing requirements for active suppliers and exit arrangements in the event of supplier failure.

In May 2019, we published a working paper setting out a long-list of policy options to strengthen requirements in these areas.<sup>2</sup> We held a workshop in June 2019 to get stakeholders views on these options and to seek further suggestions for options they thought we should consider.<sup>3</sup> We took stakeholder feedback on board in prioritising our proposals. We published a policy consultation and a draft impact assessment in October 2019.<sup>4</sup> The consultation set out a series of proposals that seek to ensure suppliers have effective risk management processes in place, maintain appropriate governance, increase accountability, and enhance our market oversight. We summarise the stakeholder responses to our proposals below.<sup>5</sup>

**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?

## Overall package

Most respondents welcomed Ofgem's proposed package of proposals, with the majority of responses focusing on suggestions for how the package could be further refined in order to achieve the principles of the Supplier Licensing Review. Most respondents were of the view that the package, or parts of it, would reduce the likelihood of disorderly market exits and

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<sup>1</sup> Ofgem, [Decision on new Applications Regulations and guidance document](#), June 2019

<sup>2</sup> Ofgem, [Update on the way forward for the 'ongoing requirements' and 'exit arrangements' phases of the Supplier Licensing Review](#), May 2019

<sup>3</sup> Ofgem, [Supplier Licensing Review workshop summary notes and slides – 21 June 2019](#), July 2019

<sup>4</sup> Ofgem, [Supplier Licensing Review: Ongoing requirements and exit arrangements](#), October 2019

<sup>5</sup> Responses to licence drafting questions (question 12) are included within each of the policy-specific sections.

ease disruption caused to consumers. The majority of stakeholders did not suggest other actions that Ofgem could take in order to achieve our aims.

Some common themes and messages were prevalent in the responses that seemed to apply to many of the proposals within the package. A number of stakeholders believed that parts of the proposal package duplicated existing regulations, such as milestone assessments, the fit and proper requirement and both the 'operational' and 'open and cooperative' principles. Some respondents called for the proposals to be more targeted and proportionate – especially in regards to cost mutualisation protections, milestone assessments and portfolio splitting. Most respondents noted that the implementation of some of the proposals will require careful thought.

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

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

**Question 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.

## Impact assessment

A large number of stakeholders did not directly address all three questions we asked in relation to our impact assessment. We have therefore condensed the views we received into a broad summary of stakeholder views on the impact of our proposals.

### General comments on our impact assessment

The majority of respondents did not agree with the outputs of the impact assessment, and most respondents focussed largely on our assessment of the impacts of our cost mutualisation protections. Many stakeholders suggested that the impact assessment should do more to consider the costs to a wider range of supplier sizes, business models and integration in the wider market. Stakeholders commented that the assessment of impacts for the other policy proposals was largely qualitative.

As a whole, many stakeholders were keen that we conduct more detailed analysis. They did not, however, provide significant evidence to support further refinement. Some presented evidence to support their positions on cost mutualisation, or pointed to relevant data in previous Ofgem reports. Very few stakeholders provided any evidence or supporting data for policy areas outside our cost mutualisation proposals.

### **Cost mutualisation**

Nearly all respondents who commented on the impact assessment were of the view that our assumptions in relation to the costs associated with implementing the cost mutualisation policy were too low. In particular, stakeholders considered that the indicative fee rate of 0.5% of the protected amount per annum would be unachievable for most of the market other than vertically integrated suppliers.

Some stakeholders offered alternative indicative rates, ranging from 3% to 7% or more for independent suppliers. Stakeholders also challenged the assumption that the current rate of failures in the market would continue. They noted that if the number of supplier failures decreased then this could undermine the benefits case and would likely result in a net cost to consumers of implementing this policy package.

Several stakeholders also suggested that we had not fully considered the associated benefits that these protections would bring to consumers and the market, suggesting that the benefit of our cost mutualisation proposals may be much greater than what we presented in our impact assessment.

**Question 5:** Do you agree with our proposed option for 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.

### **Cost mutualisation protections**

In general, stakeholders were supportive of our policy intent in this area, and many agreed with the idea of protecting against the need to mutualise costs. However, there was a significant divergence of views among stakeholders about how far such protections should go. Many respondents suggested requiring suppliers to protect 50% of the costs that may be mutualised in the event of their failure was too extreme. Whereas many others argued it did

not go far enough. Stakeholders were generally in favour of further work to outline how the protections would work in practice and the costs involved.

### **Scope of protections**

Some stakeholders made a case for extending cost mutualisation protections to 100% for both credit balances and government scheme costs. They considered it important to minimise the impact of mutualisation on wider industry and to ensure each supplier bears an appropriate share of the risk. Others advocated for lower or no protections, citing concerns over costs and business cash liquidity impacts.

Many stakeholders specifically raised the issue of mutualisation of the Renewables Obligation. Those that did were often keen that we explored options with Government for changing the payment frequency of the Obligation, suggesting that this may be preferable to cost mutualisation protections. Some stakeholders pointed out that other government schemes already have appropriate credit control measures in place and suggested that these schemes need not be protected through our policy.

There were varying views among stakeholders with regards to who the protections should apply to. Some agreed with our position that the protections should apply to all suppliers, whereas others were of the view that they should be more targeted – suggestions included domestic only, smaller suppliers only and a risk-based assignment of protections.

### **Impact of our protections**

It was noted that our protections would impact suppliers' ability to use credit balances as working capital, and as such this would have to be funded from elsewhere. However, there was some disagreement over the appropriateness of this practice in the first instance. Some stakeholders, including small and medium-sized suppliers, expressed the view that an efficient business should not use its credit balances as working capital. Others argued that it was necessary and appropriate to do so. A few raised concerns that restricting suppliers' access to credit balances could put some out of business.

A small number of suppliers raised concerns that our proposals could incentivise suppliers to move away from offering fixed direct debits, which would make it difficult for households to budget. Some also raised concerns about the interaction of our protections with other collateral requirements in the market and encouraged us to consider the cumulative effect of these as part of our impact assessment.

## **Implementation**

Most stakeholders agreed that a 3-6 month implementation period was too ambitious. Many stakeholders suggested that an implementation period of 12 months would be needed, while others thought that up to two years would be required to allow businesses adequate time to adjust their business models and cash flow arrangements to reflect the new requirements. Some also raised the idea of a phased implementation period, where protection obligations would be increased over a period of time to allow time for businesses to adjust.

Stakeholders had some practical concerns with regards to implementing our proposals. These primarily related to the availability of protections. Many stakeholders argued that a market for third party guarantees did not yet exist, that many suppliers would not be able to obtain a parent company guarantee, and that it was not clear who the counterparty to an escrow account would be. It was also noted that monitoring compliance with the obligation could be challenging, and that there was no guarantee that firms would not remove the protections and use the funds elsewhere if they were in financial distress.

## **Definition of credit balances**

Many stakeholders sought clarity on how 'credit balances' would be defined, including in relation to:

- differences in how it is accrued and held depending on payment method
- calculation on an ongoing basis or at a specific point in time
- calculation net or gross of unbilled consumption
- offsetting overall debit and credit balances
- inclusion of non-domestic customer credit balances.

Many non-domestic stakeholder argued against applying these protections to non-domestic customer credit balances, arguing that cost mutualisation was largely a problem in the domestic sector.

## **Alternative proposals**

Stakeholders suggested a variety of alternatives, although generally did not go in to sufficient detail on how these would work in practice or how the alternative would better achieve our policy intent. Of the alternatives suggested, the most common were to introduce an industry-wide insurance scheme similar to that of ABTA in travel and FSCS in banking or for Ofgem to



carry out greater monitoring of a variety of financial metrics. Some stakeholders also called for us to use our existing powers or introduce principles while developing more robust longer-term proposals.

**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?

## Milestone assessments

Most respondents were generally supportive of Ofgem's proposal to introduce milestone assessments for suppliers before they reach customer number thresholds and were supportive of the thresholds proposed. Some respondents felt that it made sense to link the thresholds to current obligations, but warned that Ofgem should make clear that the assessment was not just focussed on meeting these obligations but on wider preparedness to ensure that assessments do not become redundant when obligation thresholds change.

Some respondents felt that there should be higher thresholds to include larger suppliers. A couple of respondents suggested a threshold of somewhere between 1 – 2 million customers. It was pointed out that some suppliers above the highest threshold proposed (500,000 – 800,000 customers) were low in the Citizens Advice supplier ratings and had not delivered their ECO obligations. Those calling for a higher threshold also suggested that a higher threshold would be appropriate due to the risks posed by rapidly-growing medium suppliers, and to ensure that these suppliers had a robust approach to vulnerability, as at this stage they would likely have a significant number of vulnerable customers. Others felt that larger suppliers could be assessed using a dynamic approach where necessary, rather than a higher customer number threshold.

Several respondents commented that assessments should not be burdensome. Some suggested that checks should be consistent with those conducted at market-entry. Others argued this would be too onerous and checks should be more light touch. It was suggested that milestone assessments should scrutinise suppliers' ability to operationally handle any changes (for instance, servicing prepayment customers at 50,000 accounts, or offering ECO

at 150,000 accounts<sup>6</sup>), take into account key systems and processes such as billing, contact methods, complaints and vulnerable consumers, require suppliers to demonstrate that systems are robust enough to deal with the various obligations that they will be subject to, and require that suppliers are able to clearly demonstrate their financial strategy, specifically relating to hedging policy, trading relationships and tariff pricing policy.

Some respondents requested further clarity on the nature and robustness of the checks, including what will be assessed and how, how far in advance Ofgem would allow a supplier to undertake the review and whether a review for multiple milestones could be taken at the same time. It was also questioned what would happen in instances where suppliers fluctuate above and below the customer number thresholds. Respondents also argued that Ofgem should have a clear KPI for conducting the assessments.

A number of respondents felt that milestone assessments were not targeted enough. They felt that assessments should be more risk-based and based on intelligence, so as not to impact financially robust businesses with strong customer service and reasonable growth rates who happen to be approaching the customer number threshold.

## **Dynamic assessments**

There was strong support for dynamic assessments. Respondents suggested a number of factors that might suggest that a supplier is financial difficulty, though they argued that non-financial factors should also trigger assessments in certain cases. Suggestions for dynamic assessment triggers included:

- Repeatedly selling tariffs below the cost of supply
- Material deterioration in customer service
- Rapid growth
- Spike in complaints
- Sharp increases in customer direct debits without reasonable justification
- Failure to pay invoices on time or missing deadlines for industry or regulatory payments
- Outstanding statutory demands

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<sup>6</sup> The current domestic customer number threshold for ECO is 200,000 domestic customers, however this is changing to 150,000 domestic customers from 01 April 2020.

- Credit default
- Indications from industry parties of insufficient collateral being posted to cover future obligations.

Of those respondents who were against the proposals, some had concerns that Ofgem did not have the expertise to assess supplier business models. One respondent raised concerns that Ofgem would not have sufficient resource if several submissions were received in a short space of time, which could create a backlog and result in customers' being unable to switch to those suppliers awaiting assessment.

Another respondent commented that milestone checks are at odds with Ofgem's position that "Ofgem should not be testing business viability" and that it is not Ofgem's role "to forensically analyse suppliers' operations and finances".

Others commented that suppliers already submit regular data to Ofgem and have quarterly meetings with Ofgem in which significant financial changes can be discussed. It was suggested that Ofgem could use the intelligence we already gather to identify high risk suppliers, use existing powers to request information, put remedial measures in place and if necessary use Provisional Orders to restrict growth, without the need for new licence conditions.

**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, that you believe suppliers should assess in conducting checks?

## Ongoing fit and proper requirement

Most respondents were generally supportive of our proposal to introduce an ongoing fit and proper requirement because of its potential to raise overall standards by ensuring proportionate scrutiny of the management of supply businesses. Some stakeholders recognised that similar tests are already part of the new entrant process and it would be appropriate to apply the same standards as an ongoing requirement.

Consumer groups considered it sensible for suppliers to ensure that people in a position of responsibility are fit and proper to undertake their roles. As a minimum, they argued that suppliers should be able to self-certify and ready to evidence compliance if required by

Ofgem. In contrast, one respondent expressed doubts about the reliability of self-certification. They argued that this may not be effective in preventing poor supplier practices.

A small number of stakeholders suggested the scope of the proposal should expand to include requirements:

- Ensuring suppliers are obligated to have certain risk management policies in place
- For relevant senior managers to take full responsibility for understanding and delivering their regulatory obligations.

Not all respondents were convinced that the proposal would be effective in delivering the intended policy outcomes. Some respondents questioned whether the proposed requirement was duplicating existing corporate regulations.

Several stakeholders expressed concerns with the wording of the draft licence condition and suggested that amendments were necessary to ensure it reflects policy intent. Some respondents considered the definition for 'significant managerial responsibility or influence' to be too broad and subjective, which could lead to inconsistent application across the sector. In addition, a few stakeholders questioned whether some of the prescriptive elements contained in the draft licence condition could unintentionally create a recruitment 'blacklist' for senior roles in energy supply businesses.

**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?

## Living wills

Stakeholders were mixed in their views of our living will proposal. Many agreed that responsible suppliers should have a robust exit strategy, and that this would have a beneficial impact on market confidence. There was a strong consensus for a data-focused exit plan that outlines key information useful for a Supplier of Last Resort (SoLR). Others questioned how effective it would be at securing good outcomes and suggested it could be quite administratively burdensome to produce and maintain.

Enforceability of a living will at the point of supplier exit was a key concern for respondents. There were also some concerns that producing a living will would be administratively

challenging, depending on content, and some respondents felt that the proposed 1 to 2 month implementation period was impractical.

Stakeholders made numerous suggestions for the minimum content of living wills, including:

- A clear outline of the supplier's methodology used to maintain accurate data
- Ensuring data is available in a portable and accessible format for an appointed Supplier of Last Resort to access
- Agreements with external service providers such as network companies, billing companies and meter operators
- Plans to ensure continuity of service for PPM customers such as enabling meters to go into a 'safe mode' to guarantee supply
- Information about key contacts both internally and externally such as key staff for each department and shippers
- Details about any open complaints
- Plans to mitigate the excessive mutualisation of debts including obligations under government schemes such as the renewables obligation
- Information about any trading agreements.

Some suppliers felt that requiring all suppliers to hold a living will could be burdensome, and thus suggested that a risk-based approach could be more effective. However, other stakeholders countered this view and believed it should be required for all domestic suppliers. There was strong agreement that an up-to-date living will would be the most useful option; therefore, suggestions were made for a regular update, perhaps annually.

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

## Independent audits

The majority of respondents agreed with our proposal to allow us to compel independent audits. Though almost all stakeholders suggested that this ability should be exercised proportionately and in specific and defined circumstances. Many respondents also recognised the cost burden this proposal might have on smaller suppliers, or poor performing suppliers that are already in financial distress.

Several respondents suggested it would be reasonable for Ofgem to request a supplier to undertake an independent audit in the following instances:

- Where Ofgem has significant concerns about a company's financial resilience and there is reason to believe that the supplier in question is preventing Ofgem from performing its statutory duties
- Where specific technical or financial expertise is required to identify the root cause of a customer service failure.

Some stakeholders expressed concerns that the draft licence condition did not reflect the policy intent as stated in the consultation. Those that commented were also concerned that the wording was too broad and provides us with wide discretion in our use of this licence condition. A small minority were not in favour of this proposal and argued that it duplicates existing regulatory tools, namely SLC 5.

**Question 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?

Stakeholders agreed that improvements should be made to the SoLR process, where possible, to provide greater protection to consumers, especially against the undesirable debt recovery practices of administrators. A small number of stakeholders said that the responsibility for debt collection should be transferred to the SoLR to make the financial reconciliation process more straightforward. A small number of stakeholders suggested improving the quality of the data held by suppliers would have a positive impact on the SoLR process..

## **Customer interactions with administrators**

Some stakeholders argued that Ofgem had no powers or legal rights over the administration process. They suggested that Ofgem should instead look to work with other relevant regulators such as the Financial Conduct Authority and the Insolvency Service. A few stakeholders suggested that administrators currently ignore requirements in the terms & conditions of failed supplier contracts, such as rules around backbilling.

**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?

## **Operational capability and open and cooperative principles**

Stakeholders were broadly supportive of our proposal to introduce principles requiring suppliers to have sufficient operational capability and to be open and cooperative with the regulator. A significant minority of respondents did, however, question whether these would duplicate existing requirements. They also suggested that the proposed licence drafting could be improved on to make it less broad and open to interpretation, and to better link it to the policy intent.

## **Portfolio splitting**

The majority of stakeholders were open to the idea of portfolio splitting, outlining its potential benefits for competition in the SoLR process and thus better consumer outcomes. Most stakeholders were supportive of the proposal as long as “cherry-picking” was avoided and the benefits of the proposal were clearly shown to outweigh the costs.

Many stakeholders who supported the proposal had a preference for limiting the ways in which portfolios could be split. This was largely due to concerns that the proposal could lead to discrimination against vulnerable consumer groups. Some stakeholders believed that splitting should only be allowed in strictly-defined ways and not involve customer profiling. A significant minority of stakeholders supported portfolio splitting solely on the basis of domestic and non-domestic customers.

Some stakeholders were concerned about the costs associated with the code and system changes that could be required to implement the proposal. Similarly, stakeholders outlined that this could add complexity to the SoLR process, making it more prone to errors and inefficiencies, leading to worse consumer outcomes. Others suggested they would welcome an assessment of the costs and benefits involved before offering a view.

## Trade sales

Most respondents were supportive of Ofgem taking forward further actions to better protect consumers affected by trade sales. Several stakeholders felt that Ofgem should not allow transactions that seek to separate assets from liabilities in the lead up to a SoLR process and that partial trade sales involving a supplier in distress are undesirable. Many felt that intervention was necessary to prevent transactions where there is a high likelihood that other suppliers and ultimately their customers will need to bear the costs 'left behind' by the gaining supplier and to produce a more competitive SoLR process.

Suppliers commented that an acquiring supplier should not be permitted to purchase the assets of another supplier under a trade sale if at the time it has outstanding financial obligations. Another suggested that Ofgem currently has to approve the sale of part of a transporter's assets and that a similar power in relation to supplier trade sales could be adopted.

Some respondents were against the proposal. They felt that Ofgem should not get involved in purely commercial decisions and that doing so could set a dangerous precedent. Some respondents noted that restricting trade sales could contradict company directors' fiduciary duties and obligations to run their businesses as per the Companies Act 2006. Others noted that Ofgem's refusal to allow a customer book sale could lead to further supplier failure.



## Consultation respondents

We received 45 non-confidential responses. The stakeholders that provided responses were from across different parts of the energy industry, and include:

Stakeholder	Stakeholder
Association of Meter Operators	Ombudsman Service
BES Utilities	Orbit Energy
Bristol Energy	Orsted
Bulb	PFP Energy
Centrica	R3
Citizens Advice	RGJ Consulting
Compare The Market	Robin Hood Energy
Drax Group plc	RWE Supply & Trading GmbH
Dyce Energy	Scottish Power
E (Gas & Electricity) Ltd	SECAS
E.ON	Shell Energy Retail Limited
Ecotricity	SmartestEnergy
EDF Energy	So Energy
Electricity North West	Social Energy
Energy UK	SSE Energy Services
ENGIE	SSE Group
ESB	Total Gas & Power
Gemserv	Utilita
Green Energy UK	Utility Warehouse
Green Network Energy	Wales & West Utilities
ICoSS Group	Yü Energy
NEA	Zebra Power
Npower	