

Supplier Licensing Review: Energy UK Response

23 January 2018

Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. 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 very much welcomes this review of supplier licensing. We have been calling for Ofgem to undertake this work for some time and are pleased to engage with Ofgem's proposals within the consultation. The importance of this workstream has been unfortunately highlighted in the recent months with the growing frequency and size of market exits and Supplier of Last Resort (SoLR) events which have placed additional costs onto customers and market participants.

Energy UK is generally supportive of the proposals that Ofgem outlines in the consultation, in particular the proposed requirement for additional information and altering the timing of the assessment phase to gain a more current understanding of applicants' plans and understanding of regulatory responsibilities.

However, we believe that Ofgem has not fully made the case against the strictest of its proposals and the limitation of information requirements to 12 months. Given that such requirements would provide consumers with the greatest protection from risks, we would welcome further evidence from Ofgem that such requirements would be too resource intensive to be proportionate to the risks. In particular, with the possibility that the frequency of market exits is increased further in 2019 and beyond by the imposition of the default tariff cap, it is imperative that market entrants are sufficiently scrutinised to minimise the risk of consumer harm.

Alongside stricter market entry requirements, Energy UK also welcomes Ofgem's plans for greater ongoing market monitoring. Ofgem should ensure that this workstream remains a priority as it is consumers who are directly impacted via the smeared costs of failing suppliers, which reached over £50m in 2018.

Additionally, Ofgem should seek to ensure that its work to introduce stricter market entry or ongoing requirements are taken into account within its considerations of the future of the Supplier Hub model. In particular, Ofgem should be mindful of re-introducing or increasing the very same risks through any reforms to the model that it is seeking to mitigate with its supplier licensing review.

Consultation Response

Chapter 2

Do you agree with the principles we have set out to guide our reforms?

Energy UK agrees with the high-level principles set out by Ofgem in the consultation document. However, Ofgem could also consider the principle that suppliers should bear the cost of the risk that they pose to the system to ensure these costs are fairly balanced.

Chapter 4

Do you agree with our proposal to introduce new tougher entry requirements and increase scrutiny of supply licence applicants? Do you agree this can be achieved with increased information requirements and qualitative assessment criteria?

Energy UK is supportive with Ofgem's general proposal to introduce tougher entry requirements and increase scrutiny of supply licence applications, especially as we are seeing an increasing frequency of Supplier of Last Resort (SoLR) events. The review is also particularly welcomed as the market adjusts through 2019 and beyond to any potentially detrimental unintended consequences of the default tariff cap that took effect on 1 January.

Energy UK does not specifically oppose Ofgem's minded-to position of Option 2 as the preferred proposal to introduce tougher entry requirements. However, we do not believe that Ofgem have sufficiently made the case against requiring certain detailed information it proposes as part of Option 3, especially with regards to the expected resource intensiveness. A number of Energy UK members view that only Option 3 would be robust enough to provide the needed level of customer protection and impose the necessary requirements around adequacy and being fit and proper.

Due to Option 3 providing lowest exposure of consumers to risks associated with financial instability, Energy UK would welcome Ofgem's further consideration on the possibility of taking forward some of the additional requirements in order to minimise the risk of increasing even further the frequency, consumer detriment and market-wide costs of SoLR events. We would also welcome Ofgem providing clarification on its estimates of increased resource requirements to enable its conclusion of disproportionality to be effectively commented upon.

As an example, such additional application requirements could include business and growth strategies, and evidence of the applicant's ability to service customers within the expected growth. Alternatively, this additional scrutiny could be implemented through Ofgem's ongoing market monitoring activities that will be set out in a future consultation.

Energy UK disagrees with Ofgem's conclusion that the speculative nature of projections and business/growth plans past 12 months necessarily merits their exclusion from consideration completely. While post-12-month projections and plans may be more speculative, Ofgem should consider the benefits for their use as a baseline to assess suppliers against as part of its future proposals for ongoing market monitoring.

Whatever the final proposal that Ofgem decides to implement for stricter market entry requirements, it will be paramount that the application process ensures that Ofgem deals directly with those who will be supplying energy through the licence, rather than any separate entity who may be applying for the licence on their behalf. While such off-the-shelf licence providers play a role within the market, not least in reducing administrative barriers to entry and innovation, they should not be allowed to be used a vehicle to circumvent proper scrutiny.

Chapter 5 – Entry criteria: initial proposals

Do you agree that our proposed assessment criteria for supply licences applications are appropriate?

Energy UK is supportive of Ofgem's proposed assessment criteria. However, as we noted above, Ofgem should provide more evidence in its argument against additional detailed information requirements from Option 3. With the possibility of greater frequencies of SoLR events in a price-capped market, we do not believe that Ofgem has sufficiently made the case against Option 3 in this consultation, particularly given that it provides consumers with the greatest protections.

Do you agree that applicants should provide evidence of their ability to fund their activities for the first 12 months, and provide a declaration of adequacy?

Energy UK agrees that the proposals represent an improvement on the status quo. However, we do not believe that Ofgem has sufficiently made the case for limiting information requirements to 12 months and it should clarify its evidence against a requirement for applications to show a longer-term ability to fund activities or provide credit cover. This longer-term information could then be utilised as part of Ofgem's ongoing market monitoring work to better identify risks from suppliers by using them as a baseline to assess suppliers against.

Do you agree with the specific information we would generally expect applicants to provide (in Appendix 1)? If not, why/what would you add or change?

Energy UK agrees with the specific information required, as outlines in Appendix 1. However, we are concerned that Ofgem has not proposed to make a judgement on applicants' assumptions used in the projections, which would seem undermine the usefulness of such an exercise. Ofgem should provide clarification on any judgements it will seek to make about the information received, which we note could change the role that Ofgem currently plays in market entry.

Do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence?

Energy UK agrees that it would be sensible to expect and to check that suppliers can do what they are meant to from day one, noting the high level of regulatory complexity in the retail energy market and the need to protect consumers from harm.

Do you agree with the areas we would generally expect applicants to cover (in Appendix 1)? If not, why/what would you add?

Energy UK agrees with the areas that Ofgem would generally expect applicants to cover.

Do you agree that we should ask additional 'fit and proper' questions as part of the application process (as set out in Appendix 1)?

Energy UK would welcome clarity from Ofgem as to the specific questions it would ask regarding past practices from directors of failed suppliers and whether past enforcement action information, that Ofgem is privy to, will be used to make a judgement. We would also welcome greater specificity in general within Appendix 1 to get a better picture of the questions Ofgem considers it would ask, rather than broad areas, and how Ofgem intends to use the information.

It would also be beneficial for Ofgem to clarify how it would benchmark for 'fit and proper' and provide clarity on how it intends to track ongoing adherence over 12 or 18 months, or longer. Ofgem should also consider the feasibility of allowing an applicant to transfer a 'fit and proper' assessment from elsewhere into supplier licensing, where appropriate, to cut down on unnecessary duplication in administration processes.

Chapter 6 – Timing of licensing: initial proposals

Do you agree that Ofgem's licensing process should be undertaken closer to proposed market entry? Do you identify any barriers to this approach or any adverse impacts of this change?

Energy UK agrees that Ofgem's proposal are a sensible approach, as the information required will be current and it will be from those seeking to run the licence. Energy UK is particularly supportive as this would ensure that suppliers are not able to avoid the tougher market entry requirements by utilising off-the-shelf licencing providers.

Chapter 7 – Ongoing requirements

Do you consider that suppliers should report on their financial and operational resilience on an ongoing basis? If so, do you have any initial views on the content of these reports/statements?

Energy UK agrees with Ofgem's proposal for suppliers to report on their financial and operational resilience on an ongoing basis. However, Ofgem should provide clarity on how it would intend to use the information. For example, the reports could be checked against long-term growth plans to identify any potential risks, or track certain KPIs such as complaints volumes to ensure that suppliers retain, and can evidence sufficient infrastructure for both real customer growth, and anticipated. Energy UK considers that such ongoing requirements should need a reason, and suppliers should not be required to undertake the burden of providing regular reports that are not being utilised by the regulator. It may be beneficial for Ofgem to examine how its current reporting requirements are used to assess whether existing arrangements could be better utilised to achieve the stated aim before introducing new requirements.

Do you have any initial views on the potential introduction of targeted or strategic monitoring/requirements on active suppliers?

With regards to using any action or customer threshold/milestone for a trigger, Energy UK believes that Ofgem needs to provide specific details of how any information resubmission would be used. Energy UK does not believe that it would be beneficial to require information resubmissions without a specific purpose. We would, therefore, welcome clarity on how the information provided would be used and what actions Ofgem proposes to take should certain 'leading indicators' or thresholds be triggered. As part of this work, Ofgem should review and present their evidence regarding what previous indicators were ahead of supplier failures to enable stakeholders to better assess any specific policy proposals.

In addition, Ofgem should recognise that the fiduciary duties, capital adequacy and financial reporting requirements differ greatly between different corporate entities (e.g. PLCs vs Ltd vs private companies). Any additional burdens placed on suppliers by new ongoing reporting requirements should reflect these differing levels of assurance around financial sustainability from different entities.

Do you have any initial views on the potential introduction of prudential/financial requirements on active suppliers?

Energy UK welcomes Ofgem's examination of options that would limit the exposure of customers' credit balances to supplier failure and we look forward to engaging with Ofgem's future consultation.

Do you consider that Ofgem should introduce a new ongoing requirement on suppliers to be 'fit and proper' to hold a licence?

Energy UK would welcome clarity from Ofgem as to the purpose of this proposal, the problem that it has identified that requires such an action and how their proposals would go above and beyond what is already required by the Companies Act.

Chapter 8 – Exit arrangements: managing supplier failure

Energy UK welcomes Ofgem's intention to launch a separate consultation to examine whether new ongoing requirements are needed to minimise the financial and disruptive impacts of a supplier exit. With the growing frequency of SoLR events in recent months, we would urge Ofgem to ensure that this workstream remains a priority.

Energy UK looks forward to engaging positively with Ofgem as it develops policy ideas through the consultation. An example of an ongoing requirement that Ofgem could consider exploring as part of its future consultation might be the introduction of a new licence condition, governed by Ofgem's monitoring and enforcement parameters, requiring licensees to take all reasonable steps to avoid mutualisation of their debts in the event of supplier failure. Such steps could include:

- reporting to Ofgem on whether, and the extent to which, their customers' credit balances are used for working capital and refundable upon request, and
- providing security cover (e.g. letter of credit, parent company guarantee) for mutualisable costs.

As noted above, Energy UK is welcoming of stricter market entry requirements and support Ofgem taking action on this issue. However, given that material risks to consumers and market participants only arise when suppliers are of material scale, we believe that Ofgem should ensure that developing ongoing oversight should be a priority. We note that Ofgem's draft work programme indicates change in this area by mid-2020. With the growing frequency of supplier failures and SoLR events, with the consequential impact and costs on remaining suppliers, there is a clear need for Ofgem to make more timely progress in order to better protect consumer interests.

In this regard, Energy UK would urge Ofgem to assess the impact of the mutualisation of costs under the default tariff cap, such as Renewables Obligation and Feed-in-Tariff. We have noted to the CMA that such considerations should also be part of its mid-term review of the PPM cap. Bearing in mind the principle that suppliers should bear the costs of the risk they impose on the system we raise in response to Question 2, Ofgem could also give consideration to ensuring appropriate arrangements are in place for such schemes to best protect participants and consumers from the default risk of suppliers.

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.