

Supplier Licensing Review

Ofgem Policy Consultation

A Response by Utility Warehouse

This document sets out the views of Utility Warehouse regarding the Ofgem Policy Consultation “*Supplier Licensing Review*” published by Ofgem on 21 November 2018.

Utility Warehouse is the UK’s only fully integrated provider of a wide range of competitively priced utility services spanning both the Communications and Energy markets. Customers benefit from the convenience of a single monthly statement, consistently good value across all their utilities and exceptional levels of customer service. Utility Warehouse does not advertise, relying instead on ‘word of mouth’ recommendation by existing satisfied customers and distributors in order to grow its market share.

We take our responsibilities as an energy provider very seriously and make every effort to ensure we provide such essential services to our customers with the utmost integrity; the customer is at the heart of our business model and the way in which we operate. Customer value is the cornerstone of the success we have had and continue to achieve.

Utility Warehouse welcomes Ofgem reviewing their approach to licensing suppliers and believe it’s particularly timely given the unparalleled recent developments in the GB retail energy market.

We have previously advocated for more rigorous stress testing of a new supplier’s ability to operate before they can commence the provision of energy supply to domestic customers. While we fully support competition in the sector, it is imperative that companies who operate in the market take their responsibilities incredibly seriously and those that choose to do so must have the appropriate infrastructure in place, from financing, ability to hedge, backing to the necessary operation of systems and staffing levels to support.

In recent years, we have seen a range of evidence in the sector, through the opening of Ofgem compliance investigations, where some suppliers have clearly failed to ensure an appropriate infrastructure is in place to manage customer growth, complaints and billing etc. Indeed, we have recently seen sizeable energy suppliers exit the market while subject to such compliance investigations. Repeatedly suppliers seem able to offer cheap unsustainable prices to fund their growth without actually having the supporting infrastructure in place to manage it.

Politically there has been a constant rallying cry for cheaper energy tariffs that appears to ignore the commercial reality that if such tariffs, designed to encourage competition particularly with the disengaged, attract high growth for individual suppliers they also threaten the financial viability of a sustainable relationship when such suppliers can operate loss making tariffs in order to drive growth.

Utility Warehouse were part of the CMOC trial earlier this year in which Ofgem directed five energy suppliers to offer the cheapest deals in the market at the time to a randomly selected sample of their own customers. Despite raising our concerns with Ofgem at the time, we found ourselves in the position where for circa 40% of our customers in the trial, we had to offer Usio Energy tariffs only to subsequently see the supplier exit the market in October 2018, an exit within three months of us having to promote their cheap, yet clearly unsustainable tariffs. As a customer centric energy supplier, it is incredibly difficult to justify how in this case we are treating our own customers fairly and in the way in which they deserve.

The growing independent sector is at real risk due to “irresponsible” suppliers going into administration which naturally sees customers flock back to the safety of the Big 6 thus damaging the confidence in the independent supplier market.

It is unfair to ask customers who haven’t switched supplier to pay for the losses incurred by those who have benefitted from an artificially cheap price operated by an undercapitalised supplier, which if other suppliers are asked to fund, needs to be recovered from their customers through even higher prices.

While Ofgem have an accredited licence application process in place, as recognised in the consultation it appears far too easy for a new entrant to simply purchase a supply company ‘off the shelf’ and then seek to commence trading without actually undergoing any testing itself.

While we recognise that Ofgem’s licensing application arrangements include checks about the financial solvency of the applicant and any parent undertaking, if these were sufficiently robust it would seem far less likely that an energy supplier could face the potential risks of insolvency further down the line.

We have provided comments below regarding the questions raised by Ofgem; we have used the consultation document chapters accordingly.

Chapter 2- The case for change and our aims

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

We are generally supportive of the overarching principles set out by Ofgem in their guide to reform. Ofgem as the regulator has a responsibility to adequately protect customers and the whole energy system. We recognise that while Ofgem has recently made changes to its SoLR process to ensure its arrangements are as effective as possible when a supplier goes into insolvency, it is fundamentally too late to adequately protect customers and their confidence in the market when a supplier reaches this stage. It is therefore essential that the issues identified in the consultation are addressed and we welcome the focus of this important workstream.

Chapter 4- Entry criteria: background

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?

We are encouraged by the proposals set out by Ofgem to ensure there are tougher entry requirements for applicants. In particular, it is imperative that suppliers provide enough detail to Ofgem including demonstrating the ability to source financing and hedging arrangements, so that business plans can be appropriately scrutinised to ensure customers exposure to risk is limited to a reasonable level. We therefore do not consider that the information requested should be restricted to the first 12 months of operation. Instead, projections should be provided for the first three years of operation, with this information acting as a baseline for monitoring against on an ongoing basis.

Chapter 5- Entry criteria: initial proposals

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

We are broadly supportive of the proposed assessment criteria.

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?

As previously stated, we do not agree that applicants should be limited to only providing evidence for the first 12 months of operation following market entry. It is imperative that suppliers are thinking strategically and long-term about their enduring operation in the market. The assessment criteria within the strengthened arrangements should reflect this by requesting details on working capital and financial projections for three years after entry.

New entrants must be able to evidence they have the finance to allow for investment to build sufficient customer service operations and systems that will provide positive experience for customers and to allow for the responsible hedging of their energy requirements. Given energy is such an essential service, entering the market should not be undertaken without the ability to adjust and cope with changes in wholesale prices or unexpected additional costs.

We consider that the financial adequacy of applicants is intrinsically linked to how suppliers manage credit balances given some suppliers currently utilise this as working capital. We set out our initial thoughts on the appropriate management of credit balances later in this response.

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?

We are broadly supportive of the proposed assessment information that would be required.

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

We consider it imperative that applicants have a thorough understanding of their key customer-related regulatory obligations. We have seen recent examples in the market where Ofgem have had to intervene due to service failings of a new entrant leading to significant customer detriment. As Ofgem notes in the consultation, new suppliers have previously underestimated the cost of compliance and this review provides an opportunity to ensure this is not possible in the future. It is essential Ofgem continues an ongoing dialogue with new entrants throughout their entry into the market, reviewing performance against the narrative new entrants provide.

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

We are broadly supportive of the areas Ofgem expects 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)?

We agree that Ofgem should strengthen their 'fit and proper' test seeking additional disclosures from applicants as this will provide Ofgem with greater transparency. It is essential,

as discussed later in the consultation, that the 'fit and proper' test scrutinises the people or entity that will actually operate the supply business.

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?

We welcome Ofgem recognising that the 'off the shelf' market entry model presents significant risks that the eventual supplier has no engagement with Ofgem during the current market entry process. Currently with such a low barrier to entry, unqualified suppliers are able to operate in a complex market in which they are not appropriately prepared and without sufficient care and due diligence.

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?

It is imperative that Ofgem specifies exactly how all monitoring information would be used so ongoing reporting does not become a box ticking exercise.

We believe there is place for all suppliers to report on their financial and operational resilience, however the frequency and level of content of what is provided to the regulator should vary relating the suppliers size and years of operation in the market. We therefore consider a combination of ongoing monitoring requirements working in a coordinated manner is needed and we set out our initial thoughts on this relating to the relevant questions below.

We consider that established suppliers who have operated for longer than three years and whose customer numbers surpass regulatory obligation scheme thresholds should report every one to three years as Ofgem deem appropriate. We support Ofgem's proposal that suppliers should provide a certificate of adequacy, and believe the makeup of this should be comparable to what public companies already publish on an annual basis, reducing the resource burden on suppliers. We also support the proposal that these certificates are audited and signed-off by an appropriate director and data controller to ensure reliability and credibility.

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

As stated earlier in our response to this consultation, we firmly believe the supply licence application process should involve new entrants providing financial projections for the first three years of operation. This information can then act as a baseline which these specific new suppliers report against on an annual basis using the same metrics as is set out in their licence applications. This reporting regime lasting three years would enable Ofgem to better understand if suppliers are performing in accordance with their business plans while providing greater insight into their operational financial resilience. Furthermore, over time it would provide useful insight to help Ofgem understand if the metrics included in the licence application process remain fit for purpose.

We fully support Ofgem's initial proposal of a milestone assessment. This should be undertaken as a supplier is approaching customer number thresholds where they must comply with regulatory obligation schemes such as ECO and the Warm Home Discount. We recognise the thresholds are changing and therefore the reporting requirements should reflect this

through a tiered approach. This point in time assessment will highlight to Ofgem if a small but growing supplier will cope with the additional costs and operational challenges required that they will encounter through participation in the schemes. We consider that Ofgem should determine the content of the milestone assessments.

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

We have set out above our views on the ongoing requirements we believe should be introduced.

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

We have set out above our views on the ongoing requirements we believe should be introduced.

Chapter 8- Exit arrangements: managing supplier failure

We recognise Ofgem's concern around the appropriate management of credit balances and welcome Ofgem's intention to conduct a separate consultation on introducing requirements to limit the disruptive impacts of supplier exit. We have seen extreme examples recently of some suppliers encouraging customers to build up large credit balances by offering preferential terms such as high interest rates or encouraging customers to pay their annual usage upfront. We are not an advocate of such arrangements as we feel it places undue risks on potentially large credit balances.

We therefore fully support Ofgem's initial proposal of making new entrants 'ring-fence' aggregate customer credit balances in such a way so they cannot be used for general business purposes.

This requirement could:

- (i) Apply to all new suppliers for their first 5 years; or
- (ii) Apply to all suppliers with an equity base of (a) less than £1million or (b) less than £50 per customer, whichever is the higher.

Out of the two options we have put forward, we consider option (ii) to be most appropriate.