

Supplier Licensing Review: Ongoing Requirements & Exit Arrangements Statutory Consultation

20 August 2020

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses. The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

This is a high-level response to Ofgem's statutory consultation for ongoing requirements and exit arrangements as part of its Supplier Licensing Review. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes action from Ofgem to protect customers from the impact that financially ill-prepared suppliers have on other market competitors and consumers overall, and we recognise the customer detriment created by certain suppliers' financial instability and poor customer service that it is seeking to address through this review.

However, some of the licence drafting proposed by Ofgem is very broad and could be read as providing Ofgem with power beyond the scope of the consultation. For example, both the proposals for the 'independent audit' and the 'open and cooperative' licence conditions do not specify under what circumstances they would apply. In addition, some proposals do not have a clear justification for introduction as they would provide Ofgem with no additional powers over and above what it already holds through other licence conditions.

As part of this statutory consultation Ofgem has also introduced a new principles-based requirement for suppliers to prevent mutualisation of costs should they fail. Introducing a significant change in policy at the Statutory Consultation stage means industry and stakeholders have limited time to consider and appraise the new proposal. Ofgem should set out clear success criteria for the Financial Responsibility Principle, and how it will seek to enforce the principle in practice to ensure that customers are better protected from the cost of mutualisation in the future.

Better Risk Management

Cost Mutualisation Protections

We believe that Ofgem needs to set out in greater detail how it envisages the Financial Responsibility Principle will be enforced in practice. In particular, Ofgem should set out how it will seek to act proactively using the proposed principle to ensure that the market is protected from mutualisation before a supplier fails. We are concerned that if Ofgem was only to act once a supplier is already failing, then that would offer little to no improvement from the current circumstances. For example, the costs associated with the Renewable Obligation (RO) have been a major reason for supplier failures in recent times. Ofgem should closely monitor how suppliers comply with the financial responsibility principle during 2021, including how they approach costs that could be mutualised. We also note that in a February 2020 open letter, Ofgem stated that it was coordinating with BEIS on potential changes to the RO scheme, but there have been no further updates.¹ We would urge Ofgem to ensure that BEIS addresses any deficiencies in the RO policy design that increase the risk and costs of mutualisation.

We would welcome clarification on how Ofgem intends to measure the success of the principle in practice. For example, will Ofgem be using the reduced impact of mutualisation expected from the prescriptive controls that were outlined in the previous Impact Assessment as a form of benchmark for success of the Financial Responsibility Principle?² We would also urge Ofgem to provide the market with clarity on its previous plans to introduce prescriptive credit requirements for the customer balances and policy costs.

Operational Capability Principle

While we agree with the aim of the proposal, Energy UK does not believe that this principle is required. The principle does not add any value or grant additional powers to Ofgem over and above the Financial Responsibility Principle being proposed, or its existing powers. We are concerned that this principle will only add further burdens on compliant suppliers without having a justified rationale for inclusion or a clearly defined usage. Ofgem must clearly demonstrate how this proposal would grant any powers that it does not already hold through other licence conditions.

Milestone Assessments

Energy UK agrees with the principle of the proposal for Ofgem to assess suppliers at certain milestones to ensure that they remain sustainable throughout periods of growth, as long as it is appropriately mindful of the different ways in which businesses can be robust during periods of growth. We, therefore, welcome the changes to this proposed measure and the streamlined number of thresholds for the milestone assessments. However, further clarity would be welcome on Ofgem's decision to select the two thresholds of 50,000 and 200,000 customers. We note that thresholds for obligations such as the Energy Company Obligation (ECO) is reducing to 150,000. Ofgem needs to ensure that its rationale for the chosen thresholds remains robust and appropriate for the market.

It will be important that Ofgem strike an appropriate balance between protecting customers from supplier failure and encouraging innovation. As the regulator, Ofgem should be seeking to lay down what should be achieved, rather than necessarily making judgements on how it should be specifically achieved.

On a wider note, there are various obligation thresholds for suppliers within the licence which may create unnecessary complications. We would welcome engagement with Ofgem to explore whether these various thresholds could be streamlined and harmonised to simplify the licence and avoid any unnecessary hurdles to growth or innovation.

¹ [https://www.ofgem.gov.uk/system/files/docs/2020/02/170120 - cost mutualisation - update letter on further policy consultation v.2 0.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/02/170120_-_cost_mutualisation_-_update_letter_on_further_policy_consultation_v.2_0.pdf)

² [https://www.ofgem.gov.uk/system/files/docs/2019/10/191021 - draft impact assessment final new updated.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/10/191021_-_draft_impact_assessment_final_new_updated.pdf)

We note that the consultation sets out that an RFI for a milestone assessment will need to be completed in a “reasonable period of time”. We would encourage Ofgem to be proportionate with the timings on any RFI requests, particularly taking into account of their complexity and the timings of when the RFI would fall (e.g. holidays, overlap with existing reporting deadlines). Ofgem should also set out the actions it would seek to take if a supplier fails to notify it of approaching, or reaching a particular threshold, as this is not set out in the consultation.

Energy UK would also urge Ofgem to ensure that the thresholds do not detract from the use of focussed dynamic assessments if it has material concerns about a supplier that is approaching one of the milestones.

Dynamic Assessments

Energy UK is supportive of Ofgem’s proposals for dynamic assessments, and its intention to be flexible in its approach on a case-by-case basis. As part of this flexibility, Ofgem should ensure that any formal requests are as focussed as possible to allow it to investigate areas of concern, rather than act as a general information gathering tool which could place a disproportionate burden upon a supplier.

Responsible Governance and Increased Accountability

Ongoing Fit & Proper Person Requirement

We note that this proposal reflects the measure already put in place for the stricter market entry requirements. However, we are concerned that its use for existing suppliers may not be as effective as it is at market entry, and will instead simply add further burdens on suppliers with no gains for overall market integrity.

We would welcome clarity from Ofgem on whether this will be applied retrospectively, by requiring assessments of senior members of staff already in place, and what actions Ofgem would then expect of suppliers as a result of those checks. A clearer definition and guidance as to the staff who would be in scope would also be beneficial, and we note that the implementation of this measure may be markedly different in scope and impact depending upon suppliers’ size. We note that there will be a number of suppliers that must do similar checks as they are FCA regulated, and Ofgem must ensure that its processes take this into account to ensure there is no unnecessary duplication of effort for no gain.

We are also concerned that the draft SLCs are overly prescriptive to meet Ofgem’s stated aims, and could result in unintended consequences for the industry in the longer term. In particular, the requirement for suppliers in the draft SLCs 4C.3 (e) and (f) to account for individuals who have previously worked for a supplier which has been issued a Last Resort Supply Direction or has had experience of enforcement action against their previous employer risks unfairly excluding experienced individuals. The prescriptive nature of the proposed draft SLCs could lead to unintended consequences of discouraging suppliers from retaining experienced individuals following a Supplier of Last Resort process, meaning operational expertise and the opportunity for learning from failure is lost.

Open & Cooperative Principle

As outlined in our response to the policy consultation, Energy UK does not believe that this condition would be a useful addition to the already extensive supply licence conditions. Ofgem already has powers to compel suppliers to provide information, making this proposal redundant. Inserting a short, principles-based condition into a 500+ page licence is unlikely to impact upon culture in unreasonable suppliers. Any condition in this area needs to be well-defined and address the concerns that the Supplier Licensing Review are based upon.

Ofgem has not sufficiently outlined what it would expect from suppliers over and above current requirements, nor how it would seek to act against a supplier that it considers is in breach of this proposed condition. We believe that this principle would, in practice, also overlap with existing information gathering powers granted to Ofgem by SLC 5. Ofgem must clearly demonstrate how this proposal would grant any powers that it does not already hold.

Increased Market Oversight

Customer Supply Continuity Plans (CSCP)

While we recognise the intent of this proposal, and the importance of improving data quality overall in the sector and for SoLR purposes, Energy UK remains of the view that the proposal will not translate in practice to reliable improvements. Instead, the requirement to maintain a CSCP will create additional burdens for compliant suppliers while any supplier who is approaching failure will be lax in its upkeep, leaving it unusable for its intended purpose. In practice, a SoLR will have to undertake its own processes to validate data as happens currently, giving no benefit to that supplier as proposed. In such a scenario, there would also be no route for enforcement against the failed supplier, or a failing supplier that is prioritising financial survivability over the upkeep of this document.

We are also concerned about the exact requirement on keeping this information updated, as there will be material impacts based upon whether it is daily, monthly or quarterly. The consultation notes that Ofgem could request this document at any time, but does not stipulate the timescale for a supplier to submit a response. Given Ofgem's keenness to implement the measures under consultation quickly, we are concerned that this requirement will put pressure on suppliers already responding to changing consumer needs in response to COVID-19 and an extensive regulatory programme. We continue to believe that Ofgem should continue to explore alternative measures to meet its aim.

However, if ultimately implemented, we would recommend that Ofgem revisit the requirement for all suppliers to complete a CSCP and allow suppliers to prioritise the more pressing measures outlined in this consultation. A practical solution may be to incorporate this measure into part of the dynamic assessments or independent audits that will be conducted at points of higher risk if there are causes for concern, which may be more proportionate and valuable than making every supplier produce, and continually update, a document which would have questionable value at most times. The parameters of this document must also be kept as simple as possible to minimise undue burdens on compliant suppliers.

Given the questionable usefulness of these plans, if implemented Ofgem should also commit to reporting on the effectiveness of this measure after each SoLR event, providing transparency on whether the supplier's continuity plan was of use, and conduct a full review after a certain period of time (e.g. a year) or a certain number of SoLR events into the measure as a whole.

Independent Audits

Energy UK remains concerned that the drafting of the licence condition will allow Ofgem use of independent audits far outside of its intended purpose and in areas of compliance outside of the scope of the Supplier Licensing Review. While the draft licence condition states that the audit "may" cover certain aspects of a supplier's business, there is no requirement for Ofgem to only use this power in relation to those specific areas of compliance. The licence drafting should be restricted further to ensure that this power is only used in the future for its intended purposes. An independent audit will impose significant costs upon a supplier and so should only be used where there are justified concerns within the areas outlined in the Review.

We are also concerned that Ofgem has provided little clarity as to the process it will follow when requiring an independent audit from a supplier. We believe that it should follow a similar process within Ofgem as to the launch of an investigation, requiring senior-level sign-off and a well-justified case to be built before imposing such a cost on a supplier.

Additional Reporting Requirement

Energy UK does not disagree with the intent behind this measure. However, it is unclear how this requirement is different to the proposal for an Open & Cooperative principle and other measures in practice.

On a practical level, Ofgem should clarify its expectations for how a supplier should notify Ofgem to be compliant. It is not clear what team or seniority level at Ofgem should be informed of any of the relevant changes.

Exit Arrangements

Customer Interaction with Administrators

Energy UK has previously highlighted concerns with the current practice of some administrators of failed suppliers, and supports action to better protect customers from sharp practices and to improve their overall experience.

We acknowledge that the regulation of administrators is outside of Ofgem's remit, and welcome its efforts exploring what can be done within the current regulatory framework. Energy UK is concerned that its proposed change would, however, have limited, if any, impact on influencing administrator behaviour when acting for a failed supplier and just place another burden on compliant suppliers for no benefit.

Energy UK is keen to understand the legal impact Ofgem believe this requirement will have, and would urge Ofgem to share any legal advice it has received on this proposed measure, particularly regarding whether it is enforceable for the consumer.

In addition, we have a specific concern with the current drafting of SLC 27.8A, which states:

(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.

Our concern is that, as drafted, the requirement goes further than the rest of SLC 27. Suppliers are not currently required to ascertain ability to pay before demanding payment and may prove complicated prior to the provision of a bill. For example, a supplier could be non-compliant with both SLC 27.8A and its own terms and conditions if it writes to a customer stating: *"You currently owe us £50. Please pay by x or y method or get in touch if you are facing payment difficulties"*. We do not believe this would be Ofgem's intention, and we would encourage it to review the specific wording of this condition to ensure it appropriately aligns with its intention.

Customer Book Sales

Energy UK recognises the rationale for this measure and the principle underpinning it is understandable.

However, we note that Ofgem has previously aimed to make commercial exits the norm in the retail market, rather than SoLR events, and it should be careful not to undermine this intention to complicate further the ability to make orderly, responsible market exits.

We have a number of concerns that have not been fully addressed by the consultation which we would urge Ofgem to clarify before seeking to implement.

In addition, to aid in orderly commercial exits from the market, we would encourage Ofgem to review current obstacles that may complicate such exits, such as ECO and FiT obligations, and seek to create new processes that ease the way for responsible market exits.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.