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Consultation

Statutory Consultation – Supplier Licensing Review: Ongoing requirements and exit arrangements

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In June 2018, we announced our intention to review energy supplier licensing arrangements to ensure appropriate protections are in place against financial instability and poor customer service. The review covers conditions for entering the market, ongoing requirements and exit arrangements. We consulted on changes to the new entry requirements in the initial phase of the review. These new requirements came into effect in July 2019.

We are now focusing on ongoing requirements for active suppliers, and exit arrangements. In October 2019, we proposed remedies to improve supplier standards of financial resilience and customer service. We requested feedback from stakeholders on the package of proposals set out in the policy consultation.

After considering stakeholder feedback, we are now setting out our final policy proposals. This is a consultation on the licence modifications to implement them. The majority of our reforms remain unchanged, however we are planning to consult separately on whether potential additional requirements are appropriate to further strengthen requirements relating to cost mutualisation. We set out the final proposals for this package of reforms in this consultation. We request stakeholder feedback on our proposals by 20 August 2020.

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Executive summary

We are consulting on proposals to strengthen our regulatory regime to drive up standards among energy suppliers and minimise competitors' and consumers' exposure to financial risks and poor customer service. The Supplier Licensing Review is an important step in facilitating a better functioning retail market. In March we temporarily paused this review to enable the industry to focus on the immediate and urgent priorities arising from the COVID-19 crisis. It is now time to restart this critical work.

The number of suppliers in the retail energy market has increased significantly over the last eight years. This has brought benefits to consumers through increased price competition and pressure on incumbent suppliers to improve their customer service offering. As we transition to a net zero economy, customers will need new products and services to help them adapt to smarter consumption of renewable energy, and a trusted, vibrant and innovative retail market is vital for this.

Over the past three years, we have seen an increase in supplier failures. Our current arrangements successfully protect customers' energy supply when their supplier fails and they allow for an efficient switch of those customers to a new supplier. Nevertheless, failure can be disruptive and confusing for consumers, can impose costs on competitors, and is often preceded by inadequate service provision. Many suppliers already have robust business models and manage risks effectively – however, experience has shown that not all suppliers are managed responsibly and we are determined to address this.

These proposals are even more critical in light of the COVID-19 pandemic, which has presented the energy industry with challenges to tackle on behalf of the homes and businesses that depend on the sector. Energy suppliers have been at the core of the industry response to this crisis – taking steps to provide additional support to help customers pay their bills. The impact of COVID-19 on the sector, including demand reductions and consumers finding it more difficult to top up their meters, has tested and will continue to test supplier financial resilience. Now, more than ever, we need to ensure that suppliers, as the critical interface between energy consumers and the industry, are set up in the right way to meet the challenges of today's energy system.

The scope of the review encompasses:

- conditions for suppliers entering the market (implemented in July 2019),
- ongoing requirements on suppliers, and
- arrangements for managing market exit.

Final proposals for ongoing requirements

In October last year, we proposed a package of measures designed to (i) promote more responsible risk management, (ii) improve governance and increase accountability, and (iii) enhance our market oversight. Most respondents welcomed these proposals, and suggested potential improvements to the package to best achieve our three key aims. The majority of stakeholders agreed that the proposed package, would reduce the likelihood of disorderly market exits and ease disruption caused to consumers. A number of stakeholders drew attention to the implementation challenges associated with our cost mutualisation protections. We have listened to stakeholder views, and used these to inform our final proposals.

Our final proposals contain a number of measures that work together as a package to drive up standards across the energy retail sector. The proposals are outlined below:

1. **Promoting more responsible risk management:** we propose a set of measures intended to ensure that suppliers are prepared for growth and to meet their regulatory obligations. We propose to introduce:
   - a new principles-based requirement for suppliers to take action to minimise costs that could be mutualised in future. This is a significant change which will require suppliers to make sure that they are managing their finances effectively and actively managing the risk of leaving costs to be mutualised in the event of their failure. The principle will ensure that Ofgem is able to take action where suppliers are not managing this risk effectively. This will enable us to intervene to address unsustainable behaviour, pricing practices or business models. We are also considering the case for further, more prescriptive requirements around credit balances and environmental obligations. However stakeholders have expressed serious and credible reservations about the impact on future entry and competition. We welcome further views, and would consult separately on any such changes in future.
   - new check points for suppliers, determined by customer numbers and financial and compliance indicators, at which Ofgem would scrutinise suppliers' readiness for growth and ability to meet their regulatory obligations. We may impose additional restrictions on individual suppliers, for example a restriction on them taking on new customers, if we think they are not ready for growth or able to meet their regulatory obligations.
   - a new principles-based requirement to ensure suppliers have sufficient operational capability and adopt overall better risk management practices.

2. **Improved governance and increased accountability:** our proposals aim to increase accountability, and incentivise responsible and appropriate behaviour from those in senior positions. We propose to introduce:
   - a requirement for suppliers to ensure that relevant individuals with significant influence in the business are fit and proper to occupy their role (in line with criteria for being awarded a licence at entry).
   - a new principles-based requirement for suppliers to be open and cooperative with the regulator.

3. **Increased market oversight:** effective oversight of the market by Ofgem is essential to ensure we can identify potential risks to consumers or competition, and enable us to take timely action where appropriate. We propose to introduce requirements on suppliers to:
   - undertake, at Ofgem's request, an independent audit of their financial position and/or customer service systems and processes.
   - maintain "Customer Supply Continuity Plans" (formerly known as Living Wills), so that their customers are protected and wider market impacts are minimised, should they exit the market.
   - report changes in control of the business to us promptly.

Final proposals for exit arrangements

The above proposals are aimed at reducing the likelihood and impact of disorderly supplier market exits. Where suppliers do fail, we propose the following to ensure that consumers experience minimal disruption:

- take steps to ensure administrators are held to some of the same standards as suppliers when they assume responsibility for a failed supplier's debt book.
- require suppliers to notify Ofgem if they are engaging in a customer book sale, and strengthen our ability to ensure such transactions do not cause harm to consumers.

Next steps

We invite stakeholder views on our proposals by 20 August 2020. We aim to engage with stakeholders directly and, after considering stakeholder responses, we expect to progress to decision in the autumn. In parallel, we will continue to progress our thinking in relation to additional prescriptive requirements to minimise the need for cost mutualisation in the event of a supplier's failure. We welcome feedback on this issue, and will consult further with stakeholders before introducing further requirements in this area.

1. Introduction

1.1. The retail energy market has undergone a marked change in the last half decade. The number of energy suppliers in Great Britain has grown significantly, from 27 active domestic suppliers in December 2014 to 64 by June 2019.[1] In the same period, the domestic market share of small and medium-sized suppliers has grown to around 30%.[2]

1.2. We have seen an increase in innovation and the variety of new entrant business models. This has brought benefits to consumers in the form of improved customer service – six of the top ten suppliers on the Citizens Advice customer service comparison tool are small or medium-sized suppliers.[3] The growth of small suppliers has increased price competition, with some of the lowest tariff offers available from small and medium suppliers. Across the same period, we have also seen increased consumer engagement, with annual rolling average switching rates around 20% in June 2019.[4]

1.3. In recent years, we have seen an increase in the number of supplier failures. Eighteen suppliers exited the market via our Supplier of Last Resort process since the start of 2018, and others have failed to meet their financial commitments under government schemes such as the Renewables Obligations and Feed-In Tariffs regime.

1.4. In a competitive market, we would expect some suppliers to fail. However, a supplier that cannot meet its customer service and financial obligations can cause harm to energy consumers. This harm can manifest in different ways, leading to poor customer service or unfair treatment of customers. While our current arrangements ensure there is continuity of supply and that customer credit balances are protected, a supplier failure can be disruptive and confusing for affected customers. Where a supplier fails, some of the sums it owes may need to be recovered from other suppliers – these costs may ultimately be borne by consumers, so supplier failures have consequences for all energy consumers. Other harm could arise from undermining consumer confidence in switching and the market as a whole, and in particular their willingness to switch to newer entrants.

[1] Ofgem, State of the Energy Market – 2019 report, October 2019
[2] *Ibid.*
[3] Citizens Advice, Compare domestic energy suppliers' customer service, Rating for October to December 2019
[4] Ofgem, State of the Energy Market – 2019 report, October 2019

Background to the Supplier Licensing Review

1.5. Our Supplier Licensing Review seeks to mitigate the potential for consumer harm by strengthening our regulatory regime to raise supplier standards of customer service and financial resilience. We aim to do this by introducing stronger, but proportionate, requirements so that both consumers and Ofgem have confidence that suppliers will deliver a level of service that is appropriate for an essential service. This is an important step in facilitating a better functioning retail market.

1.6. To enable the industry to focus on the immediate and urgent priorities arising from the COVID-19 crisis, we temporarily paused our review of licensing requirements. Now is the appropriate time to refocus on this critical work. These proposals are even more critical in light of the COVID-19 pandemic, which has presented the energy industry with serious challenges to tackle on behalf of the homes and businesses that depend on the sector. Energy suppliers have been at the core of the industry response to this crisis – now more than ever we need to ensure that suppliers, as the critical interface between energy consumers and the industry, are set up in the right way to meet the challenges of today's energy system.

1.7. Clearly, those challenges include the decarbonisation of the sector. By promoting better risk management and improved governance and accountability, while reinforcing our market oversight, the proposed changes to the energy industry's regulatory framework will create a better competitive environment in which responsible businesses can bring forward the innovative products and new technologies that will facilitate Great Britain's transition to net zero.

1.8. We announced our intention to review the supplier licensing arrangements in June 2018. The objectives and scope of this review encompass three areas:

- conditions for entering the market,
- ongoing requirements, monitoring and engagement, and
- arrangements for managing supplier failure and exit.

1.9. Following a period of consultation, we introduced reforms to our entry arrangements in July 2019. Since then, we have been developing proposals to reform ongoing requirements

and exit arrangements. We issued a working paper setting out options for change in May 2019[5] and consulted on a set of initial proposals in October 2019.[6]

Development of the package

1.10. There are four overarching themes that have informed our policy development as part of the Supplier Licensing Review. These are that:

- suppliers should adopt effective risk management, be adequately prepared and resourced for growth, and bear an appropriate share of their risk;
- suppliers should maintain the capacity and capability to deliver a quality service to their customers, and foster an open and constructive relationship with Ofgem;
- Ofgem should have proportionate oversight of suppliers, and there should be effective protections for consumers in the event of supplier failure, and
- Ofgem's licensing regime should facilitate effective competition and enable innovation.

1.11. In developing the proposals set out in this consultation we have sought feedback from a broad range of stakeholders. We have used this feedback to prioritise and refine the potential policy options. In their feedback, stakeholders were clear that "prevention is better than cure". As such, they considered that new ongoing requirements would likely deliver significant benefits for consumers and the market, though there have been mixed views on the detail of some proposals.

1.12. Our proposals have been designed in a targeted way to enable us to take action against poor supplier practice, without placing significant extra burden on suppliers that are already operating in a responsible manner. We expect that the reforms, combined with the new entry requirements that came into effect in July 2019, will drive up standards and increase regulatory scrutiny of poor performing suppliers without imposing undue burden on the rest of the market.

1.13. The proposals we put forward are intended to function together as a package. For instance, we consider that proposals to strengthen ongoing requirements are likely to reduce

[5] Ofgem, Update on the way forward for the 'ongoing requirements' and 'exit arrangements' phases of the Supplier Licensing Review, 24 May 2019
[6] Ofgem, Supplier Licensing Review: Ongoing requirements and exit arrangements, 22 October 2019

the need for additional rules around exit arrangements. Each individual proposal should have a positive impact and, taken together as a whole, we consider that the package should effectively protect consumers from the harmful effects associated with disorderly supplier market exits. For those suppliers that are already operating in a well-governed, consumer-focused way, implementing the new requirements may require only limited changes.

Approach to financial responsibility and cost mutualisation protection proposals

1.14. As noted in our February update letter, following careful consideration of the feedback we have had from stakeholders, we intend to introduce a new principles-based financial responsibility requirement as part of this consultation. This would drive suppliers to take action to mitigate the extent of the costs to be mutualised in the event of failure or inability to pay. We are considering whether further prescriptive requirements to protect against the need for cost mutualisation are appropriate. Any such changes would be subject to separate consultation.

Key changes from the October consultation

Cost mutualisation: Following careful consideration of the feedback we had from stakeholders, we propose to introduce a Financial Responsibility Principle to drive suppliers towards responsible behaviours that should minimise the costs that are mutualised in the event of failure. We are also continuing to consider whether this should in future be supplemented with prescriptive requirements to protect against the need for specific costs to be mutualised. Any further changes would be subject to a separate consultation. By taking this approach, we can begin to deliver benefits for consumers now, while allowing appropriate opportunities to explore stakeholder views and the detailed design aspects of any further, targeted reforms where there is particular need.

Milestone assessments: In the October consultation, we proposed to conduct assessments at the following customer number thresholds: 50,000, 150,000, 250,000 and a point to be determined between 500,000 and 800,000 domestic customers. We proposed that suppliers would not be able to pass the threshold of customers until they had successfully passed the milestone assessment. Following consultation feedback, we now propose that there would be milestone assessments at two customer number thresholds: 50,000 and 200,000 domestic customers. Under our final proposal, suppliers

would not be prevented from exceeding the customer number threshold until they have passed the milestone assessment. However, we would be likely to take action if it appears that the supplier is contravening or likely to contravene its obligations, including by taking steps to limit further growth.

Dynamic assessments: In addition to milestone assessments, we said that we may require suppliers to undergo dynamic assessments at points at which we have concerns about their financial position. We have further developed the criteria we would consider in deciding whether to conduct a dynamic assessment. These include financial warning signs such as missed payments, customer service indicators and pricing practices. Dynamic assessments would not be automatically triggered, but we would look at the picture as a whole when deciding whether to conduct them based on intelligence that we receive and what we already know about the supplier's situation.

Customer supply continuity plans (formerly 'Living Wills'): We have re-named the policy to make the purpose and required content of the plans clearer, and we have also provided more information on the required content of the plans. In our final proposals, all suppliers will be required to produce and maintain a plan that is proportionate to the scale of its business. We do not propose to require suppliers to publicly disclose the content of its plan as part of the new licence condition.

Independent audits: We have clarified the circumstances in which we would compel a supplier to commission an independent audit in the licence, and more clearly articulated what we would consider to be 'independent'.

Trade sales: We previously outlined that we were considering that intervention could be necessary in some circumstances if a supplier in financial difficulty was to pursue a trade sale. After reviewing the predominantly supportive feedback from stakeholders, we propose to introduce a licence condition that prevents licensees from engaging in commercial transactions that subvert or distort, or are likely to subvert or distort, the Supplier of Last Resort process.

We have made minor amendments to our proposals in relation to the **ongoing fit and proper requirement, operational capability principle, open and cooperative principle, general monitoring and reporting,** and **administrator proposals.** The draft licence requirements for these policies have also been adjusted.

1.15. Following our October draft impact assessment, we have considered whether an updated impact assessment is required to sit alongside these final proposals. In responding to our policy consultation, most stakeholders focused on the quantitative evidence presented in the draft impact assessment, which was calculated using data to support the introduction of our cost mutualisation proposals. For the proposals included in this statutory consultation, we received generally qualitative stakeholder feedback that focused on detailed aspects of the proposals. Therefore, for the purposes of the final policy proposals outlined below, we do not propose to produce an updated impact assessment.

1.16. We would expect the introduction of the Financial Responsibility Principle would not have a significant cost impact on suppliers or give rise to substantial additional burden. We are not being prescriptive about the exact measures a supplier must put in place to protect against the need for cost mutualisation. A financially-responsible supplier should already be managing these costs effectively, and we would not expect providing evidence of this (in the event that we were to request such evidence) to impose significant additional costs. If we determine that more prescriptive, targeted requirements are required to support this principle, we will provide an update on our intended approach to the impact assessment as part of this policy development.

Links and dependencies

1.17. **New entry requirements**: in our April 2019 policy decision on new entry requirements, we confirmed that we would apply new checks to ensure supply licence applicants are fit and proper to hold a licence, have appropriate resources to support their entry plan, and understand and have plans to fulfil their regulatory obligations. Those changes entered into force in July 2019. Our proposals for ongoing requirements and exit arrangements have been designed to complement the new entry regime.

1.18. **Compliance and enforcement**: as part of our compliance and enforcement activities, we engage with suppliers through account managers, proactive projects that tackle areas of concern and through engagement with respect to particular issues that have come to our attention. In addition to current regular reporting (eg social obligations data, complaints data and the price cap), we have information-gathering powers to require suppliers to provide us with data about various aspects of their business. Through this Supplier Licensing Review, we aim to augment our ability to effectively scrutinise suppliers and take action where they fail to meet the standards expected of providers of an essential service.

1.19. **Consolidated Segmental Statement consultation**: we are consulting on proposals to revise Standard Licence Condition (SLC) 19A of the Gas and Electricity Supply Licences and SLC 16B of the Electricity Generation Licence, 'Financial information reporting', which requires submission of a Consolidated Segmental Statement (CSS). Our proposals include changes to extend the CSS requirements to a greater number of suppliers. We are keen to take a pragmatic approach by drawing, as far as possible, on information that already exists within firms. Our proposals for ongoing and exit arrangements take into account future changes to financial reporting requirements as part of this review.

1.20. **Open letter on network cost deferral:** we published an open letter on 2 June 2020 to outline what support schemes we expect to be available for electricity suppliers and gas shippers to help them with cash flow issues they may experience as a result of the COVID-19 pandemic. The letter detailed proposals from network companies that would allow suppliers and shippers to pay some of their network charges at a later date. Electricity Distribution Network Operators and gas distribution companies have now launched their schemes. Through the Supplier Licensing Review, we expect suppliers to manage their risks and meet their financial obligations, and propose to introduce a Financial Responsibility principle. As stated in our open letter, we expect suppliers to take the aims of the Supplier Licensing Review, and any requirements we introduce, into account in relation to their use of these schemes.

Structure of this document

1.21. This document is structured as follows:

- chapter 2 outlines our proposals to **promote more responsible risk management** among suppliers;
- chapter 3 sets out our proposals to **improve supplier governance and accountability**;
- chapter 4 outlines the steps we intend to take to ensure we have **effective market oversight** and monitoring;
- chapter 5 covers our proposed measures to reduce the disruption associated with **supplier market exits**;
- appendix 1 to this document sets out changes to draft supply licence conditions from the policy consultation to the proposed supply licence conditions in this statutory consultation, as well as new proposed licence conditions;
- appendix 2 to this document outlines whether we are proposing changes to the domestic or non-domestic licence, or both;

- appendix 3 to this document outlines proposed guidance to accompany our milestone assessment proposal;
- appendix 4 provides more detail on your response, data and confidentiality;
- appendix 5 outlines our privacy notice on consultations.

Responses and next steps

1.22. We welcome stakeholder views on the proposed licence drafting set out in the statutory notices published alongside this document, by 20 August 2020. Please send your response to licensing@ofgem.gov.uk

1.23. We expect to make our final decision on the proposed licence modifications before the end of the year. In advance of this, we will engage with stakeholders to address any issues raised in relation to the draft licence conditions.

1.24. We do not anticipate that any implementation period outside of the statutory 56 days would be required to implement the proposals outlined in this consultation. This would enable all of the new requirements to be in place early next year.

2. Promoting better risk management

Section summary

The consequences of a supplier's poor risk management are ultimately felt by consumers. We propose to put in place measures to reduce the need to mutualise costs in the event of supplier failure, require suppliers to ensure they are set up to effectively discharge their obligations, and introduce new checks at key milestones and trigger points.

2.1. One of the principles of our Supplier Licensing Review is that suppliers should adopt effective risk management approaches, be adequately prepared and resourced for growth, and bear an appropriate share of their risk. We expect suppliers to maintain the capacity and capability to deliver a quality service for their customers.

2.2. In this chapter, we outline what we aim to achieve, the views of respondents to our initial consultation and our final proposals to promote better risk management among suppliers. These proposals are:

- **cost mutualisation protections:** a new principles-based requirement for suppliers to take actions that mitigate the extent of costs to be mutualised in the event of their failure.
- **operational capacity and capability:** a new principles-based requirement for suppliers to have sufficient operational capability to effectively serve their customers and adopt appropriate risk management practices.
- **milestone assessments:** new checkpoints, determined by customer numbers and financial and compliance indicators, at which we would scrutinise suppliers and impose conditions should they not demonstrate they meet certain standards.

What we aim to achieve

2.3. Poor risk management by suppliers can manifest in a number of different ways. We want to combat this and ensure that suppliers;

- are prepared to meet financial and regulatory obligations, growing in a managed way,
- have appropriate systems and processes essential to providing a quality service to customers,

- do not have unsustainable practices in the way in which they manage customer credit balances, for example holding an excessive level of customer credit balances or being overly reliant on customer credit balances to keep the business solvent,
- are able to appropriately identify and mitigate any risks to compliance or potential detriment to consumers, and
- improve the quality of their data management and operational capability which can cause consumer harm and contribute to customer disruption during a supplier failure.

2.4. These factors can cause harm to consumers in the form of poor customer service and greater likelihood of failure, which can be disruptive and mean that certain costs may need to be recovered from consumers. We want to ensure that suppliers take adequate steps to effectively mitigate the risk of harm to consumers, and reduce the likelihood and impact of a disorderly market exit.

Cost mutualisation protections

Policy consultation proposal

2.5. In our policy consultation, we proposed to require suppliers to put in place protections to minimise the costs that would otherwise be mutualised across other parties in the event of their failure. We proposed to require suppliers to protect 50% of customer credit balances and 50% of government scheme costs, using mechanisms selected from a 'menu' of options. We proposed to allow 3-6 months for suppliers to implement these proposals.

Stakeholder views

2.6. 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 divergence of views about the best way to achieve our policy intent and stakeholders raised a number of complex issues. This included:

- **scope of protections:** there were varying views on how far our protections should go. Some stakeholders argued 50% was excessively high and they raised concerns over the costs and the liquidity impacts of the proposal. Others argued it did not go far enough to minimise the impact of mutualisation and, therefore, would not result in all suppliers bearing an appropriate share of the risk. There was also a divergence of views regarding who the protections should apply to – all suppliers or just those

serving domestic customers, or whether the protections should only apply to 'risky' suppliers – and which government schemes should be included.

- **impact of our protections:** it was noted that our proposals would affect the use of credit balances as working capital. However, stakeholders disagreed over the appropriateness of this practice in the first instance. There were concerns that our proposals may incentivise a move away from fixed direct debits by penalising suppliers during the summer months when they owed money to customers, but not recognise that they may effectively be lending money to customers during the winter period. Respondents felt that this would be a step backwards with respect to customer service, given the value some customers place on the ability to smooth their energy payments. Respondents also raised concerns around the interaction between the proposed protections and other collateral requirements in the market.
- **definition of credit balances:** many stakeholders sought clarity on how 'credit balances' would be defined. Many non-domestic stakeholders argued against applying these protections to non-domestic customer credit balances, arguing that cost mutualisation was largely a problem in the domestic sector.
- **implementation:** most respondents agreed that 3-6 months was too ambitious for implementation, many suggested a minimum of 12 months was needed, and some suggested a staged implementation (increasing the scope of requirements over time). Stakeholders also had some practical concerns with regard to implementing our proposals, these primarily related to the availability and cost of suitable financial instruments. It was also noted that monitoring compliance with the obligation could be challenging.

2.7. Stakeholders suggested a variety of alternatives – the most common were to introduce an industry-wide insurance scheme or for Ofgem to carry out greater monitoring of a variety of financial metrics. Some stakeholders called for us to use our existing powers to introduce principles, while we develop more detailed longer-term proposals.

2.8. Finally, stakeholders suggested we re-assess the costs and benefits of our proposals. In particular, a majority of respondents were concerned that our indicative 0.5% fee for third party guarantee protections underestimated the cost of implementing our proposals. Several stakeholders also felt that several potential benefits of the proposals to minimise cost mutualisation had not been fully accounted for in our cost-benefit analysis.

Our views

2.9. We agree with stakeholders that reforms are needed to minimise the costs that are mutualised across the rest of the industry when a supplier fails. We also recognise some of the concerns raised by stakeholders in relation to the detailed design of the proposed protections.

2.10. In February, we published an update letter[7] setting out our intention to take a phased approach to introducing our cost mutualisation protection proposals. This will allow us to deliver benefits for consumers as quickly as possible, while allowing appropriate opportunities to explore stakeholder views and consider further the detailed design of any more prescriptive proposals.

2.11. As such, through this consultation, we are proposing to introduce a principles-based requirement - the Financial Responsibility Principle[8] - to drive suppliers towards responsible behaviours that minimise the extent of costs to be mutualised in the event of failure. We will separately consider the case for more prescriptive cost mutualisation protections in addition to the introduction of this new principle. We will consult further with the industry before progressing any further changes.

The 'Financial Responsibility Principle'

2.12. In principle, we want to ensure the costs of the supplier's business are borne by the business itself, rather than being subsidised, on its failure, by its competitors. Features of the retail energy market mean that some supplier costs risk being mutualised upon its failure if it is not managed responsibly while the supplier is trading. Customer credit balances, network charges and environmental and social scheme obligations are examples of this.

2.13. In line with the overarching themes of the Supplier Licensing Review, we want suppliers to bear an appropriate share of their risk, including by adopting responsible financial

[7] Ofgem, Update on timing and next steps on the Supplier Licensing Review, February 2020
[8] The Financial Responsibility Principle drafting is set out in Appendix 1.

management approaches to minimise the risk that costs[9] need to be mutualised in the event of their failure.

2.14. Our view is that the Financial Responsibility Principle would act as an over-arching obligation – supporting one of the key aims of the Supplier Licensing Review by ensuring suppliers act in a more financially responsible manner and begin to take steps to bear an appropriate share of their risk.

Application of the principle

2.15. The recent impacts of COVID-19 have affected the finances of all suppliers – increases in the rates of non-payment and direct debit cancellation, for instance, have affected both domestic and non-domestic suppliers. This has highlighted there are financial risks in both market segments.

2.16. We therefore consider it is appropriate that the Financial Responsibility Principle applies to all suppliers, as we consider that all suppliers should bear an appropriate share of their risk, and there is a risk of cost mutualisation if any were to fail. As we do not intend to be prescriptive in how suppliers embed the new principle, it should place little or no additional burden on either domestic or non-domestic suppliers that are already acting in a financially responsible manner.

2.17. Our monitoring approach will be proportionate to the risk of mutualisation. For example, credit balances for non-domestic customers cannot be recovered through Last Resort Supply Payments.[10] We would expect a financially responsible supplier to ensure it is managing its credit balance costs sensibly, irrespective of whether they may be mutualised. For the purposes of this condition, however, our monitoring of credit balances may be proportionately lower for non-domestic suppliers.

2.18. We have recently published an open letter[11] regarding the support we expect to be available from network companies for energy suppliers and shippers who are facing cash flow

[9] The principle will apply to costs that could be mutualised in the event of the licensees insolvency, such costs as related to government schemes and costs eligible for recovery via the Last Resort Supplier Payment (LRSP).
[10] These may be claimed using SLC 9 of the electricity and gas supply licences.
[11] Ofgem, Managing the impact of COVID-19 on the energy market – introducing the option of relaxing network charge payment terms for suppliers and shippers, 2 June 2020

challenges as a result of COVID-19. As we set out in that letter, we expect that suppliers (and shippers) would access the network charge deferral scheme as a last resort. We were also clear that we expect suppliers to take into account the aims of the Supplier Licensing Review in relation to their use of these schemes. In assessing supplier compliance with the Financial Responsibility Principle we will take into account any financial actions taken by suppliers accessing these schemes, such as paying dividends, in conjunction with their progress repaying any deferred network charges by the relevant deadline.

Meeting the principle

2.19. Our new principle provides suppliers with flexibility in how they demonstrate that they will minimise potential cost mutualisation in the event of their failure. Given the diverse range of business models and corporate structures in the market, suppliers are likely to have different approaches to meeting their obligations under the principle. Nevertheless, we would expect suppliers to have in place arrangements to demonstrate they can meet their financial obligations and, for example, to not be overly reliant on customer credit balances for their working capital or to ensure they remain solvent.

2.20. We would not expect the introduction of the principle to be a significant additional burden for suppliers, and do not think an implementation period is necessary. We would expect suppliers to be able to demonstrate they are meeting their obligations under the principle immediately once it comes into effect. We expect suppliers to provide verifiable plans and supporting evidence, for example cash flows projections, budgets, guarantees or proof of investments, as appropriate.

2.21. We may publish guidance for regarding meeting the principle and would consult on this first. As a minimum we would expect that suppliers would be able to provide evidence that they have:

- plans in place to meet their financial obligations under government schemes by respective dates.[12]
- effective processes, that are consistent with existing licence requirements, for setting direct debit levels and for checking and returning credit balances.

[12] The Financial Responsibility Principle will cover both late payments under schemes and also supplier insolvency events. In the case of the RO we recognise and will take into consideration that suppliers have a late payment window before they are in beach.

- sustainable pricing approaches that allow them to cover their costs over time, or if they are pricing below cost this risk sits with investors and not consumers. We will need to see evidence that suppliers can finance their overall business plans.
- robust financial governance and decision-making frameworks in place.

2.22. In accordance with our proposed open and co-operative principle,[13] we would expect a financially responsible supplier to seek early engagement with us to communicate, and reassure us of, significant changes to its financial position or its approach to financial management. We would also use the milestone and dynamic assessments[14] to identify any issues with suppliers not acting in accordance with the principle.

2.23. For domestic suppliers, criteria proposed as part of the milestone assessments may form part of our evidence base for assessing whether a supplier is acting in a financially responsible manner. As phases of significant customer number growth can be particularly risky times, it is vital that a supplier is acting in a financially responsible way, which would minimise the costs to be mutualised if they were to fail.

2.24. Our approach to dynamic assessments[15] would also review how both domestic and non-domestic suppliers have reflected the Financial Responsibility Principle in their financial management and decision-making. In general, we would aim to undertake these assessments at an early stage of any supplier financial difficulties. If appropriate, we may consider whether it is proportionate to take remedial action, which would seek to minimise the costs that need to be mutualised if the supplier were to fail.

2.25. The new Financial Responsibility Principle complements existing licence obligations.[16] For example, our expectations regarding suppliers' use of customer credit under the new principle would be considered alongside existing obligations on suppliers to review fixed direct debits so that they are set at the right level, and to ensure they are able, where reasonable, to refund credit balances on request.[17]

[13] Our policy proposals on the Open and Co-operative principle in chapter 3.
[14] Our policy proposals relating to milestone assessments later in this chapter.
[15] Our approach to Dynamic Assessments are outlined later on in this chapter.
[16] For example SLC 0 - "The Standards of Conduct", SLC 31F/31I – "Informed tariff and consumption choices", SLC 27.15 – "Setting Direct Debits", and SLC 27.16 – "Refunding customer credit balances on request".
[17] Under Standard Licence Obligations 27.15 and 27.16.

2.26. To ensure all suppliers have robust arrangements in place, we may undertake an initial risk assessment of suppliers' plans. It is likely that this would focus on suppliers and practices that appear to pose the greatest risks of a disorderly exit, where the costs to be mutualised may be higher. To this end, we will be particularly interested in those suppliers making use of network charge deferral schemes. In order to minimise duplication, we would expect any information gathering we do to align, wherever possible, with the ongoing requests for supplier financial information and with the Consolidated Segmental Statements (CSS)[18] that we are consulting on separately.

2.27. If we have concerns regarding some of the approaches taken by suppliers, we may seek further engagement to agree a suitable reporting arrangement. For example, we could require a supplier to report against specific financial ratios. If the supplier missed the agreed financial ratio level, this could automatically trigger a dynamic assessment. This approach should strike a balance between not overly burdening suppliers and ensuring we identify risks at an early stage. We may seek to agree with the supplier the introduction of additional financial actions or arrangements to ensure they better manage the risks of cost mutualisation.

2.28. Where we have concerns about a supplier'ssupplier'ssuppliers compliance with this principle, we may decide to undertake a dynamic assessment (discussed further below), request an independent audit, or move immediately to consider whether enforcement action is appropriate. Enforcement action could, for example, restrict suppliers from taking on more customers or preventing a supplier from altering its existing payment collection patternspatternspatters to take advance payments from customers.

Final proposal

We intend to introduce a new principles-based requirement for all suppliers in the domestic and non-domestic sectors to take actions that minimise the likelihood and extent of costs to be mutualised in the event of their failure. As a minimum, to comply with the Financial Responsibility principle, we would expect suppliers, where appropriate, to have:

[18] We are currently consulting on changes to the CCS:Ofgem, Reviewing the Consolidated Segmental Statements - Our initial proposals, 21 May 2020

- plans in place to meet their financial obligations under government schemes or other mechanisms by the respective deadlines,
- effective processes for setting direct debit levels, and proactively returning credit balances in a timely manner,
- sustainable pricing approaches that allow them to cover their costs over time or evidence the business plan is financially responsible,
- robust financial governance and decision-making frameworks in place, and
- arrangements in place or are taking steps that would reduce the need for costs to be mutualised in the event of their failure.

Operational capability principle

Policy consultation proposal

2.29. In our October 2019 consultation, we proposed to introduce a new principles-based requirement for suppliers to ensure they have, and can demonstrate that they have, the capability, systems and processes in place to enable them to effectively serve their customers and comply with their regulatory obligations – an "operational capability principle". We also proposed to require suppliers to identify, assess and manage any risks to the above. We proposed that this principle would apply to all suppliers. This would ensure that suppliers have the appropriate systems and processes to provide a quality service to their customers, meet their regulatory obligations and bear an appropriate share of their risk.

2.30. This proposal builds on the new entry requirements that we introduced last year. When applying for a supply licence, applicants must provide information to demonstrate, among other matters, how they will be sufficiently resourced to serve the number and nature of customers that they intend to serve.

Stakeholder views

2.31. About half of stakeholders provided feedback on the operational capability principle, with mixed views. Some agreed that suppliers should have appropriate capability, systems and processes in place to serve their customers and that the reforms would encourage

responsible risk management. In our workshop[19], many attendees suggested that most suppliers already had sufficient operational capability to meet the needs of their customers. Some respondents sought more clarity on how this would go beyond what suppliers already do. One stakeholder noted that similar conditions exist in the electricity distribution licence and that it may be helpful to mirror some of the wording.[20]

2.32. Some respondents questioned whether this principle would duplicate existing requirements, though most did not specify where they felt conditions overlapped. One stakeholder noted that supplier systems and processes are subject to audits by industry code bodies and that there are existing customer service obligations, such as the Standards of Conduct.[21] Another stakeholder suggested we should clarify the gaps this new principle would seek to fill.

2.33. Some respondents expressed concern that the proposed licence drafting was too broad and subjective. One respondent questioned how we would meaningfully scrutinise compliance across diverse business models, and whether the requirement would apply specifically in instances of supplier failure or more generally. A few respondents requested greater clarity on the checks that we would put in place to assess compliance with this requirement, and when we might conduct those checks.

Our views

2.34. We agree with stakeholders that suppliers should have robust capabilities, systems and processes in place to serve their customers and to enable them to meet their regulatory obligations. Responsible suppliers should continuously assess and mitigate risks to their ability to serve their customers effectively – regardless of their business model. We do not expect suppliers to maintain an ongoing risk assessment for each individual customer, but we expect suppliers to evaluate risks of consumer harm that may arise as a result of their actions or inaction. We want to raise standards among poor-performing suppliers, proactively reduce

[19] Ofgem, Supplier Licensing Review workshop summary notes and slides – 26 November 2019, February 2020

[20] Electricity Distribution Standard Licence Condition 30 requires to have resources, including management and financial resources, personnel, fixed and moveable assets, rights, licences, consents, and facilities to properly and efficiently carry out its distribution business and meet regulatory obligations. All licence conditions are available on our website.

[21] The domestic and non-domestic Standards of Conduct set out in the electricity and gas standard licence condition 0 are enforceable broad principles that require suppliers to treat domestic and microbusiness consumers fairly in the way they behave, provide information and deliver customer service.

the likelihood of consumer detriment and reduce the level of disruption in the event of supplier failure.

2.35. Certain existing obligations focus on the outcomes suppliers should achieve. These rules enable us to take action where there is a risk of consumer harm. The new principle would build on the existing rules by making explicit our expectation that suppliers proactively identify current or future risks of consumer harm, consider whether their systems and processes would effectively mitigate these risks, and to adapt them where this isn't the case. In doing so, we aim to strengthen our ability pre-empt and prevent consumer harm, and to address the root causes of poor supplier performance in a timely manner.

2.36. As a principles-based rule, we expect the new requirement to provide comprehensive protections – filling any gaps that might otherwise exist with prescriptive rules. Prescriptive rules can specify the outputs and outcomes we expect to see in certain circumstances. Principles-based rules can provide broader protections, ensuring suppliers deliver positive outcomes for their customers without specifying how. This can be particularly appropriate where suppliers may take different approaches to delivering those outcomes. As such, we expect the operational capability principle to complement existing requirements, including checks carried out by code bodies and other new requirements such as milestone assessments and the ongoing fit and proper requirement.

2.37. We would expect to take a risk-based approach in our monitoring of this requirement. Similar to our entry requirements, we do not intend to approve operational processes nor make judgements on different business models. We anticipate that many suppliers are already operating in line with this principle. For these suppliers, we would not expect significant changes would be required in how they currently operate. We would, however, expect poor-performing suppliers to raise their standards. We may take action where we see suppliers engaging in poor risk management practices and not exercising due diligence. There could be a number of indicators of this, including showing a lack of preparedness for growth through milestone or dynamic assessments or evidence of poor data management in Customer Supply Continuity Plans.

2.38. Suppliers could demonstrate compliance by, for example, showing they have appropriate data management systems and processes in place to manage the type and number of customers they have. We expect there to be processes in place to ensure effective oversight and efficient identification of risks to consumer harm that may arise, and to mitigate these. For example, if a supplier were to change the billing system they use – customers may be over-billed or under-billed, or their bills may not be sent or otherwise be

unclear or inaccurate.[22] We would expect a supplier to identify those risks and to be able to articulate the steps they would take to reduce their likelihood and impact.

Final proposal

We propose to introduce a new principle requiring suppliers to have sufficient operational capability to be able to effectively serve their customers.

Expectations of suppliers

We expect suppliers to have internal systems processes and governance in place to serve all their customers efficiently and effectively and meet their regulatory obligations. Suppliers should be proactive in identifying and mitigating risks of consumer harm, in doing so pre-empting and preventing it from arising, and acting quickly to put things right when it does.

Milestone assessments and dynamic assessments

Policy consultation proposals

2.39. In our policy consultation, we proposed new requirements for domestic suppliers to undergo milestone assessments conducted by Ofgem at certain customer number thresholds. This was intended to ensure that suppliers are adequately prepared and resourced for growth. We said that the assessments would likely be similar in nature to those that we carry out before granting licences to an energy supplier under our new entry requirements. For instance, we would consider whether suppliers can demonstrate that they have adequate IT systems and how that IT is integrated with the business and growth strategy. The customer number thresholds we proposed were 50,000, 150,000, 250,000 and at a point to be

[22] We have summarised the key lessons learned as part of past supplier system change projects in: Ofgem, Lessons Learned From enforcement and compliance activities - software implementation projects, February 2018

determined between 500,000 and 800,000. Under these proposals, suppliers would be unable to pass the customer thresholds until they had successfully passed the milestone assessment.

2.40. We also proposed additional 'dynamic' assessments where a supplier indicates signs of financial difficulty. We proposed placing limits on these suppliers' ability to alter their existing payment collection patterns.

Stakeholder views

2.41. Most respondents were generally supportive of milestone assessments and the proposed thresholds. Some highlighted that it should be clear that the assessments are not just focussed on meeting obligations, but wider preparedness for growth. Others felt that milestone assessments were not targeted enough and that assessments should be more risk-based. Several respondents commented that assessments should not be burdensome.

2.42. There was strong support for dynamic assessments. A number of respondents suggested factors that might indicate a supplier is in financial difficulty. Several respondents also argued that non-financial factors should trigger assessments. They suggested we should consider conducting assessments earlier, when suppliers display other signs that give cause for concern about their financial sustainability or ability to serve their customers. Some stakeholders argued that Ofgem could use the intelligence we already gather to identify high-risk suppliers. They suggested that Ofgem should use existing powers to gather information and require suppliers to take remedial action without the need for new licence conditions.

2.43. **Milestone customer thresholds**: Stakeholders were generally supportive of the proposed milestone assessment customer thresholds, particularly the lower thresholds. Some were also supportive of the higher thresholds to ensure that suppliers are prepared to serve a large customer base. A few stakeholders favoured a higher final threshold than was proposed, stating that the number of vulnerable customers in a larger portfolio is likely to be more significant, and some larger suppliers were low down in the Citizens Advice supplier ratings. Others did not believe higher thresholds were required due to there being no specific, existing licence obligations that begin to apply when a supplier reaches a threshold above 250,000 customers and no suppliers with 500,000 domestic customers or more (the highest customer threshold proposed) have had a disorderly market exit.

2.44. **Assessment criteria**: Stakeholders suggested a number of different assessment criteria. This included requiring suppliers to clearly demonstrate their financial strategy relating to hedging policy, trading policy and tariff pricing policy, how they plan the

integration of technical and operating models as the business grows and how they are prepared to comply with regulatory obligations. Other suggestions included an assessment of suppliers' operational processes and capability, sustainability of growth plans and approach to vulnerability. Some stakeholders were concerned that Ofgem did not have the expertise to assess suppliers' operations, commercial strategy and finances, and had concerns about the implications of Ofgem determining what good looks like in terms of how a supplier runs its business.

2.45. **Actions we could take**: Those who were supportive of the proposals were generally supportive of the action that we propose taking should a supplier not be able to pass a milestone assessment. This included limiting customer numbers by not allowing a supplier to exceed the relevant threshold and limiting a supplier's ability to alter its existing payment methods to collect advance payments from customers. Some had concerns about the implementation of the policy, for example:

- the impact on consumers of being turned away from a supplier,
- whether there would be any tolerance level in exceeding the threshold as some suppliers may receive a large number of customers unexpectedly,
- what happens where a supplier fluctuates above and below a threshold, and
- whether there would be any exemptions to the assessment process.

Our views – Milestone assessments

2.46. Periods of significant customer growth can be a particularly risky time for suppliers. We see milestone assessments as an important tool to ensure that suppliers are adequately resourced and prepared for growth at appropriate points in time after their market entry. This will give us more scrutiny over suppliers and help to mitigate the risk of consumer harm before it happens. We agree there is merit in having a risk-based approach to assessments targeted at suppliers where we have concerns about their financial sustainability or ability to serve their customers and address this in our proposals for dynamic assessments.

2.47. **Milestone customer thresholds**: We agree that larger suppliers should not be exempt from assessments due to their size, but disagree that there is a need for a higher milestone customer threshold. We have reached this view by taking into account the fact that fewer additional regulatory obligations apply to suppliers above 250,000 customers, and they would instead be subject to dynamic assessments if we have concerns about their financial sustainability or ability to serve their customers. These suppliers could also be subject to an independent audit (circumstances in which an independent audit may be required are discussed in chapter 4).

2.48. **Assessment criteria**: Our view is that milestone assessments should be similar to the assessment criteria when suppliers enter the market, focusing on a supplier's preparedness to meet its obligations and its wider preparedness for growth in relation to its customer service function and financial strategy. This is in line with the majority of stakeholders' views.

2.49. We agree that milestone assessments should focus on operational performance, for example with regard to customer service, billing, switching, debt management practices and vulnerability. It should also look at a supplier's growth plans, and the impact of growth on core operational processes, functions and IT systems. Assessments would also look at a supplier's growth plans in relation to its pricing strategy, tariffs and products as well as projected volume of energy and purchasing strategy to understand how the supplier intends to grow its business and manage the associated risks.

2.50. The assessment should look at how a supplier budgets and plans for energy-specific charges and collateral requirements, how it budgets for costs resulting from obligations under the government's renewable energy, energy efficiency and social schemes and how it is planning for changing costs associated with business scaling. In addition, we believe that milestone assessments should look at how a supplier is meeting or is planning to meet obligations that begin at certain customer thresholds.

2.51. We acknowledge the views of those stakeholders who had concerns about Ofgem's expertise in assessing suppliers' operations, commercial strategy and finances or determining what good looks like in terms of how a supplier runs its business. We would not assess suppliers' business plans for viability or profitability, nor undertake a quantitative assessment or any financial modelling. Instead, the assessment criteria would be risk-based and, where we have concerns or need more information, we may request clarification or request an independent audit where appropriate.

2.52. **Actions we could take**: Stakeholders were generally in favour of the proposed consequences should a supplier not satisfactorily meet the milestone assessment criteria, including limiting further growth. Some respondents thought this could be done using existing powers, without the need for new licence conditions. We consider a new licence condition is required for suppliers to notify Ofgem before the point they reach a relevant customer threshold. This approach would allow more flexibility for Ofgem to determine whether an assessment is necessary and should also allay some stakeholders' concerns about the implementation of the policy, as outlined above.

2.53. Rather than being a 'pass/fail' assessment that triggers certain consequences for failure, we can take enforcement action where it appears that the supplier is contravening, or is likely to contravene, both existing obligations and new obligations introduced as part of the Supplier Licensing Review package, including the "Operational Capability principle" and "Financial Responsibility principle".

2.54. Where we have concerns about a supplier following an assessment, we may consider taking enforcement action, where appropriate – this action could, for example, result in restrictions on a supplier's ability to take on new customers or prevent it from altering its existing payment collection patterns to take advance payments from customers. This approach would reduce the burden on suppliers and minimise any unnecessary disruption for consumers – as suppliers would not automatically have to turn potential customers away as a result of not having 'passed' the assessment.

2.55. **Licence condition and flexibility of assessments**: To implement our proposed policy, we would introduce a new licence condition requiring suppliers to notify Ofgem shortly before they anticipate reaching the customer number thresholds, and at the point of reaching these thresholds. Suppliers would not have to pay a fee to undergo the assessment, however they would incur any costs associated with compliance, including an independent audit if necessary. The new requirement would allow flexibility in terms of the timing and scope[23] of assessments. Any delays in assessments are unlikely to have an adverse impact on a supplier, although we will generally aim to conduct an assessment early so that we can step in to protect consumers quickly if necessary.

Rationale

2.56. **Threshold of 50,000 domestic customers**: We consider 50,000 domestic customers to be an appropriate point for the first milestone assessment. In our draft impact assessment, we noted that, since July 2016, the 11 compliance and enforcement cases (against 9 suppliers) that Ofgem opened in relation to domestic customer service issues were all against

[23] A supplier will have to undergo milestone assessment if requested by Ofgem under Condition 5 of the Electricity and Gas Supply Licence Conditions which enables broad information gathering for the purpose of performing our statutory duties

suppliers who had passed the 50,000 customer threshold. It is also the first customer number threshold at which certain other obligations begin to apply.

2.57. Since 2016, on average, a supplier took just under two and a half years (28 months) to reach 50,000 domestic gas customers and just over three years (37 months) to reach 50,000 domestic electricity customers. The shortest time a supplier took to reach 50,000 domestic customers was 13 months for gas and 16 months for electricity.[24] As suppliers are required to provide details of their proposed plans for their first two years' operation at entry, we consider a milestone assessment at 50,000 domestic customers, which is likely to take place between two and four years in the market, is an appropriate checkpoint.

2.58. **Threshold of 200,000 domestic customers**: We propose a second milestone assessment at 200,000 customers. In our policy consultation we proposed thresholds of both 150,000 and 250,000, largely because we considered that there would be benefit in aligning the assessments with thresholds at which new regulatory obligations begin to apply. We consider that it may be more efficient to have a single checkpoint at 200,000 domestic customers. This would reduce the burden on both suppliers and Ofgem, but would still allow us to check suppliers' preparedness to meet regulatory obligations at 250,000 domestic customers, with the benefit of being able to look at how a supplier is meeting its obligations that began to apply when they reached 150,000 customers.

2.59. We recognise that milestone assessments are about overall preparedness for growth, not just preparedness to meet regulatory obligations. Regulatory thresholds can change, and although we want to test preparedness to meet obligations, these can still be checked as part of the assessments without tying the thresholds to specific regulatory obligations. We are also mindful that suppliers could grow from 150,000 to 250,000 in a relatively short space of time, meaning that it may be more practical and efficient to have one assessment.

[24] Includes suppliers who passed 50K domestic gas/electricity customers between January 2016 and October 2019 and is based on meter points rather than number of customer accounts.

Final proposal

Milestone thresholds

We propose to introduce milestone assessments at 50,000 and 200,000 domestic customers, for each individual fuel. These thresholds apply in terms of the number of unique customer accounts, rather than meter points.

Process

Suppliers would be required to notify Ofgem when they approach, and when they reach, these thresholds for each fuel, but we may only conduct one assessment at each threshold if both fuels pass the same threshold within a short space of time.

Ofgem would then issue a milestone assessment Request for Information (RFI) requesting that the supplier return the information within a reasonable period of time. Ofgem would have the flexibility to decide whether it is appropriate to conduct a milestone assessment, or amend the milestone assessment, based on the information we already have on the supplier.

Assessment criteria

A typical milestone assessment would look at:

- Operational performance with regards to customer service, billing, switching, debt management practices and vulnerability.
- Scaling of customer service function against projected growth and how suppliers assure themselves that IT systems, billing systems and Customer Relationship Management (CRM) is fit for purpose and integrated into growth strategy.
- Oversight and controls over outsourced functions.
- Growth plans in relation to pricing strategy, tariffs and products, projected volume of energy and purchasing strategy.
- How the supplier budgets for energy-specific charges and collateral requirements.
- How the supplier budgets for costs resulting from obligations under the government's renewable energy, energy efficiency and social schemes and plans for changing costs associated with business scaling.

- How the supplier is meeting (or is planning to meet) regulatory obligations that begin at certain thresholds.

Actions we could take following a milestone assessment

Ofgem could look to take enforcement action which may include imposing requirements upon the supplier for the purpose of securing compliance with other regulatory obligations. Consequences may include, but not be limited to, not allowing the supplier to acquire any new Domestic Customers, or add any Domestic Customer accounts by upgrading such accounts to dual fuel accounts, or not allowing the supplier to alter its existing payment collection patterns to collect advance payments from customers.

Our views – Dynamic assessments

2.60. **Assessment criteria**: We agree with stakeholders who said that we should consider conducting dynamic assessments not just when suppliers display signs of financial difficulty, but also at earlier stages when suppliers display other signs that give cause for concern about their financial sustainability or ability to serve their customers.

2.61. We agree that there would be merit in conducting assessments when a supplier is repeatedly offering cheap tariffs and displays poor customer service, as well as other indicators of financial difficulty, such as missed network or balancing payments. Several past supplier failures have involved suppliers who offered unsustainably cheap tariffs to the market and, as a result, grew rapidly and were not adequately prepared or resourced to serve their customers, resulting in poor customer service and eventual failure.[25] Gathering information at these key risk points and taking remedial action could help prevent unmanaged growth and potentially harmful actions by suppliers.

2.62. We also agree with stakeholders who said that we should use the intelligence we already gather to identify high-risk suppliers, use existing powers to request information, if

[25] In March 2018 Ofgem banned Iresa from taking on new customers, increasing existing customers' direct debits, and asking them for one-off-payments, for up to 3 months until it resolved its customer service issues. Iresa ceased to trade in July 2018. In January 2019, Ofgem banned Economy Energy from taking on new customers. Economy Energy ceased to trade in the same month.

required, and put remedial action in place without the need for new licence conditions. This is how we propose to conduct dynamic assessments.

2.63. We think that dynamic assessments should be flexible. We considered having criteria that would automatically trigger a dynamic assessment. However, we understand that each supplier's situation is different, so we may already have the information we need or we may be aware of a supplier's situation and already be engaging with them. Instead, we consider that it would be less burdensome on suppliers and more proportionate to use our existing intelligence to identify, for example: suppliers who are showing signs of potential financial difficulty; are repeatedly offering cheap and potentially unsustainable tariffs to the market; or have poor or deteriorating levels of customer service. We can then consider what information we have and whether a dynamic assessment is required.

2.64. Some stakeholders thought that our proposals should be more targeted and risk-based. We consider that reducing the number of milestone assessment thresholds and widening the criteria we use to consider whether to conduct a dynamic assessment represents a more risk-based and targeted approach. It is less burdensome for suppliers who have not given us cause for concern, is more flexible, and may be more effective in preventing unmanaged growth and consumer harm.

2.65. The assessment criteria for dynamic assessments would be similar to milestone assessments as both would seek to understand how a supplier is adequately prepared and resourced for further growth and how they are able to provide the level of customer service their customers would expect. However, dynamic assessments may be more tailored based on the reason for our concern. The approach could also be more flexible – for example it could involve an initial informal contact to understand the situation, before progressing to a more formal 'dynamic assessment' information request if needed. We may then request an independent audit if further detailed information is required.

2.66. **Actions we could take**: Following a dynamic assessment, we would use our existing compliance and enforcement tools in the same way as following a milestone assessment. These could be applied if it appears that the supplier is contravening or is likely to contravene its obligations, whether these are existing obligations or new obligations introduced as part of the Supplier Licensing Review.

2.67. More intense regulatory scrutiny in the form of milestone and dynamic assessments should incentivise suppliers to comply with their obligations, ensure that they are able to effectively serve their customers and that they are adequately prepared and resourced for

growth. Suppliers who are able to demonstrate this through these assessments are likely to avoid being required to undergo an independent audit.

Final proposal

We propose to undertake dynamic assessments in response to specific concerns about a supplier's financial sustainability or ability to serve their customers.

When we may conduct a dynamic assessment

We will look at a range of criteria when determining whether to conduct a dynamic assessment, including financial warning signs, customer service indicators and pricing practices.

Financial warning signs will include indicators such as missed industry or regulatory payments, credit default and statutory demands, winding up petitions or other debt enforcement action being taken against the company. We would also take into account customer service indicators, such as customer service failings and spikes in complaints, as well as pricing practices such as sharp increases in direct debits or consistently pricing at the bottom of the market.

Each of these indicators alone may not trigger a dynamic assessment – we would take into account the indicators collectively before deciding whether further scrutiny is warranted. As with any regulatory tool, we would use it proportionately where it is needed in order, to best protect consumers.

Assessment criteria

Assessments would be similar to milestone assessments to ensure that a supplier is adequately prepared and resourced for growth and to meet its obligations, but may be more tailored based on the cause of our concern. This may begin with an informal contact with the supplier to understand the situation and may lead to issuing a formal information request, if further detailed information is required. Ofgem could then request that the supplier completes an independent audit if we deem this necessary.

Dynamic assessments will not require the implementation of any additional licence conditions.

Actions we would take

Ofgem could look to take enforcement action which may include imposing requirements upon the supplier for the purpose of securing compliance. Consequences may include, but not be limited to, limiting a supplier's ability to acquire any new customers or preventing a supplier from altering its existing customer payment collection patterns.

3. More responsible governance and increased accountability

Section summary

We propose to introduce two new requirements to mitigate the risk of poor supplier behaviour causing detriment to consumers and the energy market. They are an ongoing 'fit and proper' requirement and a principle to be open and cooperative with the regulator. The proposals aim to promote more responsible governance and increased accountability among supplier senior managers.

3.1. In chapter 2, we outlined the steps we want to take to ensure suppliers manage their risks appropriately. It is equally important that they have good governance structures in place, and strong accountability among management and key decision makers. They should also be prepared to maintain a constructive relationship with Ofgem as the regulator.

3.2. In this chapter, we outline the proposals we consider will best promote more responsible governance and accountability among suppliers. We propose new licence requirements for suppliers to;

- assess whether individuals with significant managerial responsibility or influence in their business are **fit and proper**,[26] and
- be **open and cooperative** with the regulator.

What we aim to achieve

3.3. If suppliers do not have good governance arrangements and strong senior management accountability, they are more likely to make poor decisions. This is likely to lead to a negative experience for their customers, as suppliers are unable to maintain appropriate customer service standards. It may also contribute to supplier failure and cause greater disruption if they do fail. This could be because more costs need to be mutualised across the

[26] Significant managerial responsibility or influence means where a person plays a role in—
(a) the making of decisions about how the whole or a substantial part of a licensee'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.

rest of the industry, or because it is more difficult for a new supplier to on-board the customers.

3.4. Our new entry requirements for suppliers include an assessment of whether the applicant is 'fit and proper' to be granted a licence. Applicants are required to disclose, among other things, if key people involved in the company have been connected to any past supplier failures, recent Ofgem compliance or enforcement action, or previous business insolvencies. We take this information into account in reaching our decision to grant or refuse an application.[27]

3.5. The licensing process involves a point-in-time assessment of the applicant. However, the licensee's management can change over time. We want to build on the new entry requirements to ensure that those with significant managerial responsibility or influence in energy companies are held to an appropriate standard on an ongoing basis.

3.6. We also want to ensure that suppliers are open and cooperative with Ofgem. We expect suppliers to maintain a constructive relationship with us, including where a supplier enters financial difficulties. An open relationship between supplier and regulator can help to minimise the disruption experienced by consumers, including as part of the Supplier of Last Resort (SoLR) process.

Ongoing fit and proper requirement

Policy consultation proposal

3.7. In our October 2019 consultation, we proposed to introduce an ongoing fit and proper licence requirement, whereby suppliers would be required to have systems and processes in place to ensure individuals in positions with significant managerial responsibility or influence are fit and proper for their role. We proposed that suppliers should not employ people in those positions who do not meet a fit and proper test. We also proposed that suppliers should conduct this assessment of relevant individuals periodically, and must provide evidence of compliance if requested by Ofgem. This is to ensure suppliers take a more responsible

[27] Ofgem, Decision on new Applications Regulations and guidance document, June 2019

approach to governance and accountability to reduce the likelihood of mismanaging a company and causing consumer or market detriment.

Stakeholders Views

3.8. Most respondents were generally supportive of our proposal to introduce an ongoing fit and proper licence requirement. They considered it should help to raise supplier standards by ensuring proportionate scrutiny of the management of energy companies. Two respondents did not think Ofgem had the legal vires to establish this licence condition or to enforce it. One respondent did not agree that an ongoing fit and proper requirement could minimise the impacts and costs associated with disorderly supplier exit. Other key points raised by respondents are set out below.

3.9. **Scope of requirement**: Some respondents thought the definition for those individuals with 'Significant Managerial Responsibility or Influence' was too broad and subjective and therefore at risk of being applied inconsistently. Some stakeholders wanted more clarity about who would be considered relevant for the purposes of this requirement.

3.10. A few respondents suggested that Ofgem should expand the scope of the requirement. These included ensuring suppliers are obliged to put in place certain risk management policies and for relevant individuals to take full responsibility for understanding and delivering their regulatory obligations. One respondent felt that we should ensure the scope of the requirement includes company owners and board members.

3.11. **Who carries out the checks**: Two respondents argued that suppliers, as a minimum, should be able to self-certify and be ready to evidence compliance if required by Ofgem. In contrast, one respondent expressed doubts about the reliability of self-certification and its effectiveness in preventing poor supplier practices.

3.12. **Interaction with existing regulations**: Some stakeholders raised concerns that the proposed requirement and associated checks duplicate existing requirements, such as checks

required for Companies House and the HMRC fit and proper test under the 2017 Money Laundering Regulations.[28]

3.13. **Implementation and monitoring**: During our November 2019 workshop, many stakeholders confirmed they already conduct many of the checks outlined in our policy consultation.[29] They wanted more clarity on how much additional reporting may be required and what actions Ofgem would take where a relevant individual did not meet the assessment criteria. Other respondents were unclear on how they would ensure their processes are robust enough to meet Ofgem's requirements. A few others felt Ofgem should provide more detailed guidance to ensure a consistent application of the proposed requirement. Some stakeholders suggested that a fit and proper requirement would not be difficult to implement – they felt that across industry, people who would not meet the fit and proper test are well known.

3.14. A small minority said it was unreasonable and unworkable to apply this requirement retrospectively. A few respondents were concerned that the new requirement may unduly restrict employment opportunities and could result in a loss of industry knowledge and expertise. One respondent said this might lead to undue risk-aversion, as individuals would be reluctant to attempt to rescue a troubled supplier for fear of negatively impacting their future ability to operate in the energy industry. Another respondent suggested that an ongoing fit and proper requirement could unintentionally create a recruitment 'blacklist' for senior roles in energy companies.

Our views

3.15. Ofgem's principal objective is to protect the interests of existing and future energy consumers. We consider requiring suppliers to ensure their decision makers are suitable for their role, together with the other proposals in the Supplier Licensing Review, supports this objective. As providers of an essential service, supplier senior managers have a responsibility to ensure their actions or inactions do not cause consumer harm or market detriment.

3.16. We consider this requirement to be an important tool to mitigate the risk that those individuals who have engaged in unacceptable past conduct, continue to occupy key roles at suppliers and cause harm to consumers. We expect this proposal would increase supplier

[28] Money Laundering, Terrorist Financing and Transfer of Funds (Information on Payer) Regulations 2017 as amended by the Money Laundering and Terrorist Finance (Amendment) Regulations 2019
[29] Ofgem, Supplier Licensing Review workshop summary notes and slides, November 2019

accountability for the appointment of individuals at senior levels; ensuring senior staff take responsibility for how they manage their companies.

3.17. We expect that many suppliers are already acting in line with our proposed new requirement. For those that are not, the new rule would ensure they put appropriate measures in place and enable us to take action where they do not.

3.18. **Scope of requirement**: As part of our entry requirements, prospective licensees must demonstrate that they are fit and proper to hold a licence.[30] However, there are no equivalent ongoing requirements for those operating in the market. We consider suppliers should be taking the necessary steps to maintain good governance practices within their organisation, and as part of this applying a fit and proper test to relevant people on an ongoing basis.

3.19. We propose to use similar definitions for this requirement as for the new entry requirements to provide consistency and clarity for suppliers.[31] We recognise that there are varying governance structures and arrangements across the sector, and therefore have not specified a list of roles captured by the definition of 'significant managerial responsibility or influence'. It is important to ensure the fit and proper requirements apply to those individuals that are in a position to make or significantly influence key decisions made by the supplier. This may be the case where an individual is not a company director, but nevertheless has significant influence in how the business operates.

3.20. This aspect of the new requirement would be consistent with the rules applied in other sectors. To inform our policy development we reviewed regulations in a number of other sectors that are comparable to our proposal. [32] In most cases, the regulation requires the company or licence holder to ensure that directors or other people with decision-making powers are fit and proper for their role.

3.21. **Who carries out the checks**: While it is Ofgem's role to assess licence applications and consider the suitability of applicants to be granted licences, direct oversight of all individuals holding relevant positions at energy suppliers on an ongoing basis would likely be

[30] While we make an assessment at the point of market entry on applicants' suitability to be granted a supply licence, this does not infer any endorsement of the individuals concerned or assurance regarding their future conduct.
[31] Ofgem, Decision on new Applications Regulations and guidance document, June 2019
[32] For example, the Care Quality Commission and the FCA have regulation comparable to our proposed ongoing fit and proper requirement.

disproportionate. Suppliers are best-placed to identify which individuals are making or influencing key decisions about their activities. Suppliers should ensure they consider who carries out the assessment and the governance arrangements they put around it, to mitigate any potential for conflicts of interest.

3.22. **Interactions with existing regulations**: Existing regulations may provide partial protection against the potential for unsuitable individuals to hold senior positions at energy suppliers. This includes legislation such as the Companies Act 2006.[33] However, this and other requirements are not specific to the energy market, may not cover individuals that are not directors but who nevertheless have significant influence, and may not reflect the particular harm that can be caused to consumers as a result of energy supplier misbehaviour or failure. Moreover, in some cases, suppliers operating in the GB energy market may not be UK companies. As such, we consider there is benefit in having a direct, explicit licence requirement setting out our expectations of suppliers.

3.23. **Implementation and monitoring**: We expect suppliers to base their assessments on information that is reasonably available to them at the time of the assessment. We expect that, for most or all of the checks specified in the requirement, information should be available to allow suppliers to make an effective assessment. As many suppliers confirmed they have similar processes in place already, we do not consider this approach overly burdensome.

3.24. We expect suppliers to take into consideration an individual's role in past supplier failures. Although an important factor to consider, involvement in a supplier failure would not automatically mean the individual is not fit and proper for their role. The nature of the failure – whether disorderly, harmful for consumers, or resulting in significant mutualisation of costs, for example – as well as the individual's role in contributing to, or helping to mitigate, any consumer harm are important criteria for a supplier to consider. As such, we do not consider the new requirement would have the unintended consequence of discouraging individuals from seeking to rescue failing suppliers.

3.25. It is for suppliers to determine the mitigating actions they take to minimise the risk that individuals with significant influence cause or contribute to customer harm. For instance,

[33] The Companies Act 2006 ('Act'), sections 171 to 177, sets out directors' duties, and is available on the legislation.gov.uk website.

where the information available to suppliers is limited, they may wish to consider seeking signed declarations or other assurances from relevant individuals. They may also wish to consider putting controls in place to clarify or limit the scope of relevant individuals' influence or decision-making ability.

3.26. We do not intend to prescribe the frequency with which suppliers carry out checks on relevant individuals' suitability. We expect suppliers to carry out checks on a regular basis, though it is up to them how they choose to reflect this within their employment cycle – some checks may most appropriately be carried out throughout the year, whereas others may be required less frequently. We propose to take a risk-based approach to assessing compliance with this licence obligation, taking into account general supplier performance in relation to customer services or financial stability.

Final proposal

We propose to introduce an ongoing fit and proper licence requirement. Suppliers would be required to have robust systems, processes and governance in place to ensure relevant individuals are fit and proper. We propose that where suppliers have determined relevant individuals do not meet this criteria, they must not appoint them to senior positions without appropriate mitigations in place.

Scope of requirement

Suppliers would be responsible for determining which individuals fall within the scope of the licence condition. This would include, but not necessarily be limited to, individuals who:

- influence or make decisions in relation to a supplier's finances, eg finance reallocation, plans to make industry or regulatory payments, or
- influence or make key decisions on how the company operates.

Who carries out the checks

It would be the supplier's responsibility to undertake these assessments on an ongoing basis to ensure that relevant individuals continue to be fit and proper to occupy that role. Ofgem would assess the systems, processes and governance a supplier has in place.

Assessment criteria

In assessing compliance with the requirement we may look at supplier recruitment, performance and disciplinary processes, governance arrangements and frameworks a supplier has in place to mitigate any risks of poor behaviour by an individual.

Principle to be open and cooperative with the regulator

Policy consultation proposal

3.27. In our October 2019 consultation, we proposed a new principles-based requirement for suppliers to be open and cooperative with Ofgem. The purpose of this requirement was to encourage suppliers to engage in a constructive dialogue with Ofgem on an ongoing basis. It also aimed to incentivise proactive and early engagement where a supplier is experiencing compliance issues, financial difficulty, or where its action or inaction may cause consumer detriment.

3.28. We anticipated that this requirement would encourage a behavioural shift among poor performing suppliers by ensuring issues did not go unreported for an extended period of time. Our view was that this should support a swift resolution to issues, and help to minimise disruption for consumers where suppliers are in financial difficulty.

Stakeholder views

3.29. Stakeholders who responded to our consultation were broadly supportive of us introducing this requirement. A small minority of respondents said they were not convinced that the proposal would be effective in delivering intended policy outcomes. Some felt that it might duplicate existing requirements, for example, Standard Supply Licence Condition 5 (SLC 5).[34]

3.30. Some respondents expressed concern that the proposed licence drafting was too broad, too open to interpretation and that it was unclear what we expected suppliers to do to

[34] SLC 5 outlines our information gathering powers. All licence conditions are available on our website.

ensure compliance. One respondent felt that the principle should be limited to matters that were necessary for the regulator to perform its statutory functions. Another respondent suggested that this obligation should only come into effect where a supplier was experiencing financial difficulty or where they were at material risk of non-compliance and there was actual or potential risk of detriment to consumers, or the market.

3.31. A few asked for greater clarity on the scope of the requirement. For example, they requested clarity on whether not responding to a voluntary request for information would constitute non-compliance, and how the principle would work where a supplier was planning to formally challenge a decision that Ofgem had taken. Some respondents highlighted concerns that this principle would infringe on a person's privilege against self-incrimination.[35]

Our views

3.32. We have consistently made clear that we expect suppliers to work with us to highlight and address any potential consumer detriment as early as possible. We consider there to be benefits in making an explicit principles-based requirement for suppliers to be open and cooperative with Ofgem. We think that this requirement will contribute to delivering one of the key Supplier Licensing Review principles by encouraging suppliers to foster an open and constructive relationship with us.

3.33. Our preference is to work with suppliers to reduce the likelihood of detriment to consumers, and promptly resolve issues when they do occur. However, in some cases suppliers are uncooperative and not transparent with us. This can lead to delays identifying and resolving issues, increasing the risk of consumer detriment or market disruption. In extreme cases, uncooperative behaviour can frustrate our ability to perform our statutory duties and risk causing harm to consumers.

3.34. We encourage suppliers to start a dialogue with us as soon as possible about circumstances that might negatively affect consumers. This is particularly important when things go wrong. Addressing issues early can help to decrease the risk of consumer harm.

[35] Privilege against self-incrimination exempts a person from being compelled to produce documents or provide information which might incriminate and/or expose them to a penalty them in any potential or current criminal proceedings in England and Wales. It is based on common law privilege (*Versailles Trade Finance Ltd (in administrative receivership) v Clough [2001] EWCA Civ 1509*) and *section 14(1)* of the *Civil Evidence Act 1968*

Doing so can also minimise the need for us to take further steps such as requiring suppliers to conduct independent audits (discussed in chapter 4).

3.35. We have considered concerns raised by stakeholders that this requirement would infringe on their right not to incriminate themselves. We consider the legal position is clear in this case that requiring disclosure of information for regulatory purposes does not infringe individuals' rights in this regard.

3.36. **Scope**: We expect suppliers to determine when it is appropriate to keep us informed of relevant developments and changing circumstances. These circumstances include, but are not limited to, where suppliers are making big changes to their customer service arrangements, such as changing billing software or moving call centres in-house, and changes that could affect their financial resilience or ability to continue to supply their customers.

3.37. To inform our policy development we reviewed arrangements in a number of other sectors with similar requirements to our open and cooperative principle. In most cases, the arrangements require the licensee to interact with the regulator in an open and cooperative way.[36]

3.38. We expect suppliers to work with us to reduce the potential for consumer harm and to resolve issues when they do occur. However, for the avoidance of doubt, this requirement would not restrict suppliers' ability to express concerns about, or challenge, any policy development, decision, or other activity that Ofgem is undertaking. We see this as engaging with us constructively on policy development issues. Similarly, where suppliers wish to take formal routes to disagree with a decision, this new requirement would not prevent them from doing so.

3.39. **Compliance**: We have considered factors we might take into account in determining whether a supplier is being open and cooperative with Ofgem. These include:

- a willingness to cooperate and engage constructively with us, both in compliance and other relevant conversations and exchanges,
- ensuring that information provided to us is timely, candid and accurate and

[36] The FCA and PSR have regulations comparable to our proposed principle.

- proactively discussing with us relevant issues or events where there is potential risk of (or has been) detriment to consumers.

Final proposal

Having considered the views expressed by stakeholders, we continue to consider that there are benefits to introducing a new principle-based requirement for suppliers to be open and cooperative with us.

While the scope of the principle remains broad, suppliers should ensure that they exercise sound judgement in determining the developments or changes about which we might expect to be informed.

We expect suppliers to come to us early in cases where there is the potential for negative impacts on consumers. We also expect suppliers to work with us to reduce the potential for consumer detriment, and resolve issues when incidents occur that threaten such harm.

4. Increased market oversight

Section summary

As part of our increased market oversight plans, we propose to require all suppliers to produce a Customer Supply Continuity Plan and undertake independent audits in some circumstances. Suppliers will also have to notify us of any changes of control of the company. These proposals will allow us to mitigate the impacts of supplier failure on the market and for consumers.

4.1 To regulate effectively, it is crucial that Ofgem has appropriate oversight of the market to alert us to potential risks to consumers or competition, facilitate timely compliance action and enable preparation to manage supplier insolvency, if necessary. Our final proposals include the ability for us to request independent audits, ensure suppliers have a sound continuity plan in place, and require effective and proportionate reporting.

4.2 In a competitive market, we would expect some suppliers to fail. Having increased oversight of the market will enable us to protect customers of a failed supplier and minimise wider market impacts. We need to access accurate information to identify risks to consumer harm, and to take appropriate action quickly when the need arises.

4.3 In this chapter, we outline our specific proposals to increase our market oversight. We propose to introduce new rules that would:

- require suppliers to produce a **Customer Supply Continuity Plan** setting out clear terms of their orderly market exit,
- allow Ofgem to require suppliers to undertake **Independent Audits** in certain circumstances, and
- require suppliers to notify Ofgem when there are changes of control of the company and ensure proportionate **reporting requirements** are in place.

What we aim to achieve

4.4 We want to improve our ability to oversee the market and our ability to act where needed, in order to mitigate the consumer harm and wider market impacts that can arise in cases of supplier financial difficulties and failure. This is in line with our review principles, according to which suppliers should adopt effective risk management and foster an open and constructive dialogue with us, so that we can maintain a proportionate oversight of suppliers.

4.5 Under current rules, there are certain standards that suppliers must meet in regards to their own financial and operational monitoring and oversight. However, in our recent experience of supplier failures, we have encountered poor standards with respect to data quality – including limited access to data sets, inaccurate customer data in billing systems, and inadequate financial record keeping. In some cases, suppliers lacked clear processes and structures in place to protect customers in the event of their failure. There is a risk that this causes difficulties in the Supplier of Last Resort (SoLR) process where information such as customer account balances may be inaccurate and unreliable – this can disrupt the appointed SoLR's ability to effectively on-board customers, for example.

4.6 At our November 2019 workshop, as well as in responses to the October consultation and Impact Assessment, stakeholders expressed support for suppliers keeping accurate and up-to-date data and information available, so they are better prepared for the possibility of a market exit. Stakeholders also agreed it would be reasonable for Ofgem to request independent audits in certain circumstances, particularly where there are concerns about a supplier's financial resilience, or in circumstances where technical expertise is required to identify the root cause of a customer service failure.

4.7 We have carefully considered all of this feedback and set out our final proposals which relate to market oversight, below.

Customer Supply Continuity Plans (formerly 'Living Wills')

4.8 Our October 2019 policy consultation described our proposal to require each supplier to maintain a Living Will. This would set out each supplier's plans to ensure an orderly exit from the market in the event of its possible failure. We have decided to rename the Living Will as a Customer Supply Continuity Plan, to make the purpose and required content of the document clearer, and address any confusion around what was meant by a Living Will. In brief, a Customer Supply Continuity Plan should encompass the following information, which we also explain in further detail later in this section:

- supplier information,
- key contacts,
- customer account information,
- access to accurate data, and
- plans that in the event of supplier failure will enable another supplier to quickly and easily obtain the data they need to on-board the customers.

4.9 We believe this will help to ensure consumers face minimal disruption in the event of a SoLR process, and further incentivise all suppliers to adopt and maintain robust, effective processes in their ongoing operations.

Policy consultation proposals

4.10 In our October 2019 policy consultation, we listed possible content for the Customer Supply Continuity Plan that would enable a supplier to make a more orderly market exit:

- an assessment of any barriers the supplier may face to an orderly market exit,
- plans to mitigate the risk of excessive mutualisation of debts (including obligations under government environmental schemes such as the Renewables Obligation[37]),
- arrangements that would ensure continuity of services by key service providers,
- sensible plans for the sale of assets (such as those tradable under the Energy Company Obligation[38] scheme for licensed suppliers),
- plans for engaging with Ofgem and industry central bodies during the wind down process, and
- a methodology for the efficient handover of information to the relevant party.

4.11 We considered whether it would be appropriate to require all suppliers to produce a Customer Supply Continuity Plan, or whether it should only apply to suppliers above a certain size. In our October 2019 consultation, we proposed that all suppliers would be subject to this requirement, and we sought views on whether or not suppliers should also be required to make some of this information public.

Stakeholder views

4.12 Stakeholders had mixed views regarding this proposal. There was a strong consensus that responsible suppliers should have a robust exit strategy, particularly where the exit may

[37] The Renewables Obligation (RO) places an obligation on licensed electricity suppliers in the UK to source a proportion of their supply to customers from eligible renewable sources. Suppliers can meet their annual obligation by presenting ROCs, making a significant payment into a buy-out fund or a combination of the two.
[38] The Energy Company Obligation (ECO) is a government energy efficiency scheme in Great Britain to help reduce carbon emissions and tackle fuel poverty.

be as part of the SoLR process, and that this would have a beneficial impact on market confidence.

4.13 There were some concerns over the enforceability of a 'Living Will' (as it was referred to at the time), and of Ofgem's ability to take meaningful action once a supplier reaches a position where it becomes likely to fail. Many stakeholders also felt the 1-2 month implementation period was impractical.

4.14 Stakeholders made numerous suggestions for the minimum content of a Living Will which are detailed in our February 2020 Summary of Responses publication[39]. These included a clear outline of the supplier's methodology to maintain accurate data, information about key internal and external contacts, and plans for ensuring continuity of service for customers.

4.15 Some stakeholders felt that requiring all suppliers to hold a Living Will could be burdensome, and 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 keeping the document up-to-date plan would be essential.

Our view

4.16 We share stakeholders' view that responsible suppliers should have a clear and well-prepared strategy for an orderly market exit. We have seen examples where poor data quality can cause disruption in the event of a supplier failure. Incomplete or incorrect data can have direct, negative consequences for consumers and can lead to the appointed supplier having difficulty contacting consumers, establishing and returning credit balances and issuing first bills. Having sound continuity plans in place would ensure that suppliers' data and handover processes have been thought through and incentivise good practice in ongoing operations, such that the right information is readily available when needed.

4.17 We propose to require all suppliers to produce and maintain a Customer Supply Continuity Plan, to ensure the information provided in its plan is accurate and prepared with due skill and care, and to keep its plan updated at all times. Introducing this requirement is

[39] Ofgem, Summary of responses to the Supplier Licensing Review: Ongoing requirements and exit arrangements consulation, 03 February 2020

likely to help support suppliers exiting the market to do so in an orderly way, and in doing so improve the experience of supplier failure from a customer's perspective. In combination with our new Financial Responsbility principle, this should lead to outcomes where suppliers will be better prepared for market exit. It should also reduce the burden on the incoming supplier following a SoLR event. We do not propose to require suppliers to make information from its Customer Supply Continuity Plan publicly available.

Final proposal

We propose to introduce a requirement for suppliers to have and maintain a Customer Supply Continuity Plan. We expect the content of this plan to include, but not be limited to, the information and plans set out below. We expect each supplier's plan to be proportionate to its scale. The plan should reflect the size and complexity of the supplier's business with appropriate governance and oversight from its senior management. We propose to give suppliers one additional calendar month from the statutory implementation date to meet this new requirement.

Contents

- **Supplier information:** Details of arrangements with third-party service providers to ensure continuity of services, billing system information, Priority Services Register customer list, customer numbers, and customer payment method information. This could potentially reduce disruption to customers during the onboarding process in the event of a SoLR process.
- **Key contacts:** Details of key staff: Directors, Heads of Teams, Senior Officers. Details of key contacts at service providers. This information would ensure individuals are aware of their responsibilities even in the event of supplier failure.
- **Customer account information:** Details of the processes that would be followed to prepare a summary of customer debt information and customer account balances. In the event of a SoLR process, it is crucial a potential SoLR is aware of critical customer account information.
- **Data:** Details of how to access data sets, and where data sets are held. Details of how the supplier proposes to keep its data sets up to date. Details of methodologies

for handing over information and customer data. This is fundamental information for a potential SoLR and would allow for a smoother transition for customers.

- **SoLR-related:** Plans for engaging with Ofgem, and central industry bodies. Customer communications plans. Assessment of any other barriers to an orderly exit. This interacts with our open and cooperative principle as we expect suppliers to have a strong and transparent relationship with us.

Reporting requirements

We have considered whether or not a supplier should be required to publicly disclose some or all of its Customer Supply Continuity Plan, but do not propose to include this requirement as part of the new licence condition. Instead, a supplier will be required to submit its Customer Supply Continuity Plan when requested by Ofgem, including as part of the new Milestone Assessments and Dynamic Assessments.

Independent audits

Policy consultation proposals

4.18 In our October 2019 consultation, we proposed to introduce a new requirement for suppliers to undertake an independent audit, if instructed to do so by the Authority. The audit would be conducted by an external auditor and could cover financial accounts, customer service systems and processes, or both.

4.19 We set out our intention to take a proportionate approach when determining whether to request an independent audit from suppliers under this new requirement, and to limit it to situations where we had significant concerns about a supplier's financial solvency or customer service arrangements. Further to this, we outlined that we would expect only to use this power in circumstances where we had been unable to ascertain a supplier's financial status or identify the root causes of customer service issues through regular supplier engagement.

Stakeholder's views

4.20 Stakeholders views on this proposal were focused on three broad themes:

- Scope of independent audits,
- interaction with existing regulatory tools, and

- costs.

4.21 **Scope of independent audits**: Stakeholders generally agreed with our proposed scope for independent audits. Several stakeholders requested more clarity on when Ofgem would request a supplier to undertake an independent audit and what we mean by 'independent'. Many respondents agreed with our intention to take a proportionate approach to using the requirement and for the licence drafting to more clearly define the circumstances in which it would be used.

4.22 **Interaction with existing regulatory tools**: Some respondents were of the view that our existing powers already provide the ability to request suppliers to undertake independent audits and that introducing a specific requirement duplicates existing regulatory tools. Of those, a minority referenced using information gathering powers, such as SLC 5, whereas others did not expand beyond noting that we have requested independent audits in the past. One respondent highlighted that suppliers are required to conduct annual financial audits by the Companies Act.

4.23 **Cost**: Many respondents highlighted the cost burden this proposal might have on smaller suppliers, or poor performing suppliers that were already in financial difficulty. One respondent suggested that a request for an independent audit could have the unintended consequence of accelerating supplier failure.

Our views

Scope – when will we use independent audits?

4.24 As we set out in our policy consultation, we agree that it is important to take a proportionate approach when determining whether to request an independent audit from suppliers under this new requirement. Our view remains that we would use the requirement for matters relating to customer service systems or processes, or matters relating to financial solvency. Further to this, we would expect to use this requirement where other measures and approaches – which could include, for example information requested as part of a milestone or dynamic assessment – have not facilitated the successful identification or the root cause, or the extent, of the issue.

4.25 We currently gather several sources of intelligence relating to financial management and customer service through our ongoing retail market monitoring – this includes information collected directly from suppliers under specific licence conditions, reported to us

by other licensees and industry bodies, and gathered from monitoring social media.[40] This information gives us insight into supplier performance and can highlight early warning signs of customer service failure. Further to this, we expect suppliers to tell us about issues that arise, why they have happened, and how they are addressing them. Where our monitoring raises concerns, we enter into more detailed engagement with suppliers to determine what, if any, additional action and information is needed.

4.26 However, we have seen instances where a supplier is either not forthcoming with relevant information or is unable to identify the root causes of customer service issues. In these circumstances, we consider that an independent audit will produce better insight into the source of customer service issues and enable us to intervene more effectively, and therefore minimise consumer harm. This may reduce the overall length of time and resource a supplier spends on trying to identify or rectify failings.

4.27 Where we have concerns that a supplier is starting to experience financial difficulty, it can be critical to identify the extent of this early, to help us mitigate or manage serious consumer and market detriment. However, we have similarly seen situations where a supplier is unaware, does not have the right expertise, or is not forthcoming with us when we are seeking to understand its financial status. In these circumstances, the ability to request an independent audit will be an important tool to establishing a robust view on supplier solvency.

4.28 We would determine whether to use an independent audit on a case-by-case basis. In addition to the factors outlined above, key considerations that could lead us to require an independent audit could include, but are not limited to:

- the urgency of information required for us to carry out our statutory duties,
- the scale of detriment or potential detriment to consumers or the market, and
- the impact of the detriment on different consumer groups, including any vulnerable consumers.

4.29 Following the audit, we will determine the appropriate next steps based on the results. We will use the regulatory tools available to us to respond appropriately when we receive the audit results. This could include continued engagement, compliance or enforcement action.

[40] Further information on how we monitor and promote supplier compliance is available on our website: Ofgem, Retail Compliance

Scope – what makes an audit 'independent'?

4.30 An external party should conduct the independent audit. This could include a party with which the supplier has a pre-existing relationship, provided there were no conflicts of interest. For example, while the frameworks and codes of conduct through which auditors operate generally ensure they remain impartial and consistent, if the auditor helped design the policies or procedures being audited, or if it was involved in the day-to-day running of the supplier, then it may not be appropriate for them to carry out the audit.

4.31 The auditors should have the necessary skills, knowledge and experience to conduct the audit. This includes, where appropriate, meeting the relevant professional standards. We do not propose Ofgem approves the auditor – it is the licensee's responsibility to ensure the auditor meets the standards required, does not have any conflicts of interest in order to ensure compliance with the requirement, and can effectively cover the areas required by the Authority.

Interaction with existing regulatory tools

4.32 We acknowledge that there are interactions with existing powers. The proposed independent audit licence condition does not intend to duplicate these powers, but rather provide us with the tools required in instances where our existing approaches have not successfully enabled a supplier to identify of root causes of customer services issues or clearly yielded sufficient insight in to a supplier's financial status.

4.33 The Companies Act 2006 requires some suppliers to report on their financial affairs and that some may be subject to annual financial audits. However, this assessment is a snapshot assessment at a point in time for different purposes to those that may apply in the case of customer service failings or financial difficulties. An independent audit would enable us to obtain an up-to-date assessment of a supplier's financial status and customer service practices. We consider that, in some circumstances, it is a necessary tool to enable us to remain adequately informed and to determine appropriate next steps.

Cost

4.34 We recognise that where we require a supplier to undertake an independent audit, this will impose a cost on the supplier. We consider expected costs should not be unduly burdensome, and would expect the supplier to ensure it can minimise its costs whilst ensuring it adequately meets the audit requirement. The cost of conducting an independent audit is

likely to vary depending on a number of factors, including for example the breadth and depth of issues covered in the audit, the size of the supplier, and the complexity of the processes. Further to this, as noted above, we will adopt a proportionate approach to using these powers.

4.35 We consider that any cost associated with carrying out an independent audit will be offset by the benefits that having an audit brings to consumers. For example, through helping a supplier to identify the root cause of any customer service issues, or through ensuring that we have the necessary information on a supplier's financial situation to enable us to take any necessary action to protect consumers.

Final proposal

We propose to introduce a new requirement to enable us to compel suppliers to undertake an independent audit of their financial status and/or customer service systems and processes. This should be conducted by an external party, with the appropriate skills, knowledge and expertise, and where appropriate, meet the required industry standards.

We have reflected in the licence drafting that we may request an independent audit in circumstances where a supplier:

- has not sufficiently demonstrated its financial status and we identify a risk of consumer harm,
- has not been able to or has not been constructively engaged in identifying root causes of systemic or prolonged customer service failings, associated with systems and/or processes, and
- if a supplier is subject to a milestone assessment or dynamic assessments and cannot provide Ofgem adequate information.

In determining when to seek an independent audit we will evaluate each situation on its merit.

We expect independent audit outcomes to provide suppliers an opportunity to improve their processes, procedures, systems and controls they have in place, or in the case of financial insolvency, to help establish necessary information needed to facilitate an orderly market exit, where necessary.

Monitoring and reporting requirements

Policy consultation proposals

4.36 In our October 2019 consultation, we proposed that we take a risk-based approach to monitoring and compliance activities for the new rules introduced as part of the Supplier Licensing Review. We also proposed a requirement that suppliers should report to us where there have been changes in control of the business.

Stakeholder views

4.37 Stakeholders were generally supportive of the intentions of our wider package of proposals. We received very few specific comments on the new proposal regarding changes of control. One supplier mentioned that Ofgem could use the change of control proposal to help facilitate intervention during trade sales.

Our views

4.38 We have decided to rename the 'change of control' requirement to 'additional reporting requirement', which reflects that the primary purpose of the requirement is to gather information for our general monitoring and reporting. This policy would help to ensure that significant changes to a supplier or its ownership would not cause a fall in standards and customer service, and also that Ofgem is informed promptly of issues which may have the potential to impact on a supplier's financial stability.

4.39 We have considered whether the new obligation should include a requirement to notify us when a supplier agrees to undertake a customer book sale, and have decided that this would be an appropriate and helpful addition to the licence condition. We have also included a requirement within the new licence condition to ensure Ofgem is notified when there has been a change in any person with significant managerial responsibility or influence. These additions will ensure that Ofgem has appropriate oversight of the market.

4.40 In all other respects, the proposed licence condition remains unchanged from the proposals in our policy consultation.

Final proposal

We intend to introduce a new requirement for suppliers to notify us in the event of some specific changes that may arise in the course of running its business, called the 'Additional reporting requirement'. This will ensure that Ofgem is informed promptly of issues which may have the ability to impact on a supplier's financial stability.

5. Exit arrangements

Section summary

In this chapter, we set out proposals to minimise the disruption associated with supplier exit. Our final proposals include changes to certain customer contract terms to ensure administrators are subject to some of the same requirements as suppliers, proposals to enable us to prevent customer book sales that may be harmful for consumers, as well as providing an update on our work in relation to portfolio splitting.

5.1 In previous chapters, we have set out the ongoing requirements we propose to introduce to reduce the likelihood and impact of supplier failures. In this chapter, we outline our final proposals to minimise disruption for consumers when suppliers fail.

5.2 We propose to require suppliers to include certain clauses in the terms and conditions of their domestic customer contracts to ensure that administrators of failed suppliers are bound by some of the same requirements as suppliers. We also propose that suppliers notify Ofgem if they are engaging in a customer book sale, and that we enhance our ability to ensure such transactions do not risk harm to consumers. We provide an update regarding our work on portfolio splitting. We also propose to make a clarificatory change to ensure suppliers honour the terms of the Supplier of Last Resort (SoLR) bids they make, which we consider will improve consumers' experience where their supplier fails.

What we aim to achieve

5.3 The current SoLR process has worked well in ensuring customers have continuous supplies of gas and electricity, while ensuring that any credit balances domestic customers hold with the failing supplier are protected. We are keen to make improvements to these arrangements, where doing so would improve the customer experience or reduce the burden on the incoming supplier. We are also seeking to ensure that customers, the appointed SoLR, and other stakeholders understand the SoLR's obligations, particularly in respect of customer credit balances. If we can achieve this without changing licence conditions or other regulatory obligations – eg where we can use our existing information gathering powers and the information packs provided to potential SoLRs – we intend to make changes in the short term.

Customer interactions with administrators

Policy consultation proposals

5.4 In our policy consultation, we 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.[41]

5.5 There are a number of consumer protections regarding how suppliers can pursue the collection of debt in the supply licences. If a supplier fails and an administrator is appointed these protections might not apply. In some situations, the practices by some insolvency practitioners have caused consumer distress, for example through particularly aggressive debt collection approaches, some of which have been in respect of vulnerable consumers.

Stakeholder views

5.6 Stakeholders generally agreed that improvements should be made to provide greater protection to consumers in debt to their supplier at the time of it failing. Some stakeholders argued that Ofgem had no powers or legal rights over the administration process. Others questioned whether the customers' contract with the failed supplier could bind the insolvency practitioners,[42] and thought the proposals would not have any impact on the administrator's debt recovery methods.

5.7 Some respondents expressed concerns as to whether our proposals were consistent with insolvency laws, and questioned whether the paragraphs referenced in the licence conditions were correct. A few stakeholders questioned the enforceability of the proposal. Some suggested that insolvency practitioners currently did not take into account requirements in the terms and conditions of failed supplier contracts, such as rules around back billing.

5.8 A number of stakeholders made some alternative suggestions. These included that the responsibility for debt collection should be transferred to the SoLR to make the financial

[41] These conditions are electricity and gas supply licence conditions 27.5 – 27.8, and 28B.
[42] We are referring to the term insolvency practitioner rather than administrator to reflect the wider roles that are undertaken, eg liquidator.

reconciliation process more straightforward. They suggested that Ofgem should look to work with other relevant regulators such as the Financial Conduct Authority and the Insolvency Service.

Our views

5.9 We expect insolvency practitioners to deal with energy customers in a fair and reasonable way, having particular regard to the needs of vulnerable consumers. In November, we published a letter setting out our expectations of administrators, and highlighted the relevant requirements that need to be taken into consideration to prioritise good consumer outcomes.[43]

5.10 In most cases, insolvency practitioners have worked collaboratively with the appointed SoLR to deliver good outcomes for consumers. In some cases, however, there have been significant delays in final billing, and debt has been pursued in ways that may have resulted in consumer harm. We appreciate that some of these issues have arisen due to the particular circumstances of a supplier's insolvency, and understand that insolvency practitioners have their own obligations and regulatory framework.

5.11 However, we do not consider that administrators should have any greater rights than a licensed energy supplier in the way they pursue debt and should not be adopting practices which could be considered more agressive than the approach a licensed supplier would be required to adopt. We continue to consider that consumers may benefit from a consistent approach when it comes to energy debt collection practices. For instance, suppliers must take all reasonable steps to send final bills within six weeks of the end of a supply contract. They must also take steps to understand whether a customer may struggle to pay a debt and to take this into account when calculating any payment instalments.

[43] Ofgem, Open letter to insolvency practitioners appointed to failed Energy Supply companies, 5 November 2019

Legal considerations

5.12 Our view is that the administrator should have regard to the terms of the former licensee's supply contracts with those customers, and it is appropriate that provisions around the collection of debt in the supply licence should be reflected in consumer contracts.

5.13 We recognise that an insolvency practitioner has its own obligations and regulatory framework. Just as energy suppliers must adhere to the provisions of its regulatory obligations, insolvency practitioners have duties as officers of the Court and must also act in accordance with any quasi-judicial, fiduciary or other duties that they may be under, as well as the Insolvency Practitioner Code of Ethics. These duties should work in line with many of the energy suppliers' regulatory obligations, and particularly those relating to treatment of customers.

5.14 We expect that a responsible organisation operating insolvency services will likely have a code of practice and a commitment to behaving ethically and treating consumers fairly. We are of the view that the proposed change to the suppliers' contracts does not contradict the duties of insolvency practitioners but ensures they cannot go further in pursuing payments than is permitted under the failed supplier's customer contracts. Rather than contradict the duties of insolvency practitioners, the change to the contracts should complement the existing consumer protection duties. The terms and conditions do not seek to override the overall objective of insolvency practitioners but are additional considerations they would need to take into account.

5.15 We are proposing the licence conditions relating to treatment of customers in payment difficulty, the proportionate use of warrants, and taking reasonable steps to produce a final bill should be reflected in contracts.[44] We expect all suppliers to add the relevant terms and conditions into their contracts and failure to do so could result in enforcement action.

5.16 Our view is that the activities relating to debt recovery in gas and electricity supply licences are appropriate for when a company is entering insolvency, as well as when it is a

[44] Electricity and gas supply licence conditions 27.5 – 27.8, and 28B as consulted upon and additionally final billing licence conditions 27.17 and 27.18

supplier, and should ensure administrators are prioritising outcomes that are in consumers' interests.

Enforceability

5.17 We do not directly regulate administrators. However, we have powers to enforce consumer protection rules and we engage with the appointed insolvency practitioner of a failed supplier as appropriate and monitor the experience of customers being transferred through a SoLR process.

5.18 Where we have significant concerns we would expect to raise these with the insolvency practitioner in the first instance and, where appropriate, could make complaints to relevant accreditation and regulatory bodies. We may escalate a complaint through formal channels within the insolvency practitioner's organisation, or consider a referral to the Insolvency Service or other appropriate regulator.

5.19 We agree with the suggestions that it could be beneficial for us to continue to engage with the relevant insolvency regulatory bodies, and where possible to work together where there are concerns regarding behaviour having consumer detriment. We also note that there is an important role for the appointed SoLR, who we consider is well-placed to engage closely with an insolvency practitioner to ensure customers are protected.

Final proposal

We intend 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.

We will also continue to engage with the relevant regulatory bodies for insolvency practitioners, and where possible consider whether there are opportunities to work together to ensure energy customers are treated in a fair and reasonable way.

Customer book sales

Policy consultation position

5.20 In our policy consultation, we said that in the event of supplier failure, our preference was for a commercial solution to be found in order to avoid the need for regulatory

intervention. However, we also noted that there were circumstances in which commercial transactions may not be in consumers' interests. We outlined that we would judge each case on its merits, but that we will take instances of suppliers proceeding with commercial transactions that are contrary to consumers' interests very seriously, and look to take robust action.

5.21 This could include instances where a transaction was being considered at a very late stage (ie where a SoLR process is otherwise imminent) and where only part of the customer book was being sold to another supplier. We outlined we could take action to proceed with the SoLR process, if we consider that will better protect consumers.

5.22 We also sought stakeholders' views on whether we should consider taking other actions, such as requiring suppliers to obtain our approval before proceeding with customer book sales. We requested stakeholders' views on whether we should further explore options related to supplier book sales.

Stakeholder views

5.23 Most respondents were supportive of Ofgem taking forward further actions to better protect consumers affected by trade sales. The majority of stakeholders felt that Ofgem should not allow transactions that sought to separate assets from liabilities in the lead up to a SoLR process, and that partial customer book sales involving a supplier in distress was undesirable. Many felt that intervention was necessary where there was a high likelihood that other suppliers, and ultimately their customers, may bear the costs 'left behind' by the gaining supplier and / or to produce a more competitive SoLR process.

5.24 Some respondents were against the proposal. They felt that Ofgem should not involve itself in commercial decisions and that doing so could set undesirable precedents. Some respondents noted that restricting customer book sales could contradict company directors' fiduciary duties. Others noted that Ofgem's refusal to allow a customer book sale could lead to further supplier failure.

Our views

5.25 We recognise that commercial transactions between suppliers are an important part of normal market functioning, and in general would not expect regulatory intervention to be needed in relation to such transactions. We recognise that there are often benefits for customers of these issues being resolved outside of the SoLR process, provided such

transactions comply with relevant licence and consumer protection requirements. Such transactions can limit the wider impact of supplier failure, and avoid the need for a failed supplier's costs to be smeared across the industry. However, not all commercial transactions will result in a positive outcome for consumers.

5.26 In our open letter to suppliers published on 4 May 2020,[45] we outlined our expectations for how suppliers should behave, particularly in relation to customer service and risk management, and in relation to commercial transactions that involve the transfer of customers between suppliers. If the sale of a customer book were to cause either supplier in the transaction to breach, or be likely to breach, a licence condition (including by treating customers unfairly), we indicated that Ofgem may seek to intervene. We have taken action previously in such circumstances in order to protect consumers.[46]

5.27 The SoLR process exists to provide a safety net to ensure that consumers have continuity of supply in the event that their supplier fails. While we recognise that the SoLR process itself can result in costs to consumers (eg through claims on the industry 'levy') – to date the process has been effective in minimising such costs. We have previously stated that transactions that distort the SoLR process, and cause detriment to consumers, risk being inconsistent with the principle of treating customers fairly. We consider there is merit in us making it explicitly clear in the licence the circumstances in which we may seek to intervene to protect consumers.

5.28 Having considered stakeholder views outlined above, we have identified a number of risks regarding some types of commercial transactions that occur in close proximity to a supplier exiting the market (and in circumstances where a SoLR process may be necessary). For example, there is a risk that commercial transactions, including 'partial book sales', being pursued at this stage can result in poor customer experience, in suppliers and ultimately consumers bearing the costs 'left behind' by the gaining supplier as well as a risk of impacting the effectiveness of any SoLR process, for those customers that have not been transferred through the commercial transaction. Ofgem will always act to protect these customers by appointing a SoLR, but there is a risk the process may be impacted - for example fewer suppliers may express an interest in volunteering, which reduces the benefits

[45] Ofgem, Open letter to energy suppliers considering and/or involved in a trade sale, 4 May 2020
[46] Ofgem, Ofgem orders E to stop transfer of former Economy Energy customers, 17 January 2019

a competitive process can bring, and may mean we are unable to identify a volunteer and must mandate a supplier that has not volunteered.

5.29 In assessing the relevance of these concerns in the case of a customer book sale, we would take into account the likely impact to the customers being switched to the new supplier and those (if any) that remain with the failing supplier. We would also take into account the impact to both the failing supplier and gaining supplier. We would seek to establish whether running a SoLR process is likely to result in overall better outcomes for consumers compared to the customer book sale proceeding.

5.30 These factors have informed the drafting of our proposed licence condition. If suppliers are unsure as to whether a commercial transaction would be in breach, or likely to be in breach, of this licence condition, then we would welcome early engagement. This is particularly the case where any of the parties to the transaction may be in financial distress. We are also introducing additional reporting obligations for trade sales under our general monitoring and reporting provisions outlined in the previous chapter.

Final proposal

We propose to introduce a new requirement for suppliers to notify Ofgem when they are planning to undertake a commercial transaction which would result in the transfer of customers.

We also propose to introduce a licence condition that prevents licensees from engaging in commercial transactions that subvert or distort, or are likely to subvert or distort, the Supplier of Last Resort process; and / or make it more likely, in the Authority's opinion, that costs will be mutualised.

Other improvements to exit arrangements

SoLR commitments

5.31 In our October consultation, we proposed to make a relatively minor change to the SoLR requirements to clarify our expectations of the appointed SoLR. Specifically, we

wanted to ensure that SoLRs take all reasonable steps to honour the terms of the bids they provide as part of the SoLR selection process.

5.32 A relatively small number of stakeholders commented on these proposals. Of those that did, two questioned the intent of the change, and one suggested that SoLRs can uncover issues following the appointment that can make it difficult to honour the terms of the bid.

5.33 A SoLR appointment is made via a formal power of direction under the licence. SoLRs are already formally bound by the Direction and the provisions in the licence in relation to being appointed as a SoLR. However, to add further clarity, and ensure the requirement to honour credit balances and adhere, in so far as it is possible, to the terms of their bid, we think there is merit in adding these explicit provisions.

5.34 In order to clarify our expectations, we propose to introduce two requirements. The first would require suppliers to include a clause in deemed contracts committing them to honour customer credit balances if the deemed contract arose as a result of the SoLR process, and the supplier committed to honour credit balances when seeking to be appointed as the SoLR. The second would require suppliers to take all reasonable steps to honour the terms of their SoLR bid.

5.35 These changes would promote certainty for customers on their legal rights when a SoLR in appointed by incorporating commitments made by the SoLR into their customer contracts. This would provide a clearer route for enforcement, by consumers themselves if appropriate, of the SoLR's commitments. It would supplement the duty for SoLRs to honour commitments made to Ofgem when seeking to be appointed as the SoLR, and reduce the need for consumers to rely upon the regulator to take enforcement action to secure their credit balances.

5.36 These changes would increase transparency in the market as to the binding nature of commitments made to Ofgem during the SoLR selection process. An explicit contractual obligation would also clarify the SoLR's duties for the failed supplier's insolvency practitioners and increase the likelihood of the SoLR securing restitution, through the failed supplier's liquidation, for the costs that it incurs by honouring customer credit balances. Securing such restitution is in the interests of consumers and will prevent market distortion by ensuring that a failed suppiler's costs are borne, as far as possible, by that supplier and its investors. While the law on restitution permits SoLRs to claim these costs through the

failed supplier's liquidation, we understand that greater clarity would assist the process of claims being made when a supplier is liquidated.

Final proposal

We propose to introduce a new requirement for suppliers to take all reasonable steps to honour the terms of the bid they provide as part of the SoLR selection process.

We also propose to introduce a requirement for suppliers to include a clause in deemed contracts committing them to honouring customer credit balances where that contract arises from a SoLR process and the supplier has committed to honouring credit balances.

Update on portfolio splitting

5.37 In our October consultation, we noted that facilitating portfolio splitting would likely require multiple code and systems changes, recognising the role that industry would need to play in taking forward changes in this area. Respondents to the consultation were open to the idea of portfolio splitting, outlining its potential benefits for competition in the SoLR process and thus supporting 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.

5.38 We have identified a potential option to enable the portfolio of a failing supplier to be split and assigned to multiple Suppliers of Last Resort, that could be realised in the context of the Central Switching Service. We consider this could deliver benefits for consumers, and are now engaging with industry to secure an assessment of the technical feasibility, and costs of implementing this option.

Appendices

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Appendix 1: Supply licence drafts

This appendix sets out the changes we have made to the licence drafting since the October 2019 policy consultation, in addition to new licence requirements proposed for each policy area. The table below includes, where relevant, the drafting as set out in October, the revised drafting, and a brief explanation of the reason for the change. The table uses the same numbering found in the electrcitiy supply licence. Additional wording is highlighted in grey, and deletions are denoted with a strikethrough. The full text of the proposed licence conditions is set out in the statutory notices published alongside this document.

Financial Responsibility principle - New

New proposed SLC drafting

4B.1The licensee shall at all times manage responsibly costs that could be Mutualised and take appropriate action to minimise such costs.

Meeting the financial responsibility principle

4B.2 The licensee shall at all times have adequate financial arrangements in place to meet its costs at risk of being Mutualised.

Guidance

4B.3 The licensee must have regard to any guidance on standard condition 4B.1 (including in respect of definitions which appear in standard condition 1) which, following consultation, the Authority may issue and may from time to time revise.

Condition 1. Definitions for condition

"Mutualised" means one or more market participants other than the licensee bearing costs incurred by the licensee, which may include Customer Credit Balances and costs incurred by the licensee under government environmental and social schemes, by virtue of regulatory mechanisms.

Operational Capability principle

Policy consultation drafting	New proposed SLC drafting	Reason for change
1.1 The licensee must ensure it has sufficient internal capability, processes and systems in place to enable the licensee to: a) serve each of its Customers, and b) comply with relevant legislative and regulatory obligations. 1.2. The licensee must ensure that it identifies, assesses and adequately manages any risks of non-compliance with 1.1. 1.3 The licensee must be able to demonstrate to the Authority (on request) compliance with 1.1 and 1.2.	~~1.1~~ 4A.1 The licensee must ensure it has and ~~sufficient~~ maintains robust internal capability, systems and processes ~~and systems in place~~ to enable the licensee to: a) efficiently and effectively serve each of its Customers; ~~and~~ b) efficiently and effectively identify likely risks of consumer harm and to mitigate any such risks; and ~~b)~~ c) comply with relevant legislative and regulatory obligations. ~~1.3 The licensee must be able to demonstrate to the Authority (on request) compliance with 1.1 and 1.2.~~	Wording has been amended to: • emphasise that this is an ongoing obligation; • remove the 'demonstrate compliance' obligation, which we consider is already required as a result of other licence conditions; • better reflect the policy intent and expected outcomes; • improve sentence structure; and • specify the relevant part of the licence where this condition would sit.

Milestone Assessments - New

New proposed SLC drafting

28C.1 The licensee must notify the Authority, in writing, a reasonable time before it reasonably anticipates reaching its first 50,000 Domestic Customers.

28C.2 The licensee must notify the Authority, in writing, when it reaches its first 50,000 Domestic Customers for the purpose of undergoing the relevant milestone assessment.

28C.3 The licensee must notify the Authority, in writing, a reasonable time before it reasonably anticipates reaching its first 200,000 Domestic Customers.

28C.4 The licensee must notify the Authority, in writing, when it reaches its first 200,000 Domestic Customers for the purpose of undergoing the relevant milestone assessment.

28C.5 The licensee must have regard to any guidance on standard condition 28C (including in respect of definitions which appear in standard condition 1) which, following consultation, the Authority may issue and may from time to time revise.

Ongoing Fit and Proper requirement

Policy consultation drafting	New proposed SLC drafting	Reason for change
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. 1.2 The licensee must have the processes, systems and governance in place to ensure that persons with Significant Managerial Responsibility or Influence are fit and proper to occupy that role. The licensee must carry out periodic assessments on such persons. 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	~~1.1~~ 4C.1 The licensee must not ~~employ a person~~ appoint or have in place an individual in a position of Significant Managerial Responsibility or Influence who is not a fit and proper person to occupy that role. 4C.2 The licensee must: a) have ~~the~~and maintain robust ~~processes,~~ systems, processes and governance ~~in place~~ to ensure that ~~persons~~ ~~with~~ any person holding a position of Significant Managerial Responsibility or Influence in the licensee is fit and proper to occupy that role; and b) ~~The licensee must~~ carry out ~~periodic~~ regular assessments on such person(s) to ensure that they remain fit and proper to occupy that role. ~~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).~~	Wording has been amended to: • better reflect the policy intent of our proposals; • emphasise that this is an ongoing obligation rather than a one-off assessment; • reflect stakeholder feedback and additional analysis suggesting 'good character' may not be an appropriate inclusion; • remove the 'demonstrate compliance' obligation, which we consider is already required as a result of other licence conditions; • remove unnecessary definitions already set out elsewhere in the licence; • move a definition to SLC 1;

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: a. Any relevant unspent criminal convictions in any jurisdiction in particular fraud or money laundering; b. Any insolvency history, including undischarged bankruptcy, debt judgements and County Court judgements; c. Been disqualified from acting as a director of a company; 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 (including where they were a person with significant management responsibility	4C.3 In complying with paragraphs 4C.1 ~~1.1~~ to ~~1.3~~ 4C.2, the licensee must have regard to and take account of all relevant matters including, but not limited to, whether the individual has: a) 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); ~~a)~~ b) ~~A~~any relevant unspent criminal convictions in any jurisdiction in particular fraud or money laundering; ~~b)~~ c) ~~A~~any insolvency history, including undischarged bankruptcy, debt judgements and County Court judgements; ~~c)~~ d) ~~B~~been disqualified from acting as a director of a company; ~~d)~~ e) ~~B~~been a person with ~~s~~Significant ~~m~~Managerial~~ment~~ ~~r~~Responsibility or ~~i~~Influence at a ~~current or~~ former Gas Supplier or Electricity Supplier in respect of whose Customers' premises the Authority issued a Last Resort Supply Direction ~~which triggered a Supplier of Last Resort Event~~ (including where they were a person with ~~s~~Significant ~~m~~Managerial~~ment~~ ~~r~~Responsibility or ~~i~~Influence at that Gas Supplier or Electricity Supplier within the 12 months prior to the Last Resort Supply Direction being issued~~Supplier of Last Resort Event~~);	• improve sentence structure; and • specify the relevant part of the licence where this condition would sit.

or influence at that Gas Supplier or Electricity Supplier within the 12 months prior to the Supplier of Last Resort Event) e. Been refused, had revoked, restricted or terminated, any form of authorisation, or had any disciplinary, compliance or enforcement action taken by any regulatory body in any jurisdiction whether as an individual, or in relation to a business in which that person held significant management responsibility or influence; 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. 1.6 The licensee must be able to demonstrate to the Authority (on request and at any time), compliance with 1.1-1.5.	~~e)~~ f) ~~B~~been refused, had revoked, restricted or terminated~~,~~ any form of authorisation, or had any disciplinary, compliance~~,~~ ~~or~~ enforcement or regulatory action taken by any regulatory body in any jurisdiction whether as an individual, or in relation to a business in which that person held ~~s~~Significant ~~m~~Managerial~~ment r~~Responsibility or ~~i~~Influence. 4C.4 The licensee must give particular regard to ~~cases~~ circumstances in which ~~where~~ the relevant person has a background in the energy sector in Great Britain and any~~the~~ previous actions of that ~~individual~~ person that resulted in or contributed towards significant consumer or market detriment. ~~1.6 The licensee must be able to demonstrate to the Authority (on request and at any time), compliance with 1.1-1.5.~~ ~~1.7 In this condition:~~ Condition 1. Definitions for standard conditions **Significant Managerial Responsibility or Influence** means where a person plays a role in— (a) the making of decisions about how the whole or a substantial part of a~~n~~ licensee's ~~undertaking's~~ activities are to be managed or organised, or	

1.7 In this condition: **Significant Managerial Responsibility or Influence** means 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. **Supplier of Last Resort Event** means when a direction is issued by the Authority pursuant to standard condition 8 of either a gas supply licence granted under section 7A(1) of the Gas Act 1986(a) or an electricity supply licence granted under section 6(1)(d) of the Act; (to be included in the Gas SLC) Electricity Supplier means any person who holds an electricity supply licence granted or treated as granted under section 6 of the Electricity Act 1989.	(b) the actual managing or organising of the whole or a substantial part of those activities. ~~**Supplier of Last Resort Event** means when a direction is issued by the Authority pursuant to standard condition 8 of either a gas supply licence granted under section 7A(1) of the Gas Act 1986(a) or an electricity supply licence granted under section 6(1)(d) of the Act;~~ ~~(to be included in the Gas SLC) Electricity Supplier means any person who holds an electricity supply licence granted or treated as granted under section 6 of the Electricity Act 1989.~~ ~~(to be included in the Electricity SLC) Gas Supplier means any person who holds a gas supply licence granted or treated as granted under section 7A(1) of the Gas Act 1986.~~	

(to be included in the Electricity SLC) Gas Supplier means any person who holds a gas supply licence granted or treated as granted under section 7A(1) of the Gas Act 1986.		
Open and Cooperative principle		
Policy consultation drafting	**New proposed SLC drafting**	**Reason for change**
1.1 The licensee must be open and cooperative with the Authority. 1.2 The licensee must disclose to the Authority appropriately anything relating to the licensee of which the Authority would reasonably expect notice.	~~1.1~~ 5A.1 The licensee must be open and cooperative with the Authority. 5A.2 In complying with paragraph 5A.1, ~~T~~the licensee must disclose to the Authority in writing or orally any circumstance ~~appropriately anything~~ relating to the licensee of which the Authority would reasonably expect notice in order to perform its statutory functions, particularly actions or omissions that give rise to a likelihood of detriment to Domestic Customers. Such disclosure should be given as soon as the circumstance arises or the licensee becomes aware to it. 5A.3 The licensee is not required to comply with paragraphs 5A.1 and 5A.2 if the licensee could not be compelled to produce	Wording has been amended to: • clarify the scope of the principle; • clarify the circumstances in which this principle would not apply; and • specify the relevant part of the licence where this condition would sit.

	or give the information in evidence in civil proceedings before a court.	

Independent audits

Policy consultation drafting	New proposed SLC drafting	Reason for change
1.1 After receiving a request from the Authority to conduct an Independent Audit that 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, the licensee must provide that Independent Audit to the Authority when and in the form requested 1.2. The licensee is not required to comply with paragraph 1.1. if the licensee could not be compelled to produce or give the information in evidence in civil proceedings before a court.	~~1.~~1 5B.1 After receiving a request from the Authority to ~~conduct~~ commission an Independent Audit that ~~it~~ the Authority considers ~~may reasonably require or that it considers~~ may be necessary for the performance of ~~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, the licensee must commission such an Independent Audit and provide ~~that Independent Audit~~ to the Authority, ~~when and~~ in the form requested by the Authority and by the date set by the Authority, a copy of the full audit report. 5B.2 The Independent Audit may include the following areas of the licensee's business: a) financial stability; b) customer service systems and processes; or	Wording has been amended to: • require suppliers to provide a copy of the audit by a deadline set by the Authority; • set out our expectations of the standards and qualifications the audit and auditor should meet; • clarify the policy intent; and • specify the relevant part of the licence where this condition would sit. • specify the relevant part of the licence where this condition would sit.

Definitions for condition 1.3 In this condition: Independent Audit means an audit carried out by a person other than the licensee or an Affiliate, instructed by the licensee, having received the Authority's prior, written approval in line with terms of reference supplied by the Authority.	c) where a licensee cannot provide adequate information under Condition 28C. 5B.3 The auditor must carry out the Independent Audit in line with terms of reference supplied by the Authority that are reasonable to meet the purpose of the audit and complying with any code of ethics or similar regulation that applies in the auditor's ordinary course of business. ~~1.2.~~5B.4 The licensee is not required to comply with paragraph ~~1.1.~~ 5B.1 if the licensee could not be compelled to produce or give the information in evidence in civil proceedings before a court. 5B.5 The licensee must ensure that: a) without prejudice to its duty to provide a copy of the report to the Authority by the date set by the Authority, each report prepared in accordance with paragraph 5B.1 is considered by appropriate members of its senior management team within four weeks of the report being provided by the auditor to the licensee; and b) it keeps a documentary record of the decisions made and actions taken by it in response to that report.	

	5B.6 The licensee must take all reasonable steps to ensure that its Affiliates cooperate fully with the Independent Audit, where appropriate. **Definitions for condition** ~~1.3~~ 5B.7 For the purposes of this condition: **Independent Audit** means an audit carried out by a person(s) with the relevant skills and expertise, other than the licensee or an Affiliate, instructed by the licensee~~,~~. Unless exempted by the Authority, the auditor must be a person or firm regulated by an appropriate professional body. ~~having received the Authority's prior, written approval in line with terms of reference supplied by the Authority.~~	

Monitoring and reporting requirements

Policy consultation drafting	New proposed SLC drafting	Reason for change
1.1 The licensee must notify the Authority of any change in any of the matters listed in 1.2, promptly and within a reasonable timescale.	19AA.1 ~~1.1~~ The licensee must notify the Authority of any change in any of the matters listed in ~~1.2~~ 19AA.2, promptly and within a reasonable timescale.	Wording has been amended to: • add a requirement for a supplier to notify us when it

1.2 The matters referred to in paragraph 1.1 are the following: • The address of the licensee's registered office; • The most appropriate email address at which the licensee can be contacted; • Whether the licensee is an active supplier; • Whether the licensee supplies any Non-Domestic Customer; • Whether the licensee supplies any Domestic Customer; • Whether a Relevant Merger Situation has arisen in respect of the licensee; • Any Person with Significant Control in respect of the licensee; • Whether the licensee supplies any Customers through a White Label Tariff; • Any significant changes that may affect how a licensee operates. **Definitions for condition**	19AA.2 ~~1.2~~ The matters referred to in paragraph ~~1.1~~ 19AA.1 are the following: a) if the licensee has agreed to undertake a Trade Sale or Trade Purchase; b) the address of the licensee's registered office; c) the ~~most appropriate~~ e-mail address of the licensee's regulatory contact ~~at which the licensee can be contacted~~; d) whether the licensee is an ~~active supplier~~ Active Supplier in respect of Domestic Customers and / or Non Domestic Customers ~~Whether the licensee supplies any Non-Domestic Customer; Whether the licensee supplies any Domestic Customer;~~; e) whether a Relevant Merger Situation has arisen in respect of the licensee; f) any Person with Significant Control in respect of the licensee; g) any Person with Significant Managerial Responsibility or Influence in respect of the licensee; h) whether the licensee supplies any Customers through a White Label Tariff; i) any significant changes that may affect how a licensee operates. **Definitions for condition**	agrees to a customer book sale; • specify the contact information we expect to receive; • add a requirement to notify us where there has been a change in any person with 'Significant Managerial Responsibility or Influence'; • add definitions to improve clarity of the requirement; • improve the structure and clarity of the condition; and • specify the relevant part of the licence where this condition would sit.

1.3 In this condition: **Person with Significant Control** has the same meaning as under section 790C of the Companies Act 2006.	19AA.3 ~~1.3~~ For the purposes of this condition: **Person with Significant Control** has the same meaning as under section 790C of the Companies Act 2006. **Relevant Merger Situation** has the same meaning as under section 23 of the Enterprise Act 2002.	

Customer Supply Continuity Plans - New

New proposed SLC drafting
19C.1 The licensee must ensure it has prepared and has in place, at all times, a customer supply continuity plan, which sets out the licensee's strategy for safeguarding the continuity of supply for its customers in the event of its exit from the market (a **Customer Supply Continuity Plan**). 19C.2 The licensee must ensure that the information provided in its Customer Supply Continuity Plan is accurate, and is prepared with due skill and care. 19C.3 The licensee must ensure that the information contained in its Customer Supply Continuity Plan is maintained and kept up-to-date at all times.

Customer interactions with administrators

Policy consultation drafting	New proposed SLC drafting	Reason for change
22F.1 The licensee must ensure that the terms and conditions of each Domestic Supply Contract or a Deemed Contract comply with the provisions of paragraphs 5 to 8 of standard condition 27 (inclusive) and paragraphs 5 and 6 of standard condition 28B	~~22F.1~~ 27.8A 27.8A The licensee must ensure that the terms and conditions of each Domestic Supply Contract or a Deemed Contract comply with the provisions of the following standard conditions: • paragraphs 5 to 8 of standard condition 27 (inclusive), and stipulate that (i) in respect of any domestic customer to which this condition applies, charges may not be demanded or recovered unless and until it is established that such payment	Wording has been amended to: • ensure final bill requirements are reflected in customer contracts; • provide more detail on the terms and conditions that need to be included in contracts;

	options referred to under this condition have been expressly offered to the customer and he/she has been given time to make payment and (ii) charges may not be demanded or recovered unless and until it can be established that such steps to ascertain a domestic customer's ability to pay have been taken and instalments set accordingly. • paragraphs 17 and 18 of standard condition 27, and stipulate that charges may not be demanded or recovered unless and until it is established that all reasonable steps to issue a final bill have been taken. • and paragraphs 5 and 6 of standard condition 28B, and stipulate that charges may not be demanded or recovered unless and until it is established that such costs which are sought to be recovered under this condition is considered proportionate. 27.8A1 The licensee must ensure that the terms and conditions of each Domestic Supply Contract or a Deemed Contract stipulate that, for the avoidance of doubt, the relevant conditions referred to above and the back-billing condition imposed by SLC 21BA.3 should (a) bind the licensee after any termination of the supply licence and (b) bind the licensee in administration.	• clarification regarding the application of the back-billing condition,and • specify the relevant part of the licence where this condition would sit.

	27.8A2 The licensee must ensure that the terms and conditions of each Domestic Supply Contract or a Deemed Contract stipulate a right to allow a domestic customer to set off against contract debts any credit balance owing under another supply contract with the licensee.	

Customer book sales - New

New proposed SLC drafting
19D.1 The licensee must not undertake a Trade Sale or Trade Purchase that: (i) subvert or distort, or are likely to subvert or distort the Supplier of Last Resort process; and / or (ii) make it more likely, in the Authority's opinion, that costs will be Mutualised.

Other improvements to exit arrangements

Policy consultation drafting	New proposed SLC drafting	Reason for change
N/A	7.12 The licensee must ensure that each Deemed Contract contains terms and conditions which: (a) reflect the effect of the provisions of standard condition 7; and	Newly proposed text to give effect to our proposal to strengthen requirements for suppliers to honour customer credit balances where they have committed to

	(b) require the licensee to honour Customer Credit Balances, provided and to the extent that the licensee committed to do so before the Authority gave it a Last Resort Supply Direction and the Deemed Contract arose as a result of the Last Resort Supply Direction.	doing so in their bid to become a Supplier of Last Resort.
8.3 In complying with the Last Resort Supply Direction, the licensee must take all reasonable steps to honour any commitment made during the Supplier of Last Resort process, having special regard for including, but not limited, to: • Appropriate resources and planning to how the licensee will on-board the new Customers, • Appropriate planning to maintain and/or improve its customer service standards in anticipation of a significant increase in customer contacts, and • Communication plans ready for immediate deployment upon acquisition of the SoLR customers.	8.3 In complying with the Last Resort Supply Direction, the licensee must take all reasonable steps to honour any commitment made ~~during the Supplier of Last Resort process.~~ to the Authority before the Authority gave it a Last Resort Supply Direction. ~~having special regard for including, but not limited, to:~~ ~~• Appropriate resources and planning to how the licensee will on-board the new Customers,~~ ~~• Appropriate planning to maintain and/or improve its customer service standards in anticipation of a significant increase in customer contacts, and~~ ~~• Communication plans ready for immediate deployment upon acquisition of the SoLR customers.~~	Wording has been amended to: • simplify the proposed clarificatory change to SLC 8; and • specify the relevant part of the licence where this condition would sit.

Appendix 2: Table outlining which policies apply to the domestic and non-domestic licensees

Chapter	Policy	Domestic	Non-domestic
Promoting better risk management	Financial Responsibility principle	✓	✓
	Operational capability principle	✓	✓
	Milestone assessments	✓	
	Dynamic assessments	✓	✓
More responsible governance and increased accountability	Ongoing fit and proper requirement	✓	✓
	Principle to be open and cooperative with the regulator	✓	✓
Increased market oversight	Customer Supply Continuity Plans (formerly 'Living Wills')	✓	✓
	Independent audits	✓	✓
	Monitoring and reporting requirements	✓	✓
Exit arrangements	Interactions with administrators	✓	
	Customer book sales	✓	✓
	SoLR commitments	✓	✓

Appendix 3: Milestone assessment guidance

This guidance provides further information on our milestone assessment proposal set out in chapter 2. It explains who would be required to notify Ofgem in order to begin the milestone assessment process and how and when to notify Ofgem. It also gives an overview of what information may be required and the criteria we would use as part of our assessment.

Following our decision, it is intended that this section will be updated and published as a separate guidance document for suppliers to understand the milestone assessment process and their obligations in relation to milestone assessments.

Who would be required to notify Ofgem?

A supplier would be required to notify Ofgem before it reaches 50,000 and 200,000 domestic customer accounts for each fuel. Notifications would need to be sent via email to licensing@ofgem.gov.uk. This email should state the number of unique domestic customer accounts that it currently has for each fuel, the date at which the threshold is expected to be crossed and provide the name and e-mail address of the supplier's key contact for the milestone assessment. Ofgem would aim to acknowledge receipt of the notification within five working days.

The requirement to notify Ofgem would apply to all domestic licensees, whether the threshold is to be exceeded due to organic growth, through mergers and acquisitions, or customer book purchases. Where a supplier exceeds a threshold due to becoming a Supplier of Last Resort (SoLR), a separate notification would not be required as Ofgem would be aware from the SoLR process that the supplier is exceeding the threshold. This does not necessarily mean that the supplier would be exempt from completing a milestone assessment.

If a supplier falls below the relevant customer threshold, it would be required to notify Ofgem when it exceeds the threshold again. Based on our analysis of suppliers' past customer numbers, we do not anticipate this scenario to occur often. Notifying Ofgem does not necessarily mean that Ofgem would require the supplier to complete a further milestone assessment. We would take into account the time elapsed since the previous assessment and whether there are likely to have been any material changes in the supplier's circumstances since then.

We do not expect to apply the new milestone assessment criteria retrospectively. Any supplier that passes the relevant thresholds prior to the conditions coming into effect would

not be subject to a milestone assessment. If they subsequently fall below the threshold before later exceeding it, the supplier would be required to notify Ofgem, at which point we may carry out an assessment. And we may conduct a dynamic assessment of any supplier where we have concerns about their financial sustainability or ability to serve their customers.

When will a supplier be required to notify Ofgem?

A supplier will be required to submit a notification for a milestone assessment a reasonable time before the threshold is passed. We do not propose to prescribe an exact notice period. However, we would generally expect a supplier to notify Ofgem at least 30 calendar days (excluding bank holidays and weekends) before they reach the point of assessment. Where they are likely to exceed the threshold as a result of a commercial transaction, we recognise this notice period may not be practical. In such cases we would accept shorter notice. However, we encourage suppliers to approach us as early as possible where this is the case. Suppliers will need to be aware of how many domestic customers they have and they will also need to be aware that they are approaching the threshold and be preparing for an assessment. There may be extenuating circumstances, but we envisage that delays in notifying Ofgem will be rare.

A supplier would also be required to notify Ofgem when they reach the threshold, which we would expect to be 10 working days from when the milestone was reached. Suppliers must confirm the number of domestic customers they have in the notification email and the date at which the threshold was crossed.

Who will be required to complete a milestone assessment?

All domestic supply licensees would be required to notify Ofgem when they reach the relevant customer number thresholds, however there may be circumstances in which Ofgem decides an assessment is not needed.

Ofgem would have the flexibility to decide whether a milestone assessment is required. For example, a supplier may have recently had a dynamic assessment, already had a milestone assessment but dropped below the threshold and is approaching it again, or is about to exceed the threshold due to becoming a Supplier of Last Resort. Ofgem would have flexibility in terms of the timing of the assessment, whether another assessment is required, or whether information requested in the assessment should be adapted based on information we already have about the supplier.

Timing of milestone assessments

Ofgem may conduct a milestone assessment at any point in time after it has been notified by the supplier. This would allow Ofgem to prioritise assessments, or delay assessments, for example when a supplier is crossing the threshold due to being appointed as a SoLR. In this situation it may be impractical to carry out a milestone assessment within the relatively short space of time we normally seek to make an appointment decision, and given the SoLR assessment itself would look at similar criteria to a milestone assessment. We therefore may want to carry out an assessment at a later date.

Ofgem would generally seek to conduct an assessment soon after being notified by the supplier that they have crossed the threshold. The purpose of the assessment would be to ensure that suppliers are adequately resourced and prepared for growth at appropriate points in time after their market entry, and that they maintain the capacity and capability to deliver a quality service to their customers. Conducting an assessment soon after notification would enable us to mitigate the risk of consumer harm in a timely manner.

When a milestone assessment is required this would be sent via email to the supplier as an information request under Condition 5 of the Electricity and Gas Supply Licence Conditions which enables us to gather information for the purpose of performing our statutory duties. This condition requires the licensee to provide the information when and in the form requested.

Ofgem would generally request a response to the milestone assessment within 15 working days of sending the request. As the supplier would have already notified Ofgem, they should be expecting the request. They should also be aware of what information may be requested and so be able to prepare for this.

There would be no set time period for Ofgem to assess responses but we would aim to review them within a reasonable time period after they have been received. The time taken to assess would vary depending on the quality of submissions and whether any follow up or clarification is required.

Content of milestone assessments

The milestone assessment form would contain questions requesting information on:

- operational performance in relation to customer service, billing, switching, debt management and vulnerability;
- scaling of customer service functions against projected growth and how the supplier has given due regard to maintaining customer service standards, including in relation to customers in vulnerable circumstances and debt management processes;
- how suppliers have assured themselves that IT systems, billing systems and Customer Relationship Management (CRM) are fit for purpose and integrated into growth strategy;
- oversight and controls over outsourced functions;
- growth plans in relation to pricing strategy, tariffs and products, projected volume of energy and purchasing strategy;
- how the supplier budgets for energy specific charges and collateral requirements;
- how the supplier budgets for costs resulting from obligations under the government's renewable energy, energy efficiency and social schemes, and plans for changing costs associated with business scaling; and
- how the supplier is meeting (or planning to meet) obligations that begin at certain thresholds.

Depending on what information we already have about a supplier, we may not necessarily require suppliers to answer all questions. This list is non-exhaustive and we may ask other questions on a case-by-case basis.

Our approach to assessment

In responding to the milestone assessment questions, suppliers would need to provide us with sufficient information to enable us to make a qualitative risk-based assessment against the following criteria.

Criteria one: the supplier has the appropriate resources (both financial and operational) to manage their current customer base and for their growth plans, including but not limited to:

- how they will manage and resource core operational processes and functions including IT systems, to maintain customer service standards, giving due regard to customers in vulnerable circumstances
- reasonable assumptions about the impacts of growth on their financial and operational resources,
- awareness of key risks and a plan to manage/mitigate these, and
- costs associated with government schemes and regulatory obligations.

Criteria two: the supplier understands and has sufficient plans to meet / is meeting regulatory obligations linked to customer thresholds (both upcoming and those that currently apply).

Depending on the responses, we may require further details or clarification from the supplier. If our concerns are significant and have not been addressed, following this we may request that the supplier undertakes an independent audit if Ofgem deems appropriate.

The criteria for passing our milestone assessment is detailed below. If a supplier is unable to demonstrate that they are meeting these criteria, it is possible that they may be contravening or are likely to contravene certain obligations.

A milestone assessment is a proactive 'deep dive' assessment that is conducted at a particular checkpoint. As with other forms of intelligence gathering, this could lead to compliance and enforcement action where it appears to the Authority that the supplier is contravening or is likely to contravene its obligations.

Detailed information requirements

Criteria one: the supplier has the appropriate resources (both financial and operational) to manage their customer base and for their growth plans.

Below we provide details of the information we would expect suppliers to provide in response to some of the milestone assessment questions.

Core operational functions and processes

Suppliers would need to explain their business functions and how they are resourced, including details of any outsourced functions. Suppliers would need to explain how they identify and serve customers in vulnerable circumstances and provide details of their debt management processes. Suppliers would also need to make clear how they intend to scale their customer service function against their projected growth and show that they have given due regard to maintaining customer service standards, particularly with reference to how they identify and serve customers in vulnerable circumstances.

Suppliers would need to include details of any outsourced functions and what oversight/controls are in place to ensure that those third parties deliver the required service to the required standard.

For all core functions, suppliers would need to provide: high level details of the main responsibilities of each function and how the number of staff in each business function aligns to growth plans.

IT systems

Suppliers would need to provide information on their IT systems and integration testing, including switching, billing and Customer Relationship Management (CRM), and how IT is integrated into the business and the growth strategy. Suppliers should be aware of the impact their growth plans could have on their systems and customer service capability, including how they identify, record and manage customers who are in a vulnerable situation to ensure that they treat these customers fairly.

Pricing strategy, tariffs and products

We want to understand how the supplier has positioned themselves in the market, including if they intend to grow the business and how they propose to manage the associated risks. Suppliers would need to provide details of their pricing strategy (both current and future) and highlight if these are considered reflective of costs. If not, suppliers would need to make clear how the risks associated with a loss-leading tariff are to be mitigated, and would need to demonstrate that they have sufficient funding to cover the costs of this strategy.

Projected volume of energy and purchasing strategy

Suppliers would need to provide an indication of the amount of energy they supply and their strategy to buy energy in line with their growth plans. This would include details of who is trading on their behalf (if applicable), their understanding of the market, the costs and risks of their strategy, and how they would mitigate their wholesale and imbalance risk.

We would expect suppliers to provide specific detail on: their hedging strategy and any reliance on the balancing market for an extended period of time; whether there are any purchasing agreements in place (or any intention to put in place purchasing agreements) and plans to deal with potential collateral requirements; how their approach differs by tariff type; and how often they plan to review their strategy.

Suppliers should understand the demand profile of their customers, the wholesale market contracts they plan to use for their hedging, and the percentage of their demand this covers. If there is no hedging strategy, the supplier would need to demonstrate an awareness of the

associated risks and how the downside risks would be addressed (and funded if applicable). This is particularly important if the supplier is offering fixed-term tariffs without hedging.

Financial costs

Suppliers would need to provide details of how they budget and plan for:

- energy-specific charges and collateral requirements (including wholesale costs, Capacity Market charging, imbalance charging, network charging, smart metering and DCC costs, Ombudsman scheme),
- costs resulting from the obligations under the government's renewable energy, energy efficiency and social schemes.
- changing costs associated with business scaling and how they plan to manage this (including additional costs from government schemes and other regulatory obligations that apply once they meet a certain number of customers).

Criteria two: the supplier understands and has sufficient plans to meet regulatory obligations that link to customer thresholds (both upcoming and those that currently apply).

We would consider whether the supplier appears to have a good awareness of the relevant obligations that currently apply to them, and will apply in future, and whether they can show what practical steps they have taken (or will take) to ensure they can comply with them.

For the assessment at 50,000 domestic customers, suppliers would need to provide details of how they are compliant with SLC 27.1, which requires suppliers to offer a wide choice of payment methods, including cash and payment in advance through a prepayment meter. They would need to provide supporting evidence to demonstrate this.

For the assessment at 200,000 domestic customers, suppliers would need to provide details of how they are meeting obligations that begin at 150,000 domestic customers. This currently includes the Warm Home Discount (WHD) and Energy Company Obligation (ECO).

For the assessment at 200,000 domestic customers, suppliers would also need to provide details of the plans in place to meet obligations that begin at 250,000 domestic customers, including the Feed-in Tariff (FIT) scheme. Where a supplier has not made plans to comply with obligations that begin at 250,000 domestic customers, we would expect them to provide an explanation of this and the expected timescales.

Appendix 4: Your response, data and confidentiality

You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

Appendix 5: Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

Your personal data will not be shared with other organisations. Please note that responses not marked as confidential (see appendix 4) will be published on our website. Please be mindful of this when including personal details.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for the duration of the consultation and decision, until the completion of any related legal proceedings.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data

- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information for more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise"

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Making a positive difference
for energy consumers