

# Decision

## Supplier Licensing Review: Final proposals on new entry requirements

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We are reviewing our approach to licensing and regulating suppliers to raise standards around suppliers' financial resilience and customer service.

In November 2018, we consulted on a new approach to licensing suppliers. We invited views on our proposals to strengthen the criteria we use to assess supply licence applications, and to amend the process for applying for a licence.

We also invited views on a number of high-level options to increase our ongoing scrutiny and oversight of suppliers already operating in the retail energy markets, and began discussion of how we might strengthen our arrangements for dealing with supplier exit.

This document outlines our final policy proposals on new market entry requirements for suppliers. We also set out next steps for the remaining phases of our Supplier Licensing Review which will cover proposals on ongoing scrutiny and oversight of active suppliers, and the market exit arrangements.

**Alongside this document we have published a consultation on new application regulations, with updated application forms and fees, and a new guidance document to implement our new entry criteria for suppliers.**

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## Contents

<b>Executive Summary</b> .....	<b>4</b>
<b>1. Introduction</b> .....	<b>6</b>
What have we been consulting on? .....	6
<b>2. The case for change and our aims</b> .....	<b>7</b>
Section summary .....	7
<b>3. Entry criteria: final proposals</b> .....	<b>11</b>
Section summary .....	11
Broad approach.....	11
Assessment criteria .....	15
Detailed requirements.....	16
<b>4. Timing of licensing: final proposals</b> .....	<b>18</b>
Section summary .....	18
<b>5. Next steps</b> .....	<b>22</b>
New entry regime.....	22
Ongoing requirements and exit arrangements .....	22
<b>Appendices</b> .....	<b>24</b>
<b>Appendix 1 – List of non-confidential consultation responses</b> .....	<b>25</b>
<b>Appendix 2 – Consultation Chapter 5: summary of responses</b> .....	<b>26</b>
Summary of responses and our views .....	26
Our response.....	31

## Executive Summary

### Overview

#### **Scope and purpose**

Under our Supplier Licensing Review we are reviewing our approach to licensing and regulating suppliers to raise standards around financial resilience and customer service. We intend to introduce a package of reforms. The scope of the review encompasses our:

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

This document confirms our final proposals on new entry criteria that applicants for a supply licence will need to meet in order to gain a licence. To give effect to these changes we have published alongside this decision a separate consultation on new Applications Regulations, with updated licence application forms and fees, and a new application guidance document. We anticipate that the new licensing procedures will be in place in June.

We will consult further on ongoing requirements for active suppliers in the summer – including ongoing ‘fit and proper’ obligations and potential rules and restrictions in respect of credit balances, to reduce the risks of costs being imposed on the wider market and consumers if a supplier fails.

#### **Context**

New entry to the market in recent years has brought benefits to customers through increased price competition, innovative offerings, and pressure on incumbent suppliers to improve their offer. However, we have also seen an increase in supplier failures and inadequate customer service provision in certain cases. Financial difficulty and poor customer service are often interrelated.

Our current arrangements successfully protect consumers when a supplier fails. Nonetheless, failure is disruptive and can impose costs on competitors. Furthermore, frequent failures risk undermining consumers’ confidence in the market and motivation to switch to a better energy deal. We want to strengthen our licensing and regulatory regime to drive up standards in the sector and minimise competitors’ and consumers’ exposure to financial risks and poor customer service.

Our licensing regime needs to be effective and proportionate in protecting consumers, while facilitating competition and innovation. At this stage in the transition to a low carbon energy system it is more important than ever that firms with innovative business models, products and services can enter the market in a way that delivers benefits for consumers. That said, energy is an essential service; there are minimum standards that suppliers must meet and any company entering the market needs to be well-prepared.

### **Our November consultation**

In November 2018 we set out the overarching principles we proposed would guide our reforms across this review. We described our initial proposals to increase scrutiny of potential new entrants at licensing stage, to ensure they are adequately prepared, resourced and fit to operate in the energy supply markets.

Respondents to our consultation broadly supported our proposed principles, and our view that the entry regime for suppliers should be strengthened. There was significant support for our proposals for how this could best be achieved.

We also discussed high level options for ongoing requirements on active suppliers, and outlined our intention to consider new rules around customer credit balances. A summary of the responses and further discussion of these elements of our review will follow in a working paper in May. That paper will outline next steps on the Supplier Licensing Review, including a stakeholder workshop in June, and further consultation in the summer.

### **Principles**

We confirm that we are adopting the four principles we proposed in November for this review, with the first one updated in response to stakeholder feedback. These principles have guided our final proposals on new licence application criteria for suppliers:

- 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 dialogue with Ofgem
- We maintain proportionate oversight of suppliers, and effective protections for consumers exist in the event of failure
- Our licensing regime facilitates effective competition and enables innovation

### **New entry requirements**

We have decided to introduce new application requirements for suppliers. Entrants will need to provide increased information to us on their market entry plans. We will undertake a qualitative assessment of this information based on three new application criteria:

- Criteria 1: The applicant has the appropriate resources for their proposal to enter the market
- Criteria 2: The applicant understands their regulatory obligations and has appropriate plans in place to meet these
- Criteria 3: The applicant is fit and proper to hold a licence

Any prudent, well-prepared entrant should be able to demonstrate to us at the point of licensing that they have planned their financial and operational resources for entry into the supply market and that they are prepared to meet the costs they will face (for example under government/environmental obligations and other industry costs). Applicants will also need to provide a 'statement of intent' regarding compliance with their licence obligations, with particular regard to customer service. Finally, we are enhancing our assessment of entrants' suitability to hold a supply licence, through new 'fit and proper' disclosure requirements.

### **Timing of licensing**

We consulted on moving the timing of Ofgem's supplier licensing process relative to the electricity market entry testing processes, which can take several months to complete. We confirm our view that licensing should take place closer to actual market entry to better enable applicants to demonstrate that they meet the new application criteria.

### **Next steps**

We are seeking views by 13 May 2019 on the changes required to the Applications Regulations and application guidance document which we have published alongside this decision in an open letter consultation.<sup>1</sup> Subject to that consultation, our strengthened entry regime will be in place from June 2019.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/consultation-new-applications-regulations-application-forms-and-guidance-document>

## 1. Introduction

### What have we been consulting on?

1.1. One of Ofgem’s key priorities is to enable a better functioning retail energy market.<sup>2</sup>

1.2. We announced a review of the supplier licensing arrangements in June last year, to ensure appropriate protections are in place against financial instability and poor customer service.<sup>3</sup> The scope of our review focuses on three areas:

- 1. Conditions for entering the market:** this document sets out our final proposals on a new approach to licensing suppliers.
- 2. Ongoing requirements, monitoring and engagement:** we have consulted on some high level options for new ongoing requirements on active suppliers. We will be publishing an update along with a summary of the consultation responses in a working paper in May. We plan to hold a stakeholder workshop in June.
- 3. Arrangements for managing supplier failure and market exit:** we set out that we are considering a range of options to limit consumers’ and other suppliers’ exposure to the costs of supplier failures, including new rules or restrictions on how suppliers hold and use customer credit balances. We have undertaken a domestic supplier Request For Information (RFI) on credit balance practices and will set out next steps in our May working paper. We will also review our Supplier of Last Resort (SoLR) process and revocation powers, to strengthen our process for appointing a new supplier effectively and quickly when a supplier fails, and review whether we need additional tools to manage orderly market exit in other exceptional cases.

1.3 In November 2018 we set out initial proposals to strengthen the licence application process for suppliers.<sup>4</sup> We proposed the introduction of three qualitative assessment criteria for future supply licence applications, with associated information requirements, and we proposed to amend the current timing of Ofgem’s supplier licensing process. We received 48 responses, 39 of which were non-confidential and have been published on our website. A list of non-confidential respondents is in Appendix 1.

1.4 We have considered all responses in full and have set out a summary of key themes within this document, relating to our proposals on new entry requirements. This document sets out our final proposals on new entry requirements that future supply licence applicants must meet to be granted a licence.

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<sup>2</sup> 2019-21 Forward Work Programme: <https://www.ofgem.gov.uk/publications-and-updates/forward-work-programme-2019-21>

<sup>3</sup> June 2018 open letter: [https://www.ofgem.gov.uk/system/files/docs/2018/06/180611\\_supply\\_licensing\\_review\\_open\\_letter\\_for\\_publication.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/06/180611_supply_licensing_review_open_letter_for_publication.pdf)

<sup>4</sup> November consultation: <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review>

## 2. The case for change and our aims

### Section summary

We recap on the case for change as set out in our November consultation, and summarise stakeholder responses to the over-arching principles we proposed to guide our package of reforms across supplier entry, ongoing requirements, and exit arrangements.

### Background

2.1. Our November consultation document set out how dynamics in the retail energy market have changed since we last reviewed our approach to how we grant licences to suppliers.<sup>5</sup> Competition has grown significantly, and consumer engagement has steadily improved with switching rates up to approximately 19% last year.<sup>6</sup> An increased share of the market held by small to medium suppliers, with a range of new business models and services on offer, has ensured greater choice and price competition for consumers than ever before.

2.2. At the same time, we have also seen an increase in supplier exits. Market exit is a normal occurrence in any competitive market, and supplier failure can occur for a number of reasons. Our licensing and regulatory regime does not seek to prevent this. However, supplier failure can be disruptive. It can lead to unnecessary inconvenience and stress for the failed supplier's customers, and can impact consumers as a whole (and the wider market) if there are significant costs of failure that are mutualised. This can happen where there are unpaid commitments under government schemes (such as the Renewables Obligation) or significant customer credit balance liabilities that the appointed SoLR makes a claim for under the SoLR levy.<sup>7</sup> If failed suppliers are exiting the market in a disorderly way, this may also lead to the competitive dynamic of the market being undermined if confidence in switching to small and newer entrants is reduced.

2.3. We also noted that while some small suppliers tend to outperform larger suppliers in terms of customer service, we have observed that some new entrants have not invested in customer service as they grow, leading to a decline in standards. We are particularly concerned that some suppliers are under-estimating their responsibilities when it comes to supporting consumers in vulnerable situations.

2.4. In light of this we launched our Supplier Licensing Review in June 2018 to seek to strengthen our licensing and regulatory regime to raise standards around financial resilience and customer service. We aim to provide an appropriate balance between protection for consumers against suppliers' financial instability and poor customer service, while ensuring the arrangements do not create undue burdens or barriers to innovation and competition.

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<sup>5</sup> Chapter 2 of our November consultation: <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review>

<sup>6</sup> Ofgem's State of the Market Report 2018: [https://www.ofgem.gov.uk/system/files/docs/2018/10/state\\_of\\_the\\_energy\\_market\\_report\\_2018.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/10/state_of_the_energy_market_report_2018.pdf)

<sup>7</sup> SoLR guidance: <https://www.ofgem.gov.uk/publications-and-updates/supplier-last-resort-revised-guidance-2016>

## Principles for reform

2.5. In our November consultation we said that, at a high level, we want to ensure that well-prepared participants can enter the market and maintain the possibility that suppliers may fail, but for this to be minimally disruptive. To achieve this we consider there is a need to (i) strengthen requirements at entry, (ii) impose new requirements on suppliers to improve our ongoing oversight and promote higher financial and risk management standards, and (iii) ensure there are robust arrangements for when a supplier exits.

2.6. Our consultation document set out our intention to deliver a package of reforms in stages, initially focusing on our entry requirements for suppliers. We proposed four overarching principles to guide our reforms across the full scope of this review, and ensure a coherent set of outcomes:

- **Suppliers should adopt effective risk management and be adequately prepared and resourced for growth.**<sup>8</sup> Significant problems can occur when new entrants grow too quickly/beyond their capabilities. Over-reliance on customer credit balances as a source of working capital can be unsustainable and shifts the costs of failure to the market and consumers. Suppliers should take a responsible approach to growth and bear an appropriate share of the risk, in order to reduce consumers' exposure to failure.
- **Suppliers should maintain the capacity and capability to deliver a quality service to their customers, and foster an open and constructive dialogue with Ofgem.** Energy is an essential service and as such there are certain minimum standards which suppliers must meet. Suppliers should understand, and be prepared to comply with, their obligations from the outset and as they grow. They should also be prepared to maintain a constructive relationship with Ofgem as the regulator.
- **We maintain proportionate oversight of suppliers, and effective protections for consumers exist in the event of failure.** Energy supply is a competitive market and we will not operate a 'zero failure' regime, but we need to ensure that arrangements are robust to protect consumers when failure occurs. Our reforms aim to improve our visibility of market risks and our ability to act where needed, and minimise the wider market impacts of failure.
- **Our licensing regime facilitates effective competition and enables innovation.** Our reforms should not deter innovative and un-tested business models, provided the new entrant is well prepared. We will adopt a proportionate, risk-based approach, that is also in line with our commitment to principles-based regulation.

2.7. We asked stakeholders if they agreed with the principles we have set out to guide our reforms.

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<sup>8</sup> Amended below following consultation – see paragraph 2.16 below.



## Stakeholder views

2.8. Respondents to our consultation supported the need for this review and recognised the case for change. All respondents who provided views to this particular question were broadly supportive of the principles we set out.

2.9. A common theme in responses was the need to review the arrangements for how the costs of a failed supplier's outstanding debts are managed. A number of stakeholders called for our guiding principles to address the need to protect consumers and the wider industry from the cost of supplier failure, in particular mutualised debts, and stressed the need for a principle that suppliers should bear the cost of their failure. One respondent called for a new supply licence condition requiring suppliers to take measures to prevent mutualisation of its debts in the event of failure; another said that when a supplier becomes insolvent, the costs on the industry should, as far as practical, be borne by the shareholders and investors in the company. One further respondent suggested the guiding principles should seek to maintain the integrity of the market, and that the SoLR safety net should not act as a disincentive for a trade sale.<sup>9</sup>

2.10. Some respondents suggested the principles could be extended or modified. For example to expressly include micro-business consumers, to clarify that consumer protection extends to all customers (not only those directly affected by a supplier failure), and, to require suppliers to have a prudent commercial strategy that enables them to operate sustainably.

2.11. One respondent considered that the cause of recent supplier failure was not the result of the supplier licensing regime, but volatility in the wholesale markets. However, another respondent felt our overarching principles should state that suppliers should be adequately prepared and resourced for such external factors. They noted that rising wholesale costs have been blamed for failure, but this is a change in market conditions that should have been considered and accounted for by prudent companies.

2.12. Some respondents advocated a risk-based approach, for example: a lighter touch regime for non-domestic suppliers, or where an application for a domestic licence was made by an established non-domestic supplier; that the level of scrutiny applied to a new supplier should be proportionate to their size; or, that companies that are part of financially secure parent companies (with a high credit rating) should not be treated in the same way as new entrants with weaker financial backing.

2.13. One stakeholder offered strong support for the principle that the licensing regime must facilitate effective competition and enable innovation, but proposed that the principle should explicitly state that this was "while maintaining minimum standards of consumer protection".

2.14. Another recognised the importance of the wider regulatory landscape working effectively to identify and mitigate risk early, and that different stakeholders (including consumer advocates) work with suppliers, both before and after market entry, to promote good customer care and service.

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<sup>9</sup> In a trade sale the new supplier would pick up the failed supplier's debt, including payments due under government schemes.

## Our final proposal

2.15. We welcome respondents' broad support for the overarching principles that we set out to guide our reforms across the full scope of the Supplier Licensing Review. Having considered the views expressed, we continue to consider these overarching principles are appropriate.

2.16. We note many respondents considered our principles should be clear that suppliers should pay for their own risk. In line with our first principle described above, we agree that suppliers should be adequately prepared and resourced for growth, adopt effective risk management and bear an appropriate share of their risk. We have decided to update this principle to provide added clarity:

- ***Suppliers should adopt effective risk management, be adequately prepared and resourced for growth, and bear an appropriate share of their risk***

2.17. In response to specific points raised, we confirm that the outcomes of our review will cover non-domestic supply where applicable, and that in our view reference to consumer protection does encompass consumers as a whole, not only those impacted directly by supplier failure.

2.18. We agree that in developing reforms under this review we should give consideration to a risk-based approach, but that the new criteria will apply to all new applications – including applications to extend or transfer an existing supply licence. We have operated a risk-based licensing regime since 2010 and believe that the proposals we have set out for new entry requirements continue to be compatible with such an approach.

2.19. We recognise that there are a number of reasons why suppliers fail, and it is typically triggered by a combination of factors. Wholesale market volatility can be a contributory factor in supplier failure and we are keen to ensure that companies are preparing effectively to cope with volatile costs, which are a feature of the energy market.

### 3. Entry criteria: final proposals

#### Section summary

We have concluded that the existing framework should be strengthened. Our reforms are targeted at improving the balance between reducing consumers' exposure to the risks and costs of poor customer service and supplier failure, and enabling market entry and innovation thereby promoting effective competition. This chapter recaps on the broad approaches we considered, and confirms our proposed way forward. We confirm that we will adopt three new qualitative assessment criteria for supply licence applications.

#### Broad approach

3.1 In undertaking this review of the supplier licensing arrangements we considered a range of broad options for reform, taking account of practice in regulatory regimes in other sectors and countries.<sup>10</sup>

3.2 In our November consultation we presented three high level approaches for our licence application process:

- Option 1: Maintain the status quo. Our current approach to licensing represents a low barrier to market entry
- Option 2: Increased information requirements, with qualitative assessment criteria
- Option 3: Detailed information requirements, with financial scrutiny and/or specific capital requirements

3.3 We proposed to adopt Option 2, increasing our scrutiny of suppliers at entry by requiring licence applicants to demonstrate they are adequately prepared and resourced to operate in the energy supply market, and subjecting this information to a qualitative assessment. This would include requiring information about financial and operational resources, market understanding, and readiness to meet the range of obligations on energy suppliers particularly around customer service.

3.4 We considered this would provide the right balance between reducing consumers' exposure to the risk of underprepared or unfit market entrants, while continuing to enable innovation and competition in the market. Our view was that all entrants should be appropriately resourced and prepared to comply with their obligations from the outset. However, the scrutiny applied at market entry should remain flexible to accommodate different business models and should not involve Ofgem analysing business plans for 'viability'.

3.5 We were clear that it was not our view that the risks and issues we identified in the 'case for change'<sup>11</sup> could or should be addressed solely by Ofgem's licensing process. Our review is encompassing the regulatory regime for suppliers as a whole, considering a package of reforms of which new licensing rules is first to be delivered.

3.6 We invited stakeholders to tell us whether they agreed with our proposal to increase scrutiny of supply licence applicants. We asked if they agreed that this can be achieved with

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<sup>10</sup> Chapter 4 of our November consultation.

<sup>11</sup> Chapter 2 of our November consultation.

increased information requirements and qualitative assessment criteria.

### Stakeholder views

3.7 Respondents generally agreed that retaining the status quo was not an appropriate option and that Ofgem should increase scrutiny of supply licence applicants. One respondent commented that it was currently too easy to set up a supply company, particularly through the 'off the shelf' model.<sup>12</sup>

3.8 The majority of respondents supported our preference for Option 2. A number of respondents who supported Option 2 suggested that our initial proposal should be extended to combine with some of the features of Option 3, such as a requirement for applicants to provide a business plan for a period longer than 12 months, with evidence of their ability to fund it including managing key risks.

3.9 It was commented that Option 2 strikes a sensible and proportionate balance between the additional scrutiny that is required, without unduly constraining competition or the entry of new and innovative energy suppliers. It was recognised that it may be complex to develop a qualitative assessment approach and set a relevant minimum standard, but that this was a necessary step and would help facilitate innovation and emerging business models not yet proven in the industry. One respondent said Option 2 was a proportionate acceptance that entry checks are a point-in-time assessment and do not provide a guarantee on the performance of a supplier once in the market.

3.10 It was observed that suppliers face a number of prescriptive and absolute requirements that they may not be aware of until after market entry, giving prospective new entrants a false impression that the barriers to operating in the market were lower than they actually are. That respondent felt our proposed approach would provide an opportunity to ensure there was appropriate awareness and understanding of what was needed to become an energy supplier and the associated costs.

3.11 A very small minority didn't think our licensing requirements for suppliers needed to be tougher, or had concerns about a 'one size fits all' assessment process being suitable for new entrants looking to enter a niche or local market. One stakeholder supported an approach somewhere between the status quo and Option 2, citing that the existing MRA and BSC<sup>13</sup> processes have good controls in place in terms of a new entrant's business readiness. Another suggested an enhanced assessment could lead to potential for leakage of sensitive information, or undue scepticism of, innovative business models by regulatory staff unused to entrepreneurial business models, or that well-intentioned assessment criteria could be misapplied and lead to a reinforcement of existing business models. That respondent considered the fundamental concern to be that the entrant could clearly demonstrate that they understand the cash flows they will be managing and that their business model is capable of meeting all industry charges as they fall due, and their obligations in relation to serving customers, especially the vulnerable, both on entry and as they grow.

3.12 Some agreed with Ofgem's proposed approach in principle, but believed that more information on the level of detail was needed to confirm this view, and/or that it would be necessary to understand the full package of reforms under the wider scope of our review. It was also suggested that evidence from recent SoLR events should inform consideration of

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<sup>12</sup> An "off the shelf" supply company is a shell company set up by a managed service provider. Managed service providers typically apply to Ofgem for a licence on behalf of a shell company, taking the entity through the initial market entry testing requirements under the industry codes, and then sell this company on to expedite entry for a new supplier.

<sup>13</sup> MRA is the Master Registration Agreement. BSC is the Balancing and Settlement Code.

appropriate options, and it should be contemplated if any of the recent failures would have been prevented if Option 2 or 3 had been in force when those suppliers entered the market.

3.13 There were a range of reasons given by respondents who did not support Option 3. These included: that the market was too volatile to consider business plans and projections for up to five years; that a specific capital requirement would create a barrier to entry and/or that it would be difficult to determine a requirement that was fair; that this level of assessment was disproportionate and likely to be beyond Ofgem's skillset, requiring commercial expertise to challenge business viability; and, that Ofgem might disagree with the applicant on their prospects of success, a matter that cannot be proved one way or the other. One respondent considered that it would be pushing the boundaries of Ofgem's role for it to opine on a company's business plan, and contrary to Ofgem's statutory duty to promote competition.

3.14 Others, however, supported Option 3. It was noted that there are more stringent entry requirements in other markets and jurisdictions, and a view was expressed that the most stringent regime should be adopted given that costs of supplier failure are mutualised. One respondent commented they did not support Option 2 because it would not provide any surety that the applicant's business model was either sustainable or that it does not place the risk on to the rest of the market.

3.15 Another said that any new entrant should be able to demonstrate clearly to Ofgem that they have sufficient capital resources to ensure they can operate in a sustainable manner for a period of 3-5 years, including industry scheme costs such as the Renewables Obligation. It was also considered that a requirement for a full business proposal and financial projections would not be disproportionate given that most suppliers would have to provide these to potential investors and should have them to hand; though it was also suggested that a certified third party may be better placed than Ofgem to conduct a rigorous and effective audit of licence applications.

3.16 A stakeholder supportive of an approach akin to Option 3 felt increased scrutiny could not be achieved through information and qualitative assessments alone, and that the criteria should be transparent, objective and also measurable. Another said that while it did not oppose Option 2, it did not believe that we had sufficiently made the case against the Option 3 approach and would welcome clarification on Ofgem's estimates of the increased resource requirements in order to be able to comment on whether this option would be disproportionate.

3.17 Some respondents also did not agree with Ofgem that a minimum capital requirement would act as an undue barrier to entry, noting that it could be used by a supplier to demonstrate how they would prevent mutualisation of debts in the event of failure. Another recognised the challenge cited by Ofgem in setting an effective level of capital requirement, but considered that it may still be possible to determine a level that does not pose a barrier to entry while being material enough to discipline the conduct of a new licensee.

3.18 While generally supporting our initial proposals, one respondent commented that suppliers with riskier business models – or those that plan to target vulnerable customers – should have to supply more information to demonstrate how they will mitigate potential risks. In their view, a more detailed information requirement and/or a minimum capital requirement could be appropriate tools in some circumstances, dependent on Ofgem's initial assessment of a company's business model and their target market.

### **Our final proposal**

3.19 Stakeholders were typically in agreement that, through the licensing process, Ofgem should seek to determine whether a company was planning to operate in the market in a prudent way. There was a range of opinions on how best to achieve this aim, though the

majority broadly supported our initial proposal. Having considered all of the views put forward, we continue to believe that a level of assessment as proposed under Option 2 will enable us to achieve this aim in a proportionate way.

3.20 We continue to believe that Ofgem should not be testing ‘business viability’ and that we should not be reaching licensing decisions based on perceived prospects of future success. It is not the role of our licensing process to ‘pick winners’, and – in the process – potentially prevent new and innovative business approaches. We also do not believe that any test on entry can provide assurance that a company will remain able to fund its liabilities on an ongoing basis, nor can we hold a supplier to the business plan it presented at entry. This leads us to conclude that detailed financial scrutiny by Ofgem would be disproportionate to the benefits gained. Indeed, we consider it would be detrimental to create an impression that Ofgem’s licensing process was a form of ‘quality assurance’ for a new entrant’s business strategy, or that the granting of a licence by Ofgem indicated that we had rubber-stamped their business plan.

3.21 As for any business, investors play a role in scrutinising business plans for viability, holding companies to account for their business plan, and weeding out unviable models. And in addition, suppliers must meet the systems testing and credit requirements under the relevant industry codes.

3.22 We acknowledge the views expressed that a robust energy supplier should be able to cover its liabilities on an ongoing basis, but we consider that this is a matter to be further considered under the next phase of our review, which will look at potential ongoing requirements – enforced through the supply licence conditions – that all suppliers would be subject to, rather than this being a point-in-time test for new suppliers only.<sup>14</sup>

3.23 We consider that our licensing criteria should be targeted at requiring new suppliers to have an appropriate foundation for market entry, but that the licensing process must be proportionate and our overall approach underpinned by ongoing regulation and robust exit provisions. We also consider that the new licensing regime will contribute to raising awareness of the range of obligations and costs involved in being an energy supplier.

3.24 We would also highlight that while we are not setting a specific minimum capital requirement, entrants will need to demonstrate to us that they have funding for their proposed plans. Our view is that entrants should not be relying on consumer credit balances for their funding, and where growth strategies are based on loss leading tariffs, there must be evidence of risk management and capital reserves to support such an approach. Licence applicants should be able to show that they are approaching the market in a responsible way.

3.25 Some respondents suggested we should provide a more detailed analysis, such as whether the proposed options would have prevented any of the recent supplier failures. It is difficult to unpick whether the new licensing approach would have changed specific situations. We recognise there are a number of factors that can impact the financial position of a supplier, and that typically it is a combination of factors that leads to a supplier failing. We have considered key contributory factors in developing our proposed new application assessment, to the extent that these issues can be foreseen prior to market entry. These include: rapid unsustainable growth without associated plans for investment in systems and customer service, inability to deal with wholesale price shocks, and lack of planning for core industry costs. Our qualitative assessment approach (described below) will incorporate several elements respondents felt were important, including whether entrants have considered how they will service their customers as they grow, and, that they understand the cashflows they will be managing.

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<sup>14</sup> If any new financial resilience measures are introduced into the standard licence conditions as part of our broader review, we may want to update our licence application process later as a result of this.

3.26 We are clear that the licensing process is just one stage in the supplier lifecycle where the risks associated with supplier failure can be addressed. Our entry regime does not seek to prevent future failure, which is a feature of any competitive market.

## Assessment criteria

3.27 In our November consultation we proposed to introduce three criteria for our assessment of future supply licence applications:

- **Criteria 1: The applicant has the appropriate resources for their proposal to enter the market**
- **Criteria 2: The applicant understands their regulatory obligations and has appropriate plans in place to meet these**
- **Criteria 3: The applicant is fit and proper to hold a licence**

3.28. In proposing these criteria we noted that the onus would be on applicants to provide us with information – as set out in the application form and guidance – to demonstrate how they meet the criteria. Appendix 1 of that consultation document provided an overview of the information we would expect to be submitted. We said that we would risk assess the responses based on objective guidance and check that the information provided is consistent across the different criteria. Where our risk assessment identifies potential concerns, applicants may need to provide us with additional information to satisfy us that they meet the criteria. If further information cannot be provided or that information remains unsatisfactory, we may refuse the licence application.<sup>15</sup>

3.29. We asked stakeholders if they agreed that our proposed assessment criteria for supply licences are appropriate.

### Stakeholder views

3.30. Most respondents agreed with the three criteria.

3.31. One respondent said that the proposed criteria are appropriate at a high-level but would welcome more information on how Ofgem will test in detail the evidence provided by applicants. It was questioned how we would make judgements on this across diverse business models, and suggested that the criteria could become an undue barrier to entry, potentially stifling innovation if they are applied over-zealously.

3.32. One stakeholder commented that learnings from Ofgem’s work on the price cap, analysing the costs of supply, could be utilised to enable Ofgem to effectively challenge applicants on their plans. Another said that ‘regulatory obligations’ should extend beyond customer service and include other requirements.

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<sup>15</sup> Applicants may withdraw from the process if they decide they are unable to satisfy the application requirements. Under the existing regime we observe a proportion of licence applicants withdrawing if it becomes apparent through further questions that they may not be ready/prepared to enter the market.

3.33. In respect of a 'fit and proper' requirement, some respondents felt this should be extended to consider previous experience in the sector. However, one respondent suggested that the history of an applicant's directors/managers may give some idea of their suitability to hold a licence, but it is not an indication of future ability or performance and should therefore not be assessed in isolation.

3.34. A respondent suggested that the new process is subject to review after six or 12 months which would, in their view, allow Ofgem a degree of flexibility in either direction in order to make the new assessment process fit for purpose.

3.35. Specific feedback from respondents on how we might assess applicants against the criteria is summarised in Appendix 2.

### **Our final proposal**

3.36. We welcome all views on the assessment criteria we proposed. Having considered the views expressed we continue to consider these criteria are appropriate.

3.37. We recognise that the introduction of these new requirements raises the bar to entry, and we consider this to be proportionate and justified. In light of our view (which is supported by responses to our consultation) that there is a need to raise standards around supplier financial resilience and customer service, we do not believe that these criteria represent an undue regulatory burden or that they would restrict effective competition. We do not consider that they will present a particular difficulty to new or innovative business models, as any new entrant – regardless of shape or size – will need to be able to resource their particular plans, and understand and comply with their regulatory obligations.

3.38. If applicants have sufficiently thought through their proposition to enter the market, and are able to demonstrate preparations to ensure the resources and capabilities necessary to offer an essential service are available (in the context of their particular plans) then we do not anticipate these criteria will be a barrier to any prudent business.

3.39. Further detail on how we propose to assess the criteria, adopting a risk-based approach, is provided in draft guidance published alongside these final policy proposals. We are now consulting on this. We agree with the respondent who said our approach and guidance may benefit from some refinements after the initial six to 12 months, once the new process has bedded in. We anticipate our assessment approach could evolve with learning, and the application guidance document updated accordingly.

### **Detailed requirements**

3.40. We asked stakeholders if they agreed with the broad information requirements we proposed to enable us to assess future supply licence applications against the new criteria.

3.41. In Appendix 2 we summarise the responses provided in respect of each of the criteria and provide our response. The detailed implementation of the new regime is now subject to a further consultation.<sup>16</sup> We are consulting on draft Statutory Instruments (new applications regulations) with updated application forms and fee levels, and draft application guidance

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<sup>16</sup> <https://www.ofgem.gov.uk/publications-and-updates/consultation-new-applications-regulations-application-forms-and-guidance-document>



(with updated application processing timescales). We welcome responses to this consultation which closes on 13 May 2019.

## 4. Timing of licensing: final proposals

### Section summary

We have decided that the timing of the supply licence application process should be moved relative to the electricity market entry processes operated by the industry codes. Licensing suppliers closer to market entry will better enable us to scrutinise the plans of, and engage with, the prospective supply licence holder as part of a strengthened entry regime. This chapter discusses respondents' views on our proposal and confirms our view on the way forward.

4.1. In our November consultation we noted that due to systems testing requirements under the electricity industry codes, our licensing process today typically takes place several months (and often more than one year) before a supplier takes on their first customer. We recognised that an applicant might have difficulties meeting some of the new information requirements this far in advance of entering the market.<sup>17</sup>

4.2. We also noted that the 'off the shelf' model of market entry means that in many cases the eventual supplier has no engagement in the market entry processes, including Ofgem's licensing process, as they only take control of the company prior to Controlled Market Entry (CME).<sup>18</sup>

4.3. The current and proposed timing of Ofgem's licensing process for electricity suppliers is shown in Figure 1 below.

4.4. We proposed to move the timing of licensing to ensure that applicants are able to demonstrate that they satisfy the new entry criteria, and to ensure that the people that will actually operate the supply business are engaging with Ofgem at point of licensing (rather than a managed service provider who is setting up a shell company to support and expedite market entry for a future client).

4.5. We considered that managed service providers should still be able to qualify companies through market entry testing under the codes, therefore retaining the benefits this service has to supporting market entry, but removing the risk that participants can enter the market without passing Ofgem scrutiny.

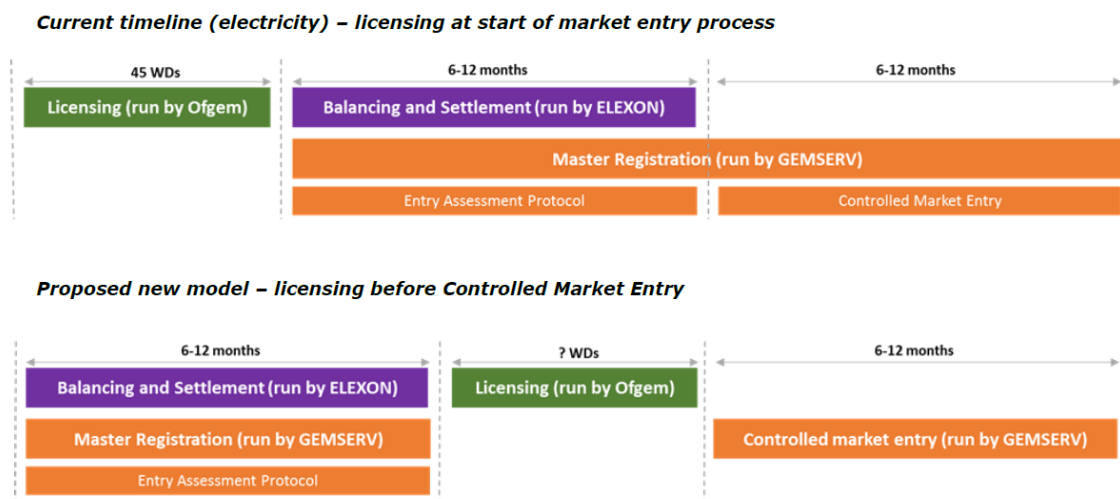
4.6. We asked stakeholders if they agreed that Ofgem's supplier licensing process should be undertaken closer to proposed market entry, and if they identified any barriers to this approach or any adverse impacts of this change.

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<sup>17</sup> Chapter 6 of our November consultation.

<sup>18</sup> Whereby suppliers commence electricity supply but are restricted in the number of customers they can onboard. This allows their systems to be tested in the live environment while ensuring risks are minimised and problems can be identified and rectified before full entry.

**Figure 1: Electricity market entry timeline**



## Stakeholder views

4.7. Respondents broadly supported our proposal to shift the timing of supplier licensing. The range of reasons for this support included: that it would ensure Ofgem was taking a decision on whether to grant a licence to the operator of the supply company, and not the operator of a company providing entry support services; and, that a licence application made closer to market entry will be more robust and accurate on its underlying business planning assumptions and forecasts.

4.8. An alternative two-stage approach to licensing was suggested, whereby a second review of the entrant would be required either just before live market entry, or, after CME. The holder of such a provisional licence would be required to provide the information required by Ofgem under the new tests before a full licence would be granted. One respondent suggested this two-tier process could enable a ‘fit and proper’ test to be conducted early in the process, to avoid Ofgem ultimately rejecting an application closer to proposed market entry for facts that could have been established earlier.

4.9. One respondent said they were generally supportive of the intention behind the proposal but was concerned that a shift in the timing of licensing could create undue pressure for very small organisations with limited resources; similarly, another suggested that making a decision on licence grant later in the process could deter potential new market entrants due to the increased cost and time involved prior to that stage.

4.10. Another respondent predicted that some companies might raise concerns that the changed timeline would impose additional costs or risks that might act as a barrier to entry, but suggested any additional risk can be reduced by allowing companies to contact Ofgem in advance of the application to discuss specific questions or concerns, in the same way that companies can seek an informal steer from the Ofgem Innovation Link.<sup>19</sup> Another questioned

<sup>19</sup> <https://www.ofgem.gov.uk/about-us/how-we-engage/innovation-link>

whether it would be possible to run the industry processes and the licensing process in parallel.

4.11. It was noted in responses that the 'off the shelf' model has contributed to the competitive market and that Ofgem's proposal should not undermine this dynamic. One respondent who agreed with our proposed approach observed that industry qualification processes could be completed without the requirement for a supply licence, so that 'off the shelf' BSC/MRA qualified companies could be produced but a supply licence would then need to be obtained prior to registering any Metering Points. Another, however, suggested that any purchase of an 'off the shelf' supply business should automatically require the new owner to go through the code qualification processes again, to ensure the new owner is able to operate the supply business competently, and that a licence should only be granted once the people who plan to run the business have been through this qualification process.

4.12. One respondent suggested that the revised timings could result in an increase in the numbers of speculative code accessions that may then sit with market entry certificates for an extended period, and this qualification should perhaps be time limited. Another respondent noted that there will be a requirement to operate with the Data Communications company (DCC) as the smart-meter rollout progresses.

### **Our final proposal**

4.13. We welcome the broad support for this proposal. We have not identified any significant barrier to this approach arising from the consultation responses. We have engaged directly with the relevant industry code administrators, and understand that where any code modifications will be required, this would not involve significant reform to the existing process.

4.14. Our proposal does not place additional demands or costs on new entrants, only that entry steps are completed in a different order. While we accept that this involves expenditure on the part of the new entrant prior to assurance that a licence will be granted, we do not think this is a barrier for serious entrants, as our licensing process and assessment criteria are public and known in advance and potential entrants can engage with us at an earlier stage if they have questions or concerns.

4.15. We noted in our November consultation that we had considered a two-stage approach, where a licence is granted before entry testing (basic assessment) but a further (more detailed) assessment of plans/resources must be passed before market entry. We did not identify that this would be particularly beneficial as the substantive assessment would still need to take place after market entry testing, therefore creating no efficiencies or reducing the risk for entrants that the second stage assessment would not be passed. If the grant of a 'full' licence was at the *end* of CME, this could also present significant operational difficulties for new suppliers if, say, they were unable to take any further customers for a number of months while their full application was considered (and indeed could be refused).

4.16. Applying only a fit and proper test prior to industry testing also does not address the current issue of suppliers buying 'off the shelf' licensed entities; where Ofgem would be still be assessing the 'suitability' of a managed service provider, rather than the people who will actually operate the supplier.

4.17. We therefore remain of the view that moving the timing of licensing is preferable to introducing a two-tier licensing approach at this time. We also doubt that the grant of a provisional licence would give substantial comfort to potential investors, if the substantive

licensing assessment was still to be undertaken at a later stage, and market entry could still be denied.

4.18. While it is possible that this change could result in an increase in code accessions/qualifications, we do not consider this would necessarily be the case, as managed service providers are already qualifying companies through the BSC and MRA requirements. With regard to the suggestion that where a new owner takes over a company that has pre-qualified through code testing, that they should have to go through industry qualification processes again, this is out of scope of our review. The industry testing processes are governed under the relevant industry codes, and interested parties have the ability to suggest changes to these through the relevant code governance processes.

4.19. We therefore confirm our proposal to conduct our entry assessment closer to proposed market entry. For electricity suppliers, this means that prospective suppliers should apply for a licence after having commenced initial entry testing under the BSC and MRA, but before CME. Both gas and electricity suppliers are also required under the licence conditions to be DCC users and we have reflected this in the draft guidance we are now consulting on.<sup>20</sup> We do not intend to be prescriptive at this time as to whether the applicant must have fully completed these processes before applying for a licence. We consider it possible for licensing to run concurrently with the later stages of these processes provided the applicant is capable of meeting our criteria.

4.20. We expect industry code administrators and the industry to now ensure that the wording of the codes and the accession procedures enable prospective new entrants to commence accessions and systems testing prior to making a licence application where applicable, with code modifications raised to achieve this where necessary.

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<sup>20</sup> In 2017 we published an open letter on compliance with DCC user mandate: [https://www.ofgem.gov.uk/system/files/docs/2017/12/2017.11\\_open\\_letter\\_on\\_smart\\_meter\\_rollout\\_-\\_dcc\\_user\\_mandate\\_tolerance\\_2019\\_submissions\\_and\\_energy\\_efficiency\\_advice.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/12/2017.11_open_letter_on_smart_meter_rollout_-_dcc_user_mandate_tolerance_2019_submissions_and_energy_efficiency_advice.pdf)

## 5. Next steps

### New entry regime

5.1. The form and manner of licence applications is prescribed in regulations made by the Authority.<sup>21</sup> Alongside this final policy proposals document we are consulting on revised gas and electricity applications regulations (draft Statutory Instruments), with new application forms and fees, and a new guidance document to implement our reforms.<sup>22</sup> That consultation is relevant to all licence types, not only supply, and closes on 13 May 2019.

5.2. We will consider all responses to that consultation and publish a final decision letter alongside the new regulations and guidance.

5.3. We will engage directly with current applicants for a supply licence in respect of how the transition to the new arrangements impacts the processing of their application.

5.4. Alongside this work we are also progressing the revocation of a number of unused supply licences, in accordance with the terms contained in those licences. To support the implementation of our new licensing regime, we are reviewing all supply licences that have been issued for over 12 months where the licensee has not yet commenced supply.

### Ongoing requirements and exit arrangements

5.5. We have received responses to the Request for Information (RFI) relating to credit balances that we issued to domestic suppliers at the end of last year. This information has given us a better understanding of credit balance practices and policies across the market.

5.6. We are also considering the responses to our initial options for ongoing requirements on suppliers that we set out in our November consultation. This is informing our policy development for the next stage of our review.

5.7. We plan to publish an update on the way forward for the next stage of our review in May. This working paper will cover:

- Our initial views on new **ongoing** requirements on suppliers, including a summary of responses from our November consultation. We will outline next steps and direction of travel.
- A summary of stakeholder views in respect of potential new credit balance rules.<sup>23</sup> Potential new rules on credit balances is a specific issue which spans both the **ongoing** and **exit** workstreams of our review – relating both to how suppliers

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<sup>21</sup> Current regulations: [http://www.legislation.gov.uk/uksi/2010/2154/pdfs/uksi\\_20102154\\_en.pdf](http://www.legislation.gov.uk/uksi/2010/2154/pdfs/uksi_20102154_en.pdf) and [http://www.legislation.gov.uk/uksi/2010/2155/pdfs/uksi\\_20102155\\_en.pdf](http://www.legislation.gov.uk/uksi/2010/2155/pdfs/uksi_20102155_en.pdf)

<sup>22</sup> Consultation: <https://www.ofgem.gov.uk/publications-and-updates/consultation-new-applications-regulations-application-forms-and-guidance-document>

<sup>23</sup> While we did not ask any specific consultation questions on this, there were common themes raised across responses around this issue.

operate in the market, and the protections in place for consumers if a supplier fails.

- The scope and indicative timings for reviewing the supplier **exit** arrangements, including the SoLR process.

5.8. We intend to hold an industry workshop in June as an opportunity to discuss the key issues set out in our working paper with stakeholders prior to a further consultation.

## Appendices

### Index

<b>Appendix</b>	<b>Name of appendix</b>	<b>Page no.</b>
1	List of non-confidential consultation responses	25
2	Consultation Chapter 5: summary of responses	26



## Appendix 1 – List of non-confidential consultation responses

1.1. We received 48 responses to our November consultation. Non-confidential responses are published on our website.<sup>24</sup>

1.2. We have summarised respondents' views on the questions asked in our consultation within the body of this decision document and in Appendix 2.

### List of non-confidential responses

List	Name	List	Name
1	Alpine Utilities	24	National Grid Metering
2	BUUK	25	Npower
3	Bristol Energy	26	Ombudsman Services
4	Citizens Advice	27	Orbit Energy
5	Calvin Capital	28	Scottish Power
6	Centrica	29	SGN
7	Co-op Energy	30	Smartest Energy
8	Cornwall Insight	31	SSE
9	EDF Energy	32	Total Gas and Power
10	ELEXON	33	Utilita
11	Electricity North West Limited	34	Utility Warehouse
12	EON	35	Vattenfall
13	ESB	36	Verastar Limited
14	ESP Utilities Group	37	Western Power Distribution
15	Energy UK	38	Which?
16	First Utility	39	Wales & West Utilities
17	Green Networks Energy		
18	Good Energy		
19	Green Energy		
20	Ibeccs		
21	ICoSS		
22	Hudson Energy		
23	Lowri Beck		

<sup>24</sup> <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review>

## Appendix 2 – Consultation Chapter 5: summary of responses

### Summary of responses and our views

2.1 Chapter 5 of our November consultation sought stakeholder views on the information requirements we should place on applicants in order to assess future applications under the new criteria.

#### Criteria 1: Resources

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

#### Stakeholder views

2.3 Respondents supported the requirement that applicants should provide evidence of their ability to fund their activities but differed on for what period of time. Several respondents supported our initial proposal that applicants should provide projections as well as evidence of their ability to fund their activities for the first 12 months; but there was also significant support for us to consider a longer period of between two to five years.

2.4 A number of respondents noted that, to their knowledge, no supplier has failed in the first 12 months of operation so restricting this requirement to only the first 12 months did not have clear benefits. One respondent said that while funding in year one is important, it is when growth increases that costs and risk increase. In respect of stress testing, they felt that while tests devised by individual companies may be helpful internally, they will not provide the necessary independence to give regulatory confidence.

2.5 One party proposed that in addition to providing evidence of funding for 12 months, new entrants should provide a three-year business plan that shows adequate consideration of how the business and operating environment may change, including how customer service will be delivered. Another said applicants should show a detailed understanding of what funding is required and when, plus a credible plan of how this will be secured, and it was also suggested that Ofgem should monitor the new entrant to see how it performs against its initial plans in order to detect early warning of possible financial distress.

2.6 A number of respondents suggested that Ofgem's entry assessment should look at the initial 24-month period of operation, highlighting that a two-year business plan would cover the riskiest period of supplier growth and an entire cycle of taking on customers and closing their accounts after a 12 or 18-month contract, plus the payment of industry costs such as the Renewables Obligation that fall due in the period.

2.7 One respondent suggested that businesses are able to secure financing for typically three to five years, with the first 12 months regarded as the start-up phase. Another said that the first 12 months would largely involve CME and that while accepting plans will change, a longer term plan would show how well the applicant understood the connections between growth, trading and funding.

2.8 It was suggested that some potential (and viable) entrants may not have the full funding in place for 12 months because funding is often conditional on the supply licence being granted and because funding may be tied to the achievement of significant milestones (including early growth metrics) and not released in one go. Another commented that funding arrangements are commercial in confidence and there should be no requirement to disclose specific sources of the funding.

2.9 There was support amongst respondents for the inclusion of a signed certificate of adequacy, however some respondents were not convinced of this requirement, saying that it would only be of use if it could be shown the directors had not signed it in good faith. Another said it was not clear what legal weight it would hold or what it would add to the process. One stakeholder felt this would be based on many assumptions and therefore would need to have caveats attached; while another said it should be accompanied by appropriate risk modelling. It was also noted that a signed declaration of adequacy may provide a route for sanction and deter blatantly false statements but would not appear to be an effective route to deter overly optimistic statements, which may be more likely than outright false statements.

2.10 Some respondents highlighted the link between our entry assessment and ongoing monitoring, with suggestions including: requiring proof of funding each year for the first five years; an initial light touch assessment of funding for the first 12 months (or until the supplier reaches 25,000 customers) and then a more detailed assessment that future growth plans are well financed/fully resourced; and, monitoring on a rolling basis until Ofgem is satisfied that the supplier is established and that ongoing liquidity within a supplier is linked to customer numbers and not based on customer credit balances.

2.11 One respondent argued that applicants should submit business plans for a longer period, because the typical products sold by suppliers during the first year of trading (eg 12 month fixed price tariffs with exit fees and paid in advance by Direct Debit) can be self-sustaining even with poor commodity hedging. Other comments included that: while a minimum capital requirement isn't needed, entrants should provide evidence they can reasonably fund their three-year plan; and, that a five-year plan with stress testing would demonstrate a more thought-through strategy.

2.12 One respondent asked that Ofgem provide more clarity and reassurance on how we would assess the evidence provided by applicants, noting that the process could amount to nothing more than additional paperwork and a box-ticking exercise.

2.13 Another noted that Ofgem does not propose to "check the applicant's working" and said it is not clear what specific validation of the financial data would occur and how this would protect consumers. They considered that there is a role for Ofgem to carry out some financial 'sense checking' to ensure that the applicant's financial planning is sound.

2.14 Although the majority of stakeholders either supported the proposal or felt Ofgem should do even more, there was one respondent that felt the level of information proposed seems over burdensome and will prevent organisations coming to market that would otherwise have gone on to become successful businesses.

## **Our response**

2.15 Our initial proposal to look at the first 12 month period was based on a number of considerations, including the role of ongoing regulation once a supplier has entered the market (our review of which will follow in a later consultation), and to reflect the difficulty in making licensing decisions based on highly speculative future projections.

2.16 However, we believe there is considerable merit in extending our initial proposal based on the broad range of feedback obtained. In particular we are mindful that new entrants should be able to demonstrate how they plan to manage their growth, and that they understand the related impact of industry costs, loss of customers, etc. Therefore entrants' projections and funding plans for the first 24 months are highly relevant. New supply businesses will take some time to reach profitability and therefore entrants should have a plan to fund their early years' losses.

2.17 We are however mindful not to introduce a high barrier which could unduly deter or prevent new entrants. We will therefore proceed with our proposal that applicants must provide evidence of their ability to fund their activities for the first 12 months, but we will require applicants to outline their projections and funding plan for the first two years, which should show how they plan to obtain further funding to support their growth, and demonstrate that they have thought through a longer-term strategy.

2.18 We are not at this time proposing specific parameters for a new entrants' stress-testing. This is the responsibility of prudent businesses to consider. We will take a view when assessing applications whether we consider the stress-testing applied by the applicant appears to be within reasonable parameters.

2.19 With respect to the proposed requirement for a Certificate of Adequacy, we consider it to be very important that no entrant misconstrues our application assessment as a 'quality assurance' exercise or 'approval' of their funding arrangements or operational capabilities. We therefore consider this requirement to be relevant and a beneficial addition to the process. The onus is on the applicant at all times to ensure their plans are robust. Any false statements made during the application process may be captured by s59 of the Electricity Act and/or s42 of the Gas Act.<sup>25</sup>

2.20 Having considered the responses from stakeholders, we have drafted a proposed new application guidance document which we are now consulting on. We welcome and encourage further feedback on this.

## **Criteria 2: Regulatory obligations**

2.21 We asked: do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence? Do you agree with the areas we would generally expect applicants to cover (in Appendix 1 of the consultation)? If not, why/what would you add?

### **Stakeholder views**

2.22 Stakeholders broadly agreed with our proposal, and with the specific information we indicated we would generally expect applicants to provide. Most respondents agreed that

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<sup>25</sup> The provision of incorrect information during the licence application process is an offence and may result in criminal proceedings being instituted under section 43 of the Gas Act 1986 (as amended) or section 59 of the Electricity Act 1989 (as amended). It may also result in an application being refused or, if discovered after a licence has been granted, in the licence being revoked.

applicants should provide a narrative in respect of their key customer-related obligations under the licence, saying, for example: that this would show the applicant is taking market entry seriously; it reinforces the need for minimum standards and reduces the risk of customers being exposed to poor quality of service; and, ensures entrants are aware of the regulatory complexity in the supply market. Some welcomed that Ofgem will not seek a prescriptive approach as to how the information should be presented, and commented that it should be flexible enough to take account of different business models.

2.23 One respondent commented that the sales and trading strategy of a new company is the area of greatest significance when assessing market entry, and if a company has an inadequate hedging strategy and an aggressive sales plan, the company will struggle from the outset to be sustainable in the long-term and this will lead to failings in areas such as customer service. Another said this should include a requirement specifically on the applicant's approach to customer service as the business grows.

2.24 One respondent suggested that customer/operational elements of the application information should be requested in the form of written responses to open questions, followed by face-to-face interviews with questions on, for instance, how the applicant intends to support customers in vulnerable circumstances, and how the applicant will manage accruals for environmental obligations.

2.25 It was considered that this requirement should be more detailed where the applicant intends to supply domestic consumers and microbusinesses, where additional licence requirements apply, and that the narrative should give particular focus to how they will identify vulnerable customers and address their needs.

2.26 There were some respondents who felt our consideration of applicants' plans to comply with their obligations should extend beyond customer service, and include for example their obligations to network companies. One respondent said they would like to see Ofgem carry out checks on the ability of new entrants to function in the market, checking that the applicant has the necessary systems and resources and knowledge of their obligations in respect of data exchange with relevant parties. A few respondents also suggested that this requirement should cover future requirements where they are known but not yet in force.

2.27 One respondent observed that new suppliers are sometimes unaware of certain licence conditions and other rules that they should have understood in advance of gaining customers, (eg around the treatment of customers with prepayment meters, and complaint handling) and also that suppliers can often underestimate the costs of compliance.

2.28 It was noted that it is important that this requirement is not simply a tick-box exercise and that the evidence provided is robust and reliable. It was considered that Ofgem should scrutinise the narrative to ensure that a supplier's plans to meet their obligations are feasible and to establish that the applicant's leadership team have considered how these issues relate to the business plan, rather than obtaining an off-the-shelf statement from a consulting company or an already licensed supplier.

2.29 It was also suggested that Ofgem should consider conducting an audit on suppliers on key compliance areas within 12 months of start-up as a means of identifying early any key issues regarding customer service obligations. Another respondent welcomed the proposals but said this will only be effective if there are regular checks to ensure a company is putting its proposals into practice, as there exists a potential for suppliers to game the application process by offering a plan for compliance without following it through.

## Our response

2.30 We welcome the support received for our proposal and the wide range of suggestions made for how this could be assessed in practice. We have taken this into account when drafting the new application guidance document which we are now consulting on. We welcome further input and feedback to help us to refine this.

2.31 While we understand the desire for applicants to be assessed on their understanding of their licence obligations more broadly than those related to customer service, we consider that a proportionate approach is required. The main aims of our Supplier Licensing Review are focussed around financial resilience and customer service and therefore we currently believe this is the relevant emphasis, though for the avoidance of doubt, suppliers must understand and be ready to comply with all their obligations when they commence supply. In respect of future obligations, we will keep our guidance under review and update it from time to time.

2.32 We acknowledge and agree that this particular criteria is most relevant to domestic suppliers, albeit non-domestic suppliers should also provide a narrative in respect of micro-businesses where relevant. We have reflected this in the proposed new fee levels for supply licence applications (which we are now consulting on), as the level of resource required to assess non-domestic only applications will typically be less.

2.33 We also acknowledge and agree there is a risk that applicants provide a 'stock' response to this application requirement. However, all applications for supply licences are reviewed by the same Ofgem team and it would readily become apparent to us if template responses were being provided. In such cases this would attract a higher risk rating and increase the potential that we escalate the application to Tier 2 of our process. Tier 2 applications are subject to increased information requirements and we can require applicants to attend interview. An escalation to Tier 2 will also likely elongate the application process, therefore we anticipate applicants will be motivated to avoid this increased scrutiny.

2.34 It should be recognised that we don't consider the hiring of consultants to support an applicant with their market entry would be a negative. Consultants can play a valuable role in educating new entrants on their requirements. However, where we do interview applicants on their response to this particular application requirement, we will be seeking to gain assurance that where applications are being supported by external consultants, the applicant themselves has understood their obligations (and the costs of compliance), and is committed to embedding good practice into their processes.

2.35 Following the grant of a supply licence, Ofgem's Compliance team engage with new suppliers once they have entered the market, and the new information provided as part of their licence application will form a foundation for future monitoring and engagement.

## Criteria 3: Fit & Proper

2.36 We asked stakeholders if they agreed we should ask additional 'fit and proper' questions as part of the application process.

## Stakeholder views

2.37 Stakeholders generally agreed that we should ask additional 'fit and proper' questions, commenting that this is consistent with rules applied in other sectors. It was considered that the requirement should capture anyone with significant management responsibility or influence. Some felt that employment history was a relevant consideration, to demonstrate the required level of expertise for the role, and that the senior management team should demonstrate a minimum level of industry knowledge.

2.38 One respondent felt it made sense to seek additional evidence around insolvency, previous SoLR events and compliance/enforcement history as these areas are in direct alignment with many of the risk areas that the Supplier Licensing Review is looking to reduce and mitigate. Another said detailed scrutiny of other corporate relationships or history is relevant.

2.39 There was a common view that company directors of failed supply businesses should not be granted another supply licence for a given period of time, eg three years since the SoLR event. Some felt that while including information about a recent SoLR event has some merit, involvement in a failed supplier should not prevent someone from obtaining a role at another supplier and thereby taking potential knowledge out of the industry.

2.40 One suggested barring directors of previously failed suppliers which have resulted in a SoLR event where there is evidence of poor management, or the failure resulted in the costs of failure being redistributed across the industry. It was also suggested that it could include enforcement activity where a fine or consumer detriment exceeded a certain threshold.

2.41 A number of respondents suggested that the test be reapplied upon a change of control at the supply company, or that Ofgem should approve any change in ownership. Another asked to what extent the information provided would lead to a licence being refused, and it was suggested there should be clear guidance on what we would consider to be not acceptable. It was also suggested that the inclusion of civil proceedings seemed potentially open-ended.

2.42 It was considered that supply licences should not be granted to persons who do not intend to be the final operator of the licence, and that this assessment must be made of the actual controllers. Another said while they agreed with this information requirement, the information submitted should be treated as highly confidential. It was also suggested Ofgem should be wary that this requirement is misconstrued as a positive endorsement of the supplier.

## Our response

2.43 We welcome that stakeholders supported us strengthening this requirement.

2.44 We agree that the people running a supply business will need appropriate skills and capabilities. That said we do not consider experience in the energy industry should be a pre-requisite to gaining a licence. We think it will be apparent from how the applicant demonstrates they meet the other two assessment criteria, as to whether an appropriate level of knowledge and understanding of the market exists. However, if we escalate a supply

licence application to Tier 2 under the new process, we may request CVs in order to give further consideration to past experience in the case of potentially higher risk applications.<sup>26</sup>

2.45 We also agree that our application guidance should cover how we will apply this assessment, however it will be necessary to make case-by-case judgements in light of the specific circumstances of the case. Our assessment under this criteria will be related only to whether we consider the applicant suitable to hold the licence applied for, and does not provide any form of endorsement. We will consider whether any disclosures are relevant to our decision to grant a licence.

2.46 We agree with the respondent who commented that disclosing ‘adverse findings in civil proceedings’ may potentially be too broad. While we will consider any relevant adverse information that is brought to our attention, we have removed specific reference to this disclosure requirement. We have proposed instead to insert a disclosure requirement that specifically captures infringements of competition law, which we consider particularly relevant.

2.47 It also follows that where a relevant individual has been involved in a SoLR, we don’t consider this should be an absolute prohibition on gaining another licence in the future. Supply businesses should be able to take reasonable risks and will potentially fail, however they should manage those risks well and in such a way that does not put the costs of their failure on the wider market or consumers. We will therefore take into account relevant factors which may include: how long ago the SoLR event was, whether material consumer or market harm was caused, and the nature of their co-operation with Ofgem during the process.

2.48 Given the increased likelihood that we will refuse a future application where a relevant individual was involved in triggering a SoLR event,<sup>27</sup> we consider this should act as an incentive for financially distressed suppliers to seek an orderly exit.

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<sup>26</sup> Further details can be found in our April 2019 consultation document: <https://www.ofgem.gov.uk/publications-and-updates/consultation-new-applications-regulations-application-forms-and-guidance-document>

<sup>27</sup> Under the Supplier Licensing Review we are also considering introducing an ongoing ‘fit and proper’ licence requirement for active suppliers.