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

Thank you for the opportunity to comment on Ofgem's proposals for ongoing requirements and exit arrangements. This response reflects the views of both E.ON and npower.

We broadly welcome the changes that Ofgem has made to the proposals it published in October 2019. However, many of the proposals duplicate existing provisions in other licence conditions and therefore are unlikely to deliver the policy intent.

We question the need to scatter these requirements across so many different parts of the licence and to have, in most cases, whole new licence conditions for just one or two paragraphs. We propose that Ofgem puts the majority of these conditions together in SLC 4A, which could be titled "Ongoing supplier requirements" for ease of reference. We have included details of our proposals in the Annex to this response.

Below we have commented on each of Ofgem's proposals.

Promoting better risk management

Cost mutualisation protections

Whilst it is to be hoped that the vast majority of suppliers already have adequate financial arrangements in place to meet their costs at risk of being mutualised, if a supplier gets into financial difficulties, such arrangements may count for nothing. For example, in Grant Thornton's recent Report in the Public Interest concerning the Council's governance arrangements for Robin Hood Energy Ltd on behalf of Nottingham City Council[1] (the RHE Public Interest report], it states *"RHE [Robin Hood Energy Ltd] were aware over the summer of 2019 that, although the majority of the cash for paying ROCs [Renewable Energy Obligation Certificates] had already been received from customers, it had been absorbed into the Company's wider cash position and was not available to make the [ROC] payment."* The report goes on to discuss a variety of issues at the supplier which had resulted in it repeatedly having to call on its owners, Nottingham City Council, to provide loans and hand-outs to allow it to continue trading. Under such circumstances, is it to be believed that RHE (or Nottingham City Council, had it been the promissory for such costs) would not have annulled any financial arrangements it had in place to meet costs at risk of mutualisation? No doubt Ofgem would have sought to encourage RHE to abide by the licence condition; however ultimately, its only recourse would have been to revoke RHE's supply licence, either for breach of this principle or failure to make ROC payments. Either way, this would have resulted in a Supplier of Last Resort (SoLR) event and mutualisations. Thus, the effectiveness of Ofgem's proposals can be seen to be nugatory.

Nevertheless, we welcome Ofgem's intention to undertake an initial risk assessment of suppliers' plans. This will allow Ofgem an opportunity to investigate further if it appears plans are inadequate. We have concerns, however, as to whether Ofgem:

[1] http://www.nottinghamcity.gov.uk/media/2835756/report-in-the-public-interest-rhe.pdf

- has the knowledge and expertise to review financial information and determine whether a supplier has adequate arrangements in place to meet its costs;
- can and will act promptly where it sees potential risks or failures;
- can act to enforce the principle, particularly given company directors' legal obligations to promote the success of their business and benefit their shareholders.

We understand Ofgem's logic for applying this principle to both domestic and non-domestic suppliers and welcome its intention to use a proportionately lower monitoring regime for non-domestic suppliers.

We welcome Ofgem's proposal to consult on Guidance for suppliers in meeting this requirement. We recommend that, as part of that Guidance, Ofgem makes it clear that suppliers must provide realistic estimates of future pricing strategies based on known or forecast market conditions.

We look forward to any further consultations by Ofgem on more prescriptive proposals to address the mutualisation issue; it is essential that there are stronger provisions in place to mitigate the risk of future mutualisation. It is important that any such proposals are fully scoped out and impact assessed to allow stakeholders to fully assess them. We would support proposals put forward by various suppliers on an insurance-based scheme. However, we recognise for some smaller suppliers the cost of protecting credit balances and monies due for social and environmental schemes could be prohibitive (although this fact alone might be an indication that a supplier is not financially viable). We also recognise that Ofgem has used its powers to the best effect in respect of failures to make payments to the Renewables Obligation and Feed-in-Tariff schemes over the past year, and expect a similar approach to be applied to late and non-payers over the coming months. We therefore eagerly anticipate the outcome of the work Ofgem is carrying out with BEIS in respect of changes to the Renewables Obligation (RO) scheme, which we believe is the solution most likely to be effective in minimising mutualisations under this scheme.

With respect to protection of credit balances, we believe that some of Ofgem's other proposals under this consultation, if applied rigorously and if Ofgem takes speedy action where it has concerns about consumer detriment or the ability of a supplier to meet its financial commitments or regulatory requirements, could help mitigate mutualisations. We have recommended, in some cases, improvements to these proposals which we believe would strengthen this further.

We would also like to see Ofgem include, as part of its consideration of mutualisations, missed/late payment of Ombudsman invoices. To date, we do not feel that Ofgem has taken an active role in this issue but it is Ofgem, and not the Ombudsman, that holds the ultimate power to apply the appropriate remedies for non-payment. Failure to pay Ombudsman invoices is also a potential indicator of financial instability and results in a mutualisation process.

Operational capability principle

We have no real concerns about the intent of this new licence condition; indeed, we still believe it is a duplication of the Standards of Conduct which have been in place for a number of years. We believe it is wholly unnecessary, merely adding to the number of words in the licence without adding any difference to supplier obligations or the ability of Ofgem to take enforcement action where necessary.

We would appreciate, however, some guidance on what Ofgem means by *'efficiently'* and *'effectively'* (proposed new SLC 4A.1 a) and b)) and how it will determine whether these requirements have been met in any particular situation.

Milestone assessments and dynamic assessments

We strongly support the provision for milestone assessments. However, we are disappointed that Ofgem is now proposing limiting these assessments to thresholds of 50,000 and 200,000 customers, and also that suppliers will be allowed to grow above the thresholds before the results of the assessment are known.

We believe there should be an assessment where suppliers are approaching 50,000 and 250,000 customers, reflecting the fact that new licence conditions become effective at these thresholds; indeed, Ofgem should carry out its assessment long before the supplier reaches these thresholds, particularly given that Ofgem does not intend to prevent the supplier from growing beyond the threshold until the review is complete and it has approved further growth. The 200,000 threshold is too late to determine whether a supplier is prepared to meet new obligations in respect of Warm Home Discount, therefore a further assessment should be undertaken where a supplier is approaching 150,000 customers. These customers are vulnerable, and it is important that a supplier understands fully its obligations to them. We also believe there should be further assessments as suppliers grow, reflecting the fact that the percentage of vulnerable customers they have is also likely to grow, and it is important that suppliers are prepared to service these in accordance with licence conditions and to manage a much larger portfolio. Such assessments could be carried out at, say, 500,000 (as initially proposed in October 2019) and 1,500,000 customers.

We propose, however, that Ofgem might like to consider appropriate wording of the licence condition to be more flexible, to allow for future changes to licence conditions or environmental and social obligations, without the requirement to consult further. For example, the threshold for suppliers being mandated to participate in the Warm Home Discount has only recently been changed to 150,000 customers, and more flexible wording should reduce the need for Ofgem to consult on changes to the licence condition to reflect such changes. Given that the Government has indicated support for removing certain exemptions or de-minimus levels in future, reference in the licence conditions to social and environmental obligations rather than customer numbers would take account of any subsequent change or additional obligation.

We strongly believe suppliers should be prevented from growing above the relevant thresholds until Ofgem has undertaken an assessment and given its approval for such growth. In recent years we have seen some suppliers grow very quickly, and on occasion with little knowledge or regard to their obligations, it is at these times of fast growth that there are the greatest risks of detriment to consumers. Suppliers would require at least four weeks to respond to a milestone assessment RFI and Ofgem would need time to review the response and possibly request further information. In the meanwhile, the supplier could have acquired a significant number of customers; if it is found to have treated its customers unfairly or to be unprepared to meet licence conditions that become effective at the threshold, Ofgem would have failed to take due care and those additional customers may have suffered unnecessarily.

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We do not understand why Ofgem should require a supplier to inform it both when a supplier is approaching a threshold and when it has reached it; it should only be necessary to require notification of approaching a threshold, to allow for time to send, respond to and evaluate a milestone assessment RFI.

The wording of the proposed SLCs 28C.1 and 28C.4: *"a reasonable time before it reasonably anticipates reaching its first ### Domestic Customers"* is not sufficiently clear. There needs to be an explanation of what Ofgem considers to be a reasonable time, or Ofgem needs to specify a particular timescale. Alternatively, Ofgem could undertake a milestone assessment *before* a supplier reaches the threshold, e.g. when it has, say, 40,000, 120,000 and 200,000 customers (as well as at 500,000 and 1,500,000 customers). This would be particularly relevant where Ofgem decides not to prevent suppliers from growing beyond the milestone level while an assessment is carried out.

Ofgem missed an opportunity when it made its decision on changes to the market entry regime[2] in 2019 to require face-to-face interviews with every applicant's persons with Significant Managerial Responsibility or Influence prior to awarding a supply licence. We propose that Ofgem should now take the opportunity of the first, if not every, milestone assessment, to carry out such an interview to help build relationships with suppliers and encourage an open and cooperative engagement with them.

We support Ofgem's proposals respecting assessment criteria and actions it could take following a milestone assessment. We recommend, however, that Ofgem includes:

- assessment of a supplier's debt collection processes. In the RHE Public Interest Report, Grant Thornton notes that RHE *"… had an inbuilt tension in relation to debt collection, with the normal debt collection policies of energy companies being seen as inappropriate as a means of tackling fuel poverty – but thus putting RHE at a competitive disadvantage."* It is probable that those processes also exacerbated RHE's financial stability and ultimately may not have been in customers' interests either.
- assessment of a supplier's hedging strategy and its ability to finance wholesale purchases in a rising or volatile market. The RHE Public Interest Report records fluctuations in wholesale energy markets, along with changes to the price cap regime, as external factors influencing the significant deterioration in RHE's financial performance in 2019.
- future energy retail change and the financial and other impacts it will have on the supplier. The RHE Public Interest Report notes the pressures on businesses of increased regulatory burdens relating to smart metering and price caps in addition to becoming obligated under Warm Home Discounts and Energy Company Obligation regulations. In addition, suppliers will be subject to additional costs in respect of Faster Switching and Market-Wide Half-Hourly Settlement and a number of other industry changes in the pipeline.

We agree with the proposal for dynamic assessments if there are signs of financial difficulty. This is something Ofgem already has the power to do, as indicated by the fact that no new licence condition has been needed for this purpose.

[2] https://www.ofgem.gov.uk/system/files/docs/2019/06/decision_on_applications_regulations_2019_and_guidance_document.pdf

We welcome Ofgem's recognition of the merit of conducting dynamic assessments where a supplier is repeatedly offering cheap tariffs; it should be unnecessary for the supplier to also be demonstrating poor customer service. For smaller suppliers, it can take some time for potential consumer harm to be noticeable, and the fact that prices are consistently lower than the majority of suppliers should be sufficient to indicate that poor customer service is likely to manifest itself in the future; thus, Ofgem could help avoid consumer detriment by acting proactively. Missed network, balancing or obligation payments and missed/late payment of Ombudsman invoices should also merit the use of a dynamic assessment, as should a significant increase in the number of Ombudsman complaints and a significant decline in customer numbers over a relatively short period of time.

We agree with Ofgem's proposals regarding the actions it could take following a dynamic assessment.

Given our comments above, we believe that significant re-working of this proposal is necessary. In addition, Ofgem should consult formally on its Guidance for milestone assessments as published in Appendix 3 of this consultation. Insufficient attention was drawn to this Appendix in the consultation and thus we do not believe sufficient comment on its content has been invited.

More responsible governance and increased accountability

Ongoing fit and proper requirement

We support Ofgem's proposals for ongoing fit and proper assessments and agree it should be for each supplier to determine which individuals fall within the scope of the licence condition. It is not clear when and how often Ofgem would assess supplier compliance with this licence condition; we assume it would only occur as part of a milestone assessment, where Ofgem is reviewing a supplier's ability to grow whilst still meeting all relevant licence conditions and treating customers fairly, or a dynamic assessment, where Ofgem has concerns about a supplier's financial stability.

We propose that Ofgem should ensure that at least one of a supplier's persons with Significant Managerial Responsibility or Influence has sufficient and recent knowledge, expertise and proven track record of energy retail markets. As Grant Thornton notes in the RHE Public Interest Report, *"A company operating in a highly competitive, highly regulated market needs non-executive members who understand that environment. It is clear that councillors who have been on the Board of RHE have taken their roles seriously and sought to understand that environment, but this is no substitute for having gained direct experience in that or a similar environment."* Similar provisions should be included at the earliest opportunity in the supply licence application process.

Principle to be open and cooperative with the regulator

We hold by the comments made to Ofgem in our response to its policy consultation. Ofgem already has powers to compel a supplier to provide information in various circumstances, including where it suspects consumer detriment; if these powers have proved insufficient to encourage some suppliers to be open and cooperative, we do not see how a licence condition of this type will achieve a better outcome.

However, if Ofgem were to implement this licence condition, the word 'material' should be inserted in the proposed SLC 5A.2: *"In complying with paragraph 5A.1, the licensee must disclose to the Authority in writing or orally any **material** circumstance relating to the licensee …".* We do not believe Ofgem intends, nor would it be pragmatic, for suppliers to report relatively minor events for which it has appropriate processes in place to rectify/mitigate quickly.

As outlined earlier, we believe that Ofgem missed an opportunity in its decision on changes to the market entry regime[3] in 2019, i.e. to hold face-to-face interviews with all supply licence applicants. E.ON proposed this as part of its response to the consultations on the entry regime and it would have enabled Ofgem to start the process of developing a relationship with the supplier from the outset. We have therefore proposed that Ofgem takes the opportunity of at least the first milestone assessment to undertake such an interview.

Ofgem should adopt a more open approach to providing advice to individual suppliers, particularly when they first enter the market or where they reach customer number milestones that increase their regulatory obligations, to help them understand their responsibilities and engender trust between the supplier and their regulator. This would, in our opinion, be far more effective than a licence condition to be open and cooperative.

Increased market oversight

Customer Supply Continuity Plans

We appreciate the improvements Ofgem has made to its proposals for living wills in its policy consultation. However, we still believe that a struggling supplier may make decisions that contradict its Customer Supply Continuity Plan but, as they concentrate on survival, they do not take the time to update.

While Ofgem could require suppliers to provide a copy of their Customer Supply Continuity Plan from time to time and under particular circumstances, we are uncertain if it has the expertise to assess whether they are relevant, accurate or up to date. In addition, having a plan does not mean it would be followed in the event of a supplier exiting the market.

Ofgem's sanctions for failure to provide a Customer Supply Continuity Plan are limited to ordering a supplier to provide one on threat of revocation, or imposing a financial penalty, which would have to be proportionate to the breach. If a supplier fails and its plan is found to have been inaccurate or incomplete, Ofgem has no sanctions it can make.

We understand Ofgem's perceived benefits of Customer Supply Continuity Plans to be:

- to ease Ofgem's collection of data to provide information to SoLR bidders; and
- to ease the transfer of data from a failed supplier to the SoLR.

For that reason, we do not believe these plans are of value in the case of the largest suppliers, for whom the SoLR process would be unsuitable, even if portfolio splitting were possible. The complexities of splitting a portfolio into manageable portions for an SoLR, plus the difficulties for suppliers in formulating a bidding strategy and for Ofgem in making optimum decisions on which

[3] Ibid.

bids should be successful, all of which would have to be undertaken in short timescales under an SoLR, must make it essential that the supplier administration process is applied to larger suppliers who fail. We therefore propose that Customer Supply Continuity Plans should not apply to suppliers with more than, say, 1,000,000 customers, or those that would fall under the supplier administration process should they fail. The construction of a Customer Supply Continuity Plan and its maintenance would take considerable resource for a large supplier such as ourselves and would, given the above, be to no purpose. Given the fragility of the retail market today where, even before COVID-19, the combined domestic and non-domestic margin across the larger suppliers was -0.7% and around three quarters of customers were with loss making suppliers, it is unreasonable to expect resource to be diverted to something that has no value.

Notwithstanding the above, greater clarity is required for suppliers to construct a Customer Supply Continuity Plan, to help them understand the purpose of each element and the minimum acceptable requirements. For example, the requirement for key contacts: Ofgem states that *"This information would ensure individuals are aware of their responsibilities even in the event of supplier failure"* (Page 52 of the consultation). We find it hard to understand how maintaining a list of Directors, Heads of Teams and Senior Officers would ensure this. Details about processes for obtaining customer account information and how to access data sets could be extremely complex for someone with no experience of the relevant systems to make use of. Suppliers need a clear understanding of what level of information is required for their plans and who the information is aimed at. We strongly recommend that if Ofgem proceeds with this proposal, that it should produce Guidance to help suppliers make adequate and realistic plans.

We welcome Ofgem's proposal not to expect these plans to be published; much of the information Ofgem expects them to contain is commercially sensitive and disclosure could help those who wish to illegally access systems to do so more easily.

An alternative may be for Ofgem to make the provision of a Customer Supply Continuity Plan a requirement only where it has, after carrying out a milestone or dynamic assessment, concluded that a supplier is financially unstable or otherwise at risk of having its licence revoked.

Independent audits

We are supportive of Ofgem's policy intent to limit its use of this licence condition to situations where it has significant concerns about a supplier's financial solvency or customer service arrangements. However, this is not reflected in the wording of the licence condition. We propose the following alternative wording:

"5B.1 After receiving a request from the Authority to commission an Independent Audit that the Authority has significant concerns about a supplier's financial solvency or customer service arrangements, the licensee must …"

Paragraph 3 to licence condition 5B reads: "*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.*" This places an obligation on auditors, who are not regulated by Ofgem; the licence condition therefore seems to be unenforceable. This should be redrafted to require

suppliers to commission the auditor to carry out the audit in line with the terms of reference supplied by the Authority.

We would point out that, in order for a supplier to be able to share an independent auditor's report with Ofgem, either Ofgem would need to be a party to the letter of engagement or the supplier should be required to make provision in the Terms of Reference to the independent auditor that Ofgem can be provided with a copy of the report. We recommend this is reflected in the licence condition.

Monitoring and reporting requirements

We are supportive of this requirement and consider that the items listed under SLC 19AA.2 are all information we would normally expect to notify Ofgem of.

Given that this requirement is closely linked to Ofgem's principle to be open and cooperative with the regulator, we would expect to see the two conditions close together in the licence. Indeed, we would recommend that both licence conditions appear within SLC 5 should Ofgem decide against our proposal to place the majority of these obligations together in SLC 4A.

Exit arrangements

Customer interactions with administrators

Insolvency practitioners have a regulatory objective to promote *"the maximisation of the value of returns to creditors and promptness in making those returns."* (Insolvency Act 1986 S391C (3) (c)). Electricity and Gas suppliers' chief obligations are to treat customers fairly (Standard Supply Licence Condition (SLC) 0.1). Therefore, where an insolvency practitioner must look first to the interests of those to whom money is owed, suppliers must look first to the interests of all energy consumers, particularly those whom it supplies and very particularly to consumers in vulnerable situations.

We do not believe there is any obligation on an insolvency practitioner to apply the terms and conditions of its client when meeting its objective. Ofgem has not produced any evidence to show that the actions it is proposing suppliers to take, i.e. including specific terms and conditions in its Domestic Supply Contracts and Deemed Contracts and requiring those contracts to state that they bind the licensee in administration, will have any legal effect. We challenge Ofgem to obtain assurances from insolvency practitioners or their professional bodies that, when dealing with a client in administration, they will apply the terms of such contracts when dealing with customers of their client.

Ofgem's requirements with respect to this proposal require suppliers to divert resources to the drafting of terms, including these in communications and notifying customers of them, all of which we believe is to no avail. Suppliers terms and conditions are already extremely lengthy due to the significant amount of regulation; this is of no benefit to consumers, for whom the effort of reading and understanding such documentation is, in some cases, too daunting.

We therefore strongly reject the application of this proposal.

However, should Ofgem choose to proceed with it, we recommend the following changes.

- 27.8A, first bullet point: the phrase *"has been given time"* is too vague and open to interpretation. We suggest a precise time limit, e.g. two weeks, be substituted.
- 27.8A.2: it needs to be clear that set off is only possible where the two supply contracts are with the same supplier. We propose the final wording should be *"under another supply contract with the same licensee."*

Customer book sales

We are supportive of this requirement. However, should a supplier undertake a Trade Sale or Trade Purchase under the conditions set out in the proposed 19D.1, either deliberately or innocently, believing that parts (i) and (ii) do not apply, it is limited in effective sanctions against that supplier. In order to deter non-disclosure, Ofgem should clarify what actions it would take in the event of breach of this licence condition.

SoLR commitments

The major concern for suppliers in committing to honour credit balances in an SoLR situation is the quality of information provided to them during the bidding process. Whilst we acknowledge that other proposals in this consultation will aim to improve the quality of data held by suppliers, as we have noted elsewhere in this response there can be a wide gap between an aim and an achievement. We do not believe it would necessarily be obvious to Ofgem whether Customer Supply Continuity Plans are accurate and up to date. Once a supplier fails, there is nothing Ofgem can do to penalise them for such failure.

The provisions of the proposed SLC 7.12(b) could result in a supplier that had bid to cover all credit balances becoming financially unstable themselves, and even following the failed company into administration. To protect themselves, bidders might state that they would honour credit balances to the value notified in the SoLR RFI; there could then be difficulties determining who should be credited and who should lose out. The licence condition might then be seen to further damage confidence in suppliers and the energy industry.

Ofgem will have knowledge of whether any SoLRs have previously failed to honour credit balances as promised in their SoLR bids. If this is a major issue, it suggests this is evidence that the SoLR process is not fit for purpose and needs a thorough review. E.ON favours greater use of the supplier company administration procedures, which would require an administrator to maintain the supply business until each and every customer had been found a suitable alternative supplier, by means of trade sales or otherwise.

This licence condition again requires suppliers to extend the length of their terms and conditions of supply, to the detriment of many customers for whom the sight of pages of even the most simply worded document is daunting. As we believe such a contract term has the potential to cause negative unintended consequences, we do not support its inclusion in this package.

Portfolio splitting

We are supportive of enabling portfolio splitting for the purposes of SoLR events to the extent that makes it possible to split domestic and non-domestic customers; this would allow those companies who only supply one or the other type of customer to bid to be SoLR where the failed supplier has a mixed portfolio.

We do not support the ability to split portfolios in other ways. Our reasons are:

- The complexity of putting together SoLR bids that take account not only of which customers a supplier prefers to take on, but constructing that bid in such a way as to make it more attractive than other bids and to make it unlikely that the bidder will have to take on customers it has no appetite for should no-one else bid for them. For example, if it were possible to split portfolios by region, a supplier wishing to bid for only certain regions must consider which regions other suppliers may bid for and how Ofgem might have to make difficult decisions on how to ensure all regions have an SoLR. Suppliers must construct and submit bids in a very short space of time and the more complex the process is the more likely they are to make errors in their responses which could have a disastrous impact should they be selected as SoLR and could even result in their own demise.
- The complexity for Ofgem in ensuring all customers of the failed supplier have an SoLR and that the portfolio is split to the best advantage of all customers. Ofgem has to make decisions quickly in order to ensure continuity of supply and the more complex the bidding process, the greater the risk of making a less than optimal decision.
- The risks of cherry picking; for example, if it were possible to bid based on customers' payment methods, there may be a significant number of competitive bids for Direct Debit customers and, for those paying on receipt of bill, there may be no bids at all, or the bids may be considerably less attractive and disadvantageous to customers.

We would welcome more information on Ofgem's proposals for portfolio splitting in order to be able to comment on the viability of different types of split.

APPENDIX

E.ON's suggested positioning for Ofgem's proposed new licence conditions

Proposal	Ofgem's proposed licence condition	E.ON's suggestion for position in licence
Operational Capability	4A	4A
Cost mutualisation	4B	4A
Ongoing fit and proper requirement	4C	4A
Principle to be open and cooperative	5A	4A
Independent audits	5B	4A
SoLR commitments	7.12	7.12
Monitoring and reporting requirements	19AA	4A
Customer Supply Continuity Plans	19C	4A
Customer book sales	19D	4A
Customer interactions with suppliers	27.8A	7.2B
Milestone and dynamic assessments	28C	4A