



Making a positive difference
for energy consumers

Gas and electricity suppliers and prospective suppliers, gas transporters and electricity distributors and all other interested parties

Licensing@ofgem.gov.uk

Date: 11 June 2018

Dear colleague

Review of Ofgem's approach to licensing suppliers

Our Forward Work Programme for 2018/19¹ sets out that one of our key priorities for the current year is to enable a better functioning retail market. We propose to achieve this in a number of ways, including by improving supplier conduct. As part of this, we have decided to review our approach to licensing suppliers, to ensure that appropriate protections are in place against poor customer service and financial instability.

This letter sets out the scope and objectives of our review. The review will consider potential reforms to the current licensing arrangements for supply market entry², as well as exit and ongoing operation and monitoring. Some of the areas we intend to consider imply potentially longer-term reform (if appropriate), while others could be delivered, and benefit consumers, more quickly. We therefore expect any changes to be introduced in stages.

Background

Licensing

Parties that supply gas and/or electricity to customers in Great Britain (GB) are licensed by Ofgem. We set criteria against which we assess applications from parties seeking to hold a supply licence.³ Any party that applies for and is granted a supply licence must comply with the 'terms' and 'conditions' of that licence when operating in the supply market.⁴ Our licensing regime seeks to minimise regulatory burden and maximise the opportunity for new suppliers to enter the market, while ensuring that the interests of existing and future consumers are protected.

¹ https://www.ofgem.gov.uk/system/files/docs/2018/03/forward_work_programme_2018-19_0.pdf

² Our review will cover only those arrangements we are responsible for through licensing, and will not consider the detailed industry code rules related to market entry.

³ These criteria are set out in Regulations established under the Gas and Electricity Acts, and we publish guidance on the process for applying for a licence: <https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/application-process>

⁴ The standard licence conditions for gas supply and electricity supply are available on our website: <https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-conditions>

The Office of Gas and Electricity Markets

10 South Colonnade, Canary Wharf, London, E14 4PU Tel 020 7901 7000 Fax 020 7901 7066
www.ofgem.gov.uk

The current licensing regime has successfully supported the increase in the number of suppliers in today's market, from 27 active domestic suppliers in December 2014 to 66 active domestic suppliers in September 2017, giving consumers more choice than ever before. Customers have benefitted from the competitive pressure caused by new suppliers entering the energy market, helping to deliver more competitive pricing and drive service quality up. However, we recognise that low entry barriers, and more participants active in the market, could increase the likelihood of companies entering the market who are not meeting expectations with respect to customer service and of supplier failure.

The current regime for obtaining a supply licence is largely based on arrangements introduced in 2003, when we reviewed the application arrangements that had been in place in broadly the same form since privatisation, and decided to significantly reduce the burden on applicants.⁵ Our last substantial review of these arrangements was in 2010, when we introduced a risk-based tiered application process, while retaining the overall approach adopted in 2003.⁶ Given the changes in the retail market since then, we consider it is timely to review the current supply licensing arrangements.⁷

Engaging new suppliers and ongoing monitoring

As part of our ongoing compliance and monitoring role, we meet new suppliers operating in the market in order to establish a compliance relationship and understand what they bring to the market. We also work closely with our partners at the Citizens Advice service and the Energy Ombudsman to keep an eye on developments and to coordinate our engagement with suppliers, to seek to avoid or mitigate any issues that could adversely impact customers. Any changes to supply licensing arrangements might be expected to have impacts on the ongoing monitoring of suppliers we carry out.

Supplier exit

The supply licence sets out the circumstances in which we may revoke the licence.⁸ For example, we can revoke a licence by agreement with the licensee (if, for example, a supplier has voluntarily decided to exit the market), or if a licensee has not commenced supply within a year of licence grant (or has ceased to supply). We can revoke a licence if the supplier is insolvent (in specific circumstances). We can also revoke a licence if the licensee has failed to comply with an order made by us in relation to breach of licence, or has failed to pay a penalty we have imposed.

The powers to revoke a licence are, appropriately, restricted. We will consider under our review whether we need additional tools to manage market exit in exceptional cases, for example where we have strong evidence of poor supplier performance leading to significant consumer detriment.

⁵ Consultation document, September 2002: <https://www.ofgem.gov.uk/publications-and-updates/review-licensing-application-regulations.-consultation-document>

Consideration of responses, April 2003: <https://www.ofgem.gov.uk/publications-and-updates/consideration-responses-consultation-document-review-licensing-application-regulations>

⁶ Amongst other things, this review responded to concerns that European energy markets could be targeted for large scale VAT fraud.

⁷ This review will consider only supply licences and not the application process for other types of licences.

⁸ The gas supply licence revocation provisions are here:

https://www.ofgem.gov.uk/sites/default/files/docs/2012/01/gas_supplier_licence_revocation_conditions_0.pdf.

The electricity supply licence revocation provisions are here:

https://www.ofgem.gov.uk/sites/default/files/docs/2012/01/electricity_supply_licence_revocation_conditions_0.pdf.

Supplier failure and our safety net

From time-to-time, a supplier in the competitive retail market will fail. We do not consider that any test Ofgem could apply as part of the licence application process can provide ongoing assurance in respect of a supplier's future conduct and/or financial performance. Nor is it our role to seek to prevent market exit, which is a normal part of a well-functioning market.

Not all instances of supplier failure will require regulatory intervention, however we have powers to act if they do, in order to minimise wider market impacts and to protect consumers. This includes our powers to appoint a 'Supplier of Last Resort' (SoLR) for the customers of a failed supplier.

In 2016, we published revised guidance⁹ on our approach to supplier failure and the criteria we would consider when selecting a SoLR. Since then, there have been two instances of supplier failure that required our intervention, in November 2016¹⁰ and February 2018.¹¹ While the process has worked well to date, these cases have shown areas where the arrangements could potentially be improved. It is therefore timely to review the SoLR and safety net arrangements to ensure that they are as efficient as possible and continue to work in the interests of consumers.

Scope and Objectives of our review

The aim of our overall approach to supplier licensing, monitoring and engagement is to be effective and proportionate in protecting consumers against poor customer service and the potential impacts of supplier financial instability, while facilitating competition and innovation which benefit consumers. We consider that appropriate arrangements to protect consumers when a supplier exits the market are an essential part of effective and proportionate supply licensing arrangements.

In undertaking our review of supplier licensing and related arrangements, including those in place to manage instances of supplier failure, our objectives are therefore broadly to:

- **Apply appropriate scrutiny and oversight of suppliers entering and operating in the market**, without unduly constraining competition and innovation;
- **Ensure consumers are protected where suppliers are failing to meet their obligations** – in particular, whether our powers to revoke licences are adequate;
- **Strengthen consumer protection in cases of supplier failure**, by protecting customers directly affected, and minimising wider market impacts.

In undertaking our review we will look at these areas:

- **Conditions for entering the market** – we will review our approach to issuing a licence to increase confidence that new suppliers can meet expected customer service standards, and to consider whether there should be any additional requirements relating to the financial health of a prospective supplier or the level of financial information it may be appropriate to obtain from those entering the market.
- **Ongoing monitoring and engagement** – we will also consider whether any changes to licensing requirements would result in the need for additional ongoing checks/requirements during a supplier's operation in the market.

⁹ https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf

¹⁰ <https://www.ofgem.gov.uk/publications-and-updates/appointment-co-operative-energy-limited-supplier-last-resort>

¹¹ <https://www.ofgem.gov.uk/publications-and-updates/appointment-green-star-energy-supplier-last-resort>

- **Arrangements for managing supplier failure and market exit** – we will review our SoLR and consumer safety net arrangements to strengthen our process for appointing a new supplier effectively and quickly where necessary when a supplier fails, and review whether we need additional tools to manage orderly market exit in other exceptional cases.

Next steps

Where we identify that change is required we will seek to implement those changes quickly, where possible, to ensure that beneficial changes to protect consumers are in place as soon as possible. This means we anticipate that the implementation of any improvements to the current processes and provisions would take place in stages.

We currently expect to issue a consultation on our review of the licensing arrangements for suppliers by late summer. In the meantime, we have identified a number of licence modifications that could be delivered sooner, to ensure our SoLR arrangements are as effective as possible. Therefore separate to our broader review, we will consult on these proposed licence changes shortly, in order that any beneficial changes to further protect consumers can be introduced quickly.

Yours sincerely,

Philippa Pickford
Interim Director Future Retail Markets, Ofgem