

Electricity and gas suppliers,
consumer groups and other
interested parties

Email: Licensing@ofgem.gov.uk

Date: 24 May 2019

Update on the way forward for the 'ongoing requirements' and 'exit arrangements' phases of the Supplier Licensing Review

Following our final proposals on new supplier entry requirements¹, this working paper sets out how we are progressing the next stage of our Supplier Licensing Review – which will consider ongoing requirements on suppliers and exit arrangements in the event of supplier failure. We set out the context and justification for the Supplier Licensing Review, and some initial thinking on these areas in our consultation in November.²

We will be holding a stakeholder workshop on 21st June 2019.³ This working paper provides an update for stakeholders on our current thinking and provides some points for consideration which will form the basis of discussion with stakeholders at the workshop. This discussion will help ensure that our work packages are focused on the right areas and we progress options to formal consultation that would achieve the principles of the Supplier Licensing Review.

In this paper we have set out:

- How we intend to structure and progress our work on ongoing requirements and exit arrangements under the review.
- Some key areas for discussion at our stakeholder workshop in June.
- A summary of our current thinking on 'ongoing requirements' and 'exit arrangements' in the Appendixes.

We have also summarised stakeholder responses from our November 2018 consultation relating to ongoing requirements and exit arrangements in a separate annex.⁴

¹ <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-final-proposals-entry-requirements>

² <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review>

³ See here for event invitation: <https://www.ofgem.gov.uk/publications-and-updates/invitation-supply-licensing-review-stakeholder-workshop-21-june-2019>

⁴ <https://www.ofgem.gov.uk/publications-and-updates/update-way-forward-ongoing-requirements-and-exit-arrangements-phases-supplier-licensing-review>

Context

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;⁵
- **ongoing** requirements, monitoring and engagement; and,
- arrangements for managing supplier failure and market **exit**.

The following principles drive policy development throughout this review for a cohesive set of reforms:

- 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.

In our November consultation we asked stakeholders their initial views on:

- 1) Whether suppliers should report on their operational and financial resilience on an ongoing basis
- 2) Whether we should introduce targeted or strategic monitoring or requirements on suppliers
- 3) Whether we should introduce prudential/financial requirements on suppliers
- 4) Whether we should introduce an ongoing 'fit and proper' requirement on suppliers

We also set out some initial thinking on treatment of customer credit balances and other costs and arrangements associated with supplier failure. Alongside the November consultation we undertook a domestic supplier Request For Information on credit balance positions and practices.

Having considered stakeholder views on the above, we have further refined the scope and approach to the 'ongoing requirements' and 'exit arrangements' stages of our review.

Structure and approach to ongoing requirements and exit arrangements stages

This working paper sets out initial working level views on a broad range of options. We have done this with the aim of informing discussion at our stakeholder workshop. We may decide to deprioritise options to facilitate faster delivery or decide it is unnecessary to progress all of these options to formal consultation. We are also keen to understand through the discussion at our forthcoming workshop if there are other alternative options we could consider.

⁵ We have published final proposals on this workstream and recently consulted on implementation via new Applications Regulations and associated guidance document. We expect to publish a final decision letter/new SIs in June.

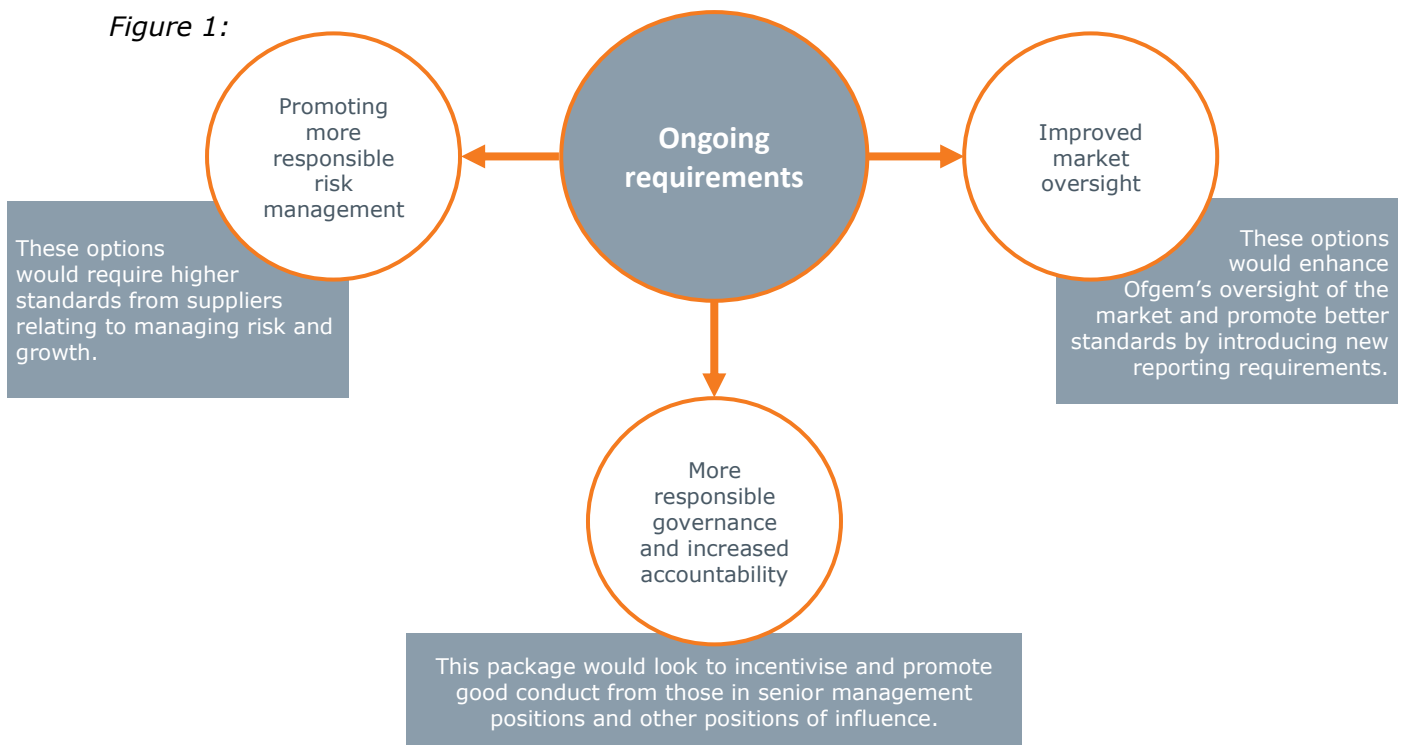
Ongoing requirements:

In November we set out some aims that any ongoing measures would be intended to achieve:

- Raise the standard of risk management and planning practices, and promoting a responsible approach to growth;
- Enhance our visibility of, and ability to monitor, potential financial instability in the market so we can act where needed. Enable us to ensure effective management of any supplier failure;
- Minimise the broader market impacts of a supplier failure; and/or
- Contributing to maintaining a constructive relationship with Ofgem as the regulator.

Building on this, we have divided our policy development for new ongoing requirements into three work packages:

Figure 1:



We want to deliver a package of ongoing requirements on suppliers that will improve current arrangements in line with the principles of the Supplier Licensing Review. It is important that the right regulatory tools exist to effectively regulate customer service performance and financial resilience, however we also want to ensure that we do not put disproportionate requirements on suppliers. See Appendix 1 for a long list of options and how they could deliver our aims.

Note on credit balances and government scheme and policy costs:

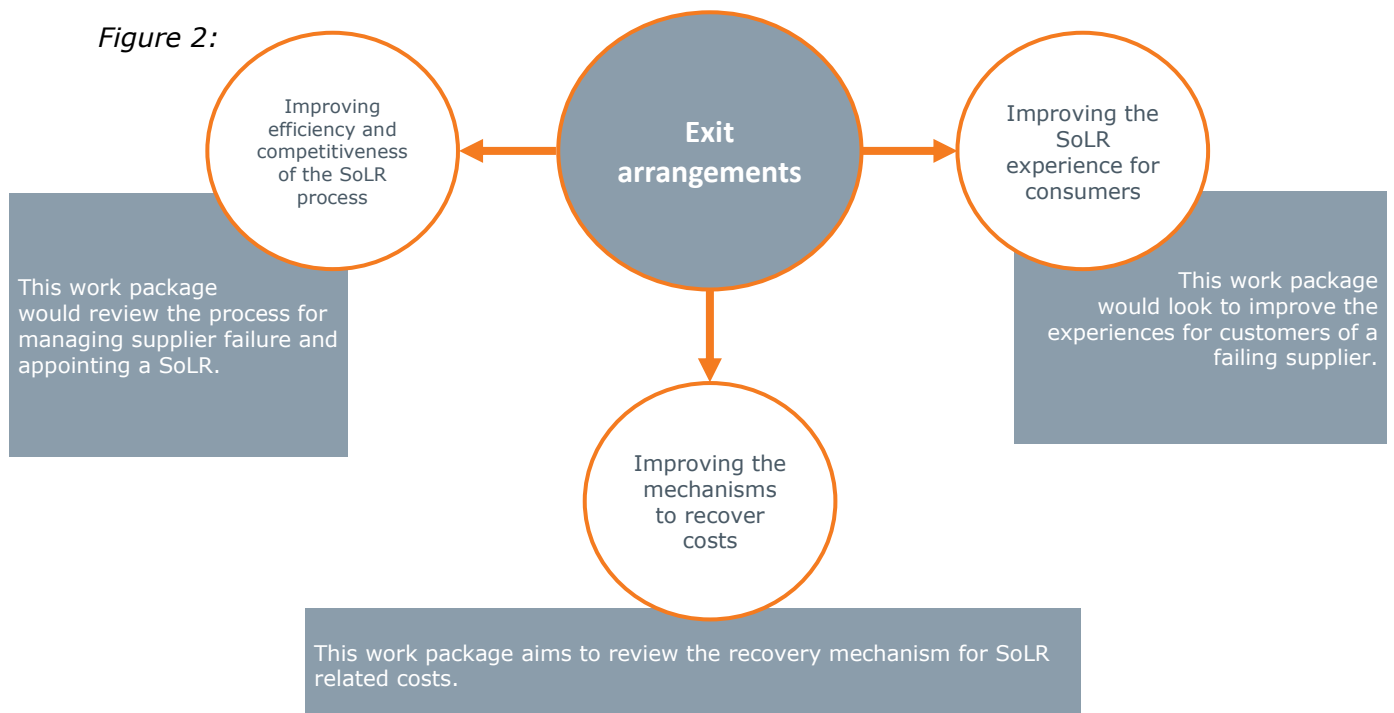
When a supplier fails, there is potential for a number of associated costs to be mutualised across remaining suppliers – either through policy cost mechanisms or through the Supplier of Last Resort (SoLR) levy. This can lead to increased cost for suppliers and ultimately consumers.

Many respondents to our November consultation expressed that this issue was a priority for us to address as part of this review. While these costs materialise if a supplier experiences financial difficulty and fails, options to mitigate these costs in the most part would require ongoing requirements on all suppliers. Therefore, while our November consultation discussed this issue in the context of the supplier exit arrangements, we are including these options under the 'Promoting more responsible risk management' work package under the ongoing requirements stage of our review. This issue will have close interactions with the supplier exit arrangements and how failure is managed – for example treatment of credit balances in the event of a SoLR.

Exit arrangements:

In addition to this we have taken on board stakeholder suggestions and propose to progress three work packages related to exit, each with its own overarching aim:

Figure 2:



We want to deliver a package of changes that improve the SoLR process to ultimately minimise costs to consumers and improve the consumer experience of SoLRs. See Appendix 2 for a long list of options and ideas for this stage of the review.

In addition to the work undertaken under the Supplier Licensing Review, we strongly support industry sharing of lessons learned and good practice relating to SoLR processes.⁶ Improvements within current arrangements could lead to a smoother experience for customers of failed suppliers and efficiencies for all parties. Energy UK will hold a workshop on 5 June 2019 to look at best practice and lessons learned, following the SoLR processes the industry has gone through in the last year.

⁶ Citizen's Advice recently published a SoLR good practice document <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Final%20-%20SoLR%20GPG.pdf>.

Next steps

We are interested in stakeholder views before we refine and further develop options for formal consultation.

We have set out some indicative points for discussion below alongside explanations of potential options. **We are not expecting formal written responses to this working paper.**

We are looking forward to discussing the options raised in this paper with stakeholders at our stakeholder workshop.

We expect to publish a formal consultation on policy changes towards the end of the summer.

Yours faithfully,

Lesley Nugent

Deputy Director, Licensing Frameworks

Appendix 1 - Our current thinking on 'ongoing requirements' work packages

1.1. We've set out a long list of options in the below table and illustrated how they target the aims we set out in our November consultation. Key points for further discussion with stakeholders are:

- **For each option, would the approach be proportionate and effective at achieving the aims of the 'ongoing requirements' stage of our Supplier Licensing Review?**
- **Would these options be appropriate for all suppliers, or should some options relate only to domestic/microbusiness supply?**
- **Are there any potential business impacts or implementation challenges for suppliers we should be considering?**
- **Are there any alternative options we should be considering?**

How the options relate to the aims we proposed in November					
Work package	Option	Raising the standard of risk management and planning practices, and promoting a responsible approach to growth	Enhancing our visibility of, and ability to monitor, potential financial instability in the market so we can act where needed. Enabling us to ensure effective management of any supplier failure	Minimising the broader market impacts of a supplier failure	Contributing to maintaining a constructive relationship with Ofgem as the regulator
1) Promoting more responsible risk management	a) Requirement to have capacity, processes and systems in place to comply with obligations	✓			
	b) Credit balance provisions in place in the event of failure	✓	✓	✓	
	c) Making prudent provision to discharge obligations under government schemes/policies	✓		✓	
2) More responsible governance and increased accountability	a) Ongoing 'fit and proper' requirement	✓		✓	✓
	b) Requirement for named officers	✓			
	c) Standards of behaviour/governance	✓			✓
3) Improved Market Oversight	a) Cyclical reporting		✓		
	b) Risk based reporting	✓	✓		
	c) Independent audits		✓		✓
	d) Requirement to maintain a 'living will'	✓	✓	✓	
	e) Change of Control notification		✓		

The Office of Gas and Electricity Markets

10 South Colonnade, Canary Wharf, London, E14 4PU Tel 020 7901 7000

www.ofgem.gov.uk

1) Promoting more responsible risk management

1.2. These options would look to create enforceable rules in the supply licence conditions relating to how suppliers manage risks. These rules would seek to set clear operational and financial standards to tackle issues associated with unmanageable growth and supplier actions that ultimately risk costs unnecessarily being imposed on consumers and wider industry. Ofgem would be able to take action where we see these standards not being met. Improved market oversight, as set out in work package 3, would support early identification of potential compliance concerns.

a) An enforceable principle requiring suppliers to have the capability, processes and systems in place that enable them to service all their customers and comply with their obligations – including assessment and management of any associated risks.

1.3. The purpose of this obligation would be to make it clear to suppliers that we expect that they have the capability to operate to the standards they are required to meet. This type of requirement would allow us, through our compliance and enforcement activities, to directly address the causes where we are seeing systemic poor supplier performance related to unmanageable growth or inadequate operational capability.

1.4. Under our final proposals for entry requirements, we will consider whether/how a new supplier has planned to resource and operate their business as they grow. A new ongoing licence requirement would make clear our expectations this should continue on an ongoing basis, and enable us to take action where this principle is not adhered to.

1.5. This requirement could be assessed by Ofgem at particular milestones (eg at certain customer number thresholds) and/or due to certain 'trigger points' (eg large numbers of customer complaints). The potential for regulatory assessments at milestones or trigger points could become a strong incentive for suppliers to operate and grow in a responsible manner, particularly if the need for assessments was based on risk factors and past performance.

1.6. If Ofgem was not satisfied with the results of an assessment, it is important that Ofgem can take action to address any issues. Potential options could include:

- Increased reporting to Ofgem
- Informal/mutual agreement from the supplier for certain remedial actions to be taken
- Enforcement action against this principle
- A new potential licence condition to enable Ofgem to issue a direction to activate certain conditions the supplier must follow until certain criteria are met. Conditions could include limiting growth or restrictions on direct debits for example.

Points for discussion:

- **Are there any other potential consequences/actions Ofgem could take in the event of an unsatisfactory assessment?**
- **Should milestones/triggers be at pre-defined events, or are there benefits in Ofgem taking a risk-based approach?**

b) An enforceable principle requiring suppliers to put provisions in place to ensure that excessive/all customer credit balances costs are protected in the event of failure.

1.7. We set out the issues related to credit balances, and the impact of the mutualisation of these costs in the event of a SoLR, in our November consultation.

1.8. For context, suppliers can build up large amounts of customer credit that they have collected from their customers. One way this can occur is where suppliers choose to even out payments across the year. This means that, due to seasonal variations in consumption, sometimes customers may be in credit and at other times in debit. In the event of supplier failure, credit balances owed to customers is honoured through the SoLR process. In some situations, this results in some or all of this money being socialised across all consumers through the SoLR levy. To mitigate the risks of these costs being passed on to consumers we are keen to encourage suppliers to take a more responsible approach to credit balance management.

1.9. In line with Ofgem's progression to more principles-based regulation, our initial view is that it may be appropriate to introduce an outcomes based rule in the supply licence to address this issue. Having considered stakeholder views and responses to our RFI on credit balance practices, it is clear that there is more than one way that this outcome could be achieved. Stakeholders suggested examples such as a parental company guarantees or by holding credit balances in escrow. A principles-based approach could retain the option for suppliers to utilise credit balances for working capital - as long as they collect and refund that money to customers in line with existing rules and provide a suitable form of financial protection in the event of failure.

1.10. This obligation could put incentives on suppliers to manage credit balances responsibly. Suppliers with business models that could lead to significant build-up of credit balances, for example upfront advance payments, would need to have provisions in place proportionate to that risk.

Points for discussion:

- **Is it proportionate to expect suppliers to put protections in place for the total value of customer credit balances, or is there a level of residual credit balances (eg due to seasonality) that is 'acceptable' in the event of failure (eg either because an incoming SoLR may be willing to absorb that costs, or because the materiality of any future levy claim would be low)?**
- **What arrangements might suppliers need to put in place to comply with this obligation?**
- **Would this principle be sufficient to ensure that suppliers take on an appropriate share of their risk relating to credit balances, or should we also be considering more specific rules on how credit balance can be held/used?**
- **In the event that we did implement a principles-based requirement, would an implementation period be necessary to enable suppliers to come into compliance? If so, what might be a reasonable timescale?**

c) A supply licence condition requiring suppliers to demonstrate they are making prudent provision to discharge their obligations under government schemes and policies.

1.11. Suppliers have a number of obligations they are required to discharge and payments they must make by virtue of the Standard Conditions of Supply Licence and relevant legislation. This includes, for example, the Renewables Obligation (RO) and the Feed-in-Tariff (FIT) scheme. There have been recent cases where suppliers have been unable to discharge their obligations and have subsequently exited the market. In many cases this was due to financial difficulty which ultimately led to insolvency. This results in the failed supplier's obligations being left undischarged, which can lead to financial shortfalls. In many cases, where this happens, the cost left behind is socialised in some form across wider industry. Changes to the mechanisms for recovery of government schemes or policy costs is not in scope of this review. However, there was interest from stakeholders for Ofgem consider if there was more we could do to mitigate the risk of suppliers failing to meet these obligations.

1.12. Under current rules we are able to engage with suppliers to monitor the risks of suppliers missing payments, but are not able to take potential enforcement action until obligation deadlines are actually missed. Introducing a licence condition requiring suppliers to make prudent provision for these obligations could allow us to intervene earlier where we consider suppliers are not giving due regard to the importance of meeting these obligations. This could promote better standards and provide earlier and more reliable warnings when payments are likely to be missed. However the impact would be limited where it is clear that a supplier has insufficient funds to discharge these obligations.

Points for discussion:

- **What might 'prudent provision' look like for different business/funding models?**

2) More responsible governance and increased accountability

1.13. These options would look to create more accountability and incentivise responsible and appropriate behaviours by those in senior positions. Ofgem could potentially take action where unsuitable behaviours have occurred.

a) Ongoing requirement for licensees to ensure named persons (or persons with significant management responsibility or influence) are 'fit and proper'

1.14. In our November consultation we asked stakeholders whether we should introduce an ongoing fit and proper requirement. There was broad support for this option, however further consideration is needed on how this would work in practice.

1.15. The purpose of this requirement would be to make sure there is accountability on individuals and would require suppliers to think carefully about the suitability of those in influential positions (which we anticipate any prudent business would do anyway). For

example, this requirement could pose a strong deterrent to unethical or irresponsible behaviour if it may materially affect an individual's future career prospects in the energy market. It would also enable Ofgem to take action against licencees where relevant persons are not assessed to be fit and proper.

1.16. One way of operationalising this requirement could be to require licensees to do their own due diligence and self-certify that relevant persons are fit and proper. This could also include annual declarations/certifications signed off at a sufficiently senior level that all persons within scope of the licence requirement are fit and proper for their roles (see option 3a). Ofgem could then take action where we have reason to believe the approach to due diligence or self-certification is not fit for purpose, or evidence is brought to our attention to suggest someone is not fit and proper for their position.

1.17. Another option would be for Ofgem to have a more proactive role in overseeing persons entering the market before taking on roles with significant influence at existing licensed businesses.

1.18. Like any other licence condition, treatment of breaches of this requirement would depend on the circumstances and severity of the breach. In some cases, compliance activity may be sufficient to ensure that the governance processes are improved to bring the company into compliance. In more egregious cases it may be appropriate to use our enforcement powers, including penalties or Provisional/Final Orders.

Points for discussion:

- **What might be the most effective way(s) to operate an ongoing 'fit and proper' persons requirement?**
- **Are there reasons why a 'fit and proper' assessment of persons at an established supplier should differ from that of persons applying for a licence under our entry requirements?**

b) Requirement for named officers

1.19. We are considering a requirement for specific persons to be named as accountable for particular aspects of the licensed supply business. For example a Compliance Officer or a Finance Officer. This could incentivise suppliers have due regard to their obligations. While that named person would be accountable for those licensed aspects (including potentially signing off any relevant declarations/decisions), it would not prevent outsourcing or delegation of delivery.

1.20. This requirement could also complement an ongoing 'fit and proper' requirement. Any fit and proper test could take into account whether an individual is suitable for a named officer role.

1.21. We recognise that suppliers may be governed in different ways. In our November consultation we suggested that requirements for a designated Compliance Officer to be appointed could come in effect once suppliers had reached a particular customer number threshold. However, all suppliers, no matter how many customers they have, are required to comply with relevant obligations. Therefore, all should be taking compliance seriously. It may be the case for some suppliers that one individual takes on all named officer roles, or a named officer role alongside other responsibilities.

Points for discussion:

- **What supplier responsibilities may require a 'named officer'?**
- **Should this requirement only come into effect once a supplier has reached a particular threshold?**

c) Enforceable principles setting out standards of behaviour/governance

1.22. We are interested in exploring whether there is value in setting out some broad expectations relating to behaviour/governance/structure that you would expect from a company providing an essential service like energy supply. Some stakeholders commented that company cultures and behaviours can lead to the poor outcomes we are looking to mitigate through the Supplier Licensing Review.

1.23. We do not want to duplicate any existing requirements on companies in how they operate (for example those who already comply with the Corporate Governance Code). We would also want any rules to be broad enough to be relevant to different business models and company sizes.

1.24. One behaviour that we would expect to see is that suppliers are open and cooperative in their engagement with the regulator – and we are considering articulating this through a new licence condition.

Points for discussion:

- **Are there key behaviours or governance standards you would expect to see from a business offering an essential service like energy?**
- **Is there value in setting these out in the licence?**

3) Improved market oversight

1.25. This work package would look to improve Ofgem's oversight of the market. Effective oversight alerts us to potential risks, facilitates timely compliance action and can enable earlier preparation for Supplier of Last Resort processes if necessary. Where we do identify issues, we can take further action under existing licence requirements or potentially one or more of the options set out in work packages 1 and 2 above.

1.26. Reporting requirements could also incentivise suppliers to improve their standards in regards to their own financial and operational monitoring and oversight. Experience from previous SoLR processes indicates that failed suppliers' standards of ongoing monitoring of their finances and operations has not always been adequate. Any new reporting requirements would not look to replace assurance that third parties may undertake as part of contractual relationships. Third parties would still be responsible for making their own assessments on the financial viability of suppliers.

a) Cyclical reporting requirements – Assurance Reporting

1.27. In November we consulted on possible reporting requirements, eg a Certificate of Adequacy or Annual Viability Statement. We agree with stakeholders that reporting should not duplicate information available from other sources. We already have access to a number of sources of information and key indicators on supplier customer service performance – and would not look for cyclical requirements to replicate this. Therefore,

cyclical reporting may focus more on financial and prudential aspects of supplier performance.

1.28. Stakeholder responses demonstrated that there are arguments for monitoring all suppliers to some extent (some argued smaller suppliers were more likely to experience financial difficulty, while others argued larger suppliers posed the greatest risk in terms of potential impact in the event of failure). In addition, if we introduce new rules, like those set out in work package 1 and 2 above, cyclical reporting may be an appropriate method of compliance monitoring. We would expect compliance with these types of rules from all suppliers on an ongoing basis – it may be less effective to start monitoring compliance with these types of obligations once a supplier is showing signs of being in financial difficulty.

1.29. We are now thinking it may be more appropriate for this to be an assurance report (potentially on an annual basis). This report would need to be signed off by appropriate senior persons. This could include:

- Assurance/evidence of compliance with any relevant rules introduced as part of the Supplier Licensing Review⁷,
- Key financial health indicators - like cash flow, capital and profitability measures,
- Overview of financial outlook for the following year, including key risks and mitigations.

1.30. It may also be appropriate in some cases for these reports to be audited (see option 3c below).

b) Risk based reporting

1.31. Suppliers can start to develop financial and/or operational difficulties quickly. While an annual report may provide a snapshot and could reveal longer term trends, it would not identify in-year changes.

1.32. We already undertake risk based monitoring and compliance, and intend to continue doing so. However, we are interested in exploring whether there are benefits in formalised reporting on this basis. For example, if suppliers chose to undertake certain types of activity, meet certain conditions or operate in particular ways deemed higher risk, this would automatically trigger additional reporting requirements. This would have the dual benefit of ensuring Ofgem has better oversight of high risk behaviours in the market and encourages supplier awareness and monitoring of the risks of those behaviours. This could include:

- Reporting against plans submitted at market entry,
- Where suppliers are offering low cost tariffs or tariffs that require significant upfront payments from customers,
- Poor performance against a milestone assessment (as per option 1a),
- Reporting against compliance plans during or after a compliance case or enforcement investigation,
- Where suppliers are experiencing rapid growth.

⁷ For example, options 1b or 2a in this appendix.

1.33. Content of reporting may depend on the risk factor. For example, reporting due to offering low cost tariffs and/or tariffs that require significant upfront payments may focus on ongoing viability and appropriate funding arrangements.

1.34. If we did decide to proceed with this option, we could develop a risk-based reporting strategy that would set out risk factors and associated reporting requirements. This strategy could be updated from time to time.

1.35. This risk based reporting could become a key consideration our application of an assessment framework set out in option 1a.

Points for discussion: (for cyclical and risk based reporting)

- **Would it be appropriate to introduce both cyclical and risk based reporting requirements?**
- **What would the most efficient and effective implementation method be if we did progress options 3a and/or 3b. Some stakeholder feedback suggested a more transparent obligation to provide information (for example a reporting licence condition) would provide more clarity, create good incentives and allow for more efficient planning. It may also be possible to achieve through our existing powers to request information. We could also utilise our account manager engagement processes to collect this information.**

c) Requirement for suppliers to provide assurance to Ofgem through independent audits

1.36. This option would introduce a mechanism for Ofgem to require suppliers to undertake independent audits where necessary.

1.37. It is a supplier's responsibility to comply with their obligations. We do not consider it is our role to forensically analyse suppliers' operations and finances. While we would not expect all reporting to Ofgem to be independently verified, there may be occasions where independent verification of information or compliance with obligations is proportionate. This could include:

- Where we have reason to believe a supplier is inappropriately withholding information or has provided us with incomplete or inaccurate information (eg through an request for information, in person or during a compliance/enforcement case).
- To identify root causes of issues where suppliers are experiencing systemic customer service or compliance issues,
- To evidence compliance with obligations that may otherwise require forensic analysis of suppliers operational or financial processes – for example preparedness in the event of supplier failure or compliance with any relevant rules implemented as part of the Supplier Licensing Review.

1.38. This obligation would incentivise supplier to be open with us about their businesses. A track record of being open with the regulator and producing timely, good quality information would significantly reduce the likelihood of Ofgem needing independent verification. It would also ensure that we can act more efficiently and effectively in instances where suppliers are not giving due regard to their regulatory obligations, are not being cooperative with the regulator or are being evasive.

Points for discussion:

- **In what circumstances might independent audits be appropriate?**

d) Requirement to maintain a 'living will'

1.39. A requirement for a 'living will' would mean that suppliers would have to set out what would happen in the event of their failure, including any barriers to an 'orderly exit'. This could include risks of costs to consumers, disruption to services for their customers and how they would ensure compliance with any relevant licence conditions. Relevant licence conditions could include any new rules that may be introduced under the Supplier Licensing Review – for example relating to credit balance protections⁸, transfer of data in the event of a SoLR⁹ and continuation of services¹⁰. This report would not ask suppliers to evaluate the likelihood of failure.

1.40. This option could prompt companies to think about any risks associated with their failure. Ofgem could request a supplier's 'living will' to demonstrate compliance with relevant obligations. One option could be to require suppliers to publish a public facing version of their 'living will' as a reputational incentive. This could also improve market confidence.

Points for discussion:

- **what might be relevant for suppliers to include in a living will?**

e) Requirement to notify Ofgem of Change of Control events

1.41. A change of control event can lead to significant changes in how a licensed business operates and that business's financial viability. This may significantly change the overall risk profile of the licensee. However, currently there is no requirement for suppliers to notify us of a change of control. A requirement to do so would give Ofgem better oversight and ability to investigate any changes in risk profile where appropriate.

Points for discussion:

- **What information may be relevant for licensees to report on in the event of change of control**
- **How might we define change of control (eg should there be a % ownership threshold, should we include increases in existing control)**

⁸ See option 1b in this Appendix

⁹ See option 4a in Appendix 2

¹⁰ See option 6c in Appendix 2

Appendix 2 - Our current thinking on 'exit arrangements' work packages

2.1. Below we set out a long list of options we could further develop grouped into three work packages. Key points for further discussion with stakeholders are:

- **For each option, would this approach be proportionate and effective at achieving the aims of the 'exit arrangements' stage of the supplier licensing review**
- **Are there any potential business impacts or implementation challenges for suppliers**
- **Whether there are any alternative options we should be considering**

Work package	Options
4) Improving efficiency and competitiveness of the SoLR process	a) <i>Data collection and transfer to relevant parties</i>
	b) <i>Powers to revoke supply licences</i>
	c) <i>Ofgem having the most appropriate process for appointing a SoLR or alternatives</i>
	d) <i>Splitting the exiting supplier's portfolio</i>
5) Improving the mechanisms to recover costs	a) <i>Move collection of levy to System Operators rather than distribution companies</i>
	b) <i>Accounting for costs recovered through the liquidation process</i>
	c) <i>Alternative mechanisms for recovering costs of SoLR</i>
6) Improving the SoLR experience for consumers	a) <i>SoLR performance</i>
	b) <i>Customers in debt to the failing supplier</i>
	c) <i>Continuity of service to customers</i>
	d) <i>Energy Ombudsman decisions not being implemented, including compensation</i>

4) Improving efficiency and competitiveness of the SoLR process

2.2. This work package would look to improve the process for running a SoLR event. This would cover the process leading up to the announcement of a supplier failure who then exits the market (ensuring we have the data we need to run the SoLR event and any competition). This would also cover the process for us to select a SoLR. We set out a number of areas where we think there is potential to improve the process along with some initial thoughts. At this stage we are keen to share these preliminary thoughts to stakeholders to hear any feedback.

a) Data collection and transfer to relevant parties

2.3. As set out in our published guidance,¹¹ where a supplier is at risk of failing, we may seek information from network operators, industry central systems providers (Elexon, Xoserve and the Data Communications Company), and the failing supplier.

¹¹ https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf.

2.4. The information we seek from the failing supplier includes details of their customer portfolio, as this enables potential SoLRs to assess the impact on their existing business of supplying additional customers. It also enables a SoLR to provide a better service to those customers. We have powers under the licence to request this information from suppliers.¹²

2.5. Whilst the process has been effective to date, we are keen to explore potential improvements to ensure we can collect information in a timely manner from a failing supplier and other relevant parties where necessary, and to ensure the information is fit for purpose to support the process of appointing a SoLR and the movement of customers to the SoLR. We are therefore considering if there are any changes required to enable us to collect this information. For example:

- Introducing new supply licence conditions requiring suppliers to regularly backup/update their customer data, in a standard/agreed format and possibly allowing Ofgem to do periodic or targeted checks that this is being done.
- Creating provisions aimed at increasing the quality/granularity of information that suppliers are currently required to keep, so they have detailed information more readily to hand.
- Suppliers maintaining an exit/handover plan for data transfer, which could be reported on in a living will (as suggested in Appendix 1 option 3d). This could include details such as service providers, the supplier's industry contracts/arrangements and other information that would enable a SoLR to easily on-board customers.
- There may be a case for additional powers for Ofgem to seize information, in exceptional circumstances. For example, similar to our powers under the Competition Act.¹³
- There may be merit in considering if other industry bodies could provide data to Ofgem to support our process, in addition to the data already provided by the networks companies and industry central systems providers (Elexon, Xoserve and DCC).

2.6. Some of these changes may be facilitated by wider industry initiatives, such as the smart meter rollout (allowing for more accurate and up-to-date usage data to be available). Additionally, the example ideas outlined above are not necessarily mutually exclusive and a number of them could be introduced.

Points for discussion:

- **What are your views on the options set out above?**
- **To what extent will other industry programmes improve data availability/provision?**
- **Are there other options that would ensure we have the data needed to run the SoLR process and ensure the SoLR can onboard customers as smoothly as possible?**

b) Powers to revoke supply licences

2.7. In order to be able to appoint a SoLR, Ofgem must first revoke the licence of the previous supplier.

¹² Standard Condition 5 of the gas and electricity supply licences give us the power to request information that we may reasonably require or consider necessary to perform our functions.

¹³ Sections 26 to 28 of the Competition Act 1998 <https://www.legislation.gov.uk/ukpga/1998/41/contents>

2.8. The supply licence sets out the circumstances in which we may revoke the licence.¹⁴ For example, we can revoke a licence by agreement with the licensee (if, for example, a supplier has voluntarily decided to exit the market), or if a licensee has not commenced supply within a year of licence grant (or has ceased to supply). We can revoke a licence if the licensee has failed to comply with an order made by us in relation to breach of licence, or has failed to pay a penalty we have imposed. We can also revoke a licence if the supplier is insolvent (in specific circumstances).

2.9. The powers to revoke a licence are, appropriately, restricted. However, changes to the revocation provisions may be appropriate to address more 'technical' issues. For example, since the standard terms of revocation were first drafted, an additional means of appointing an administrator was created (the "Out-of-Court Route"),¹⁵ which is not included as one of the circumstances in which we may revoke a licence. In addition, further changes may be appropriate to reflect the changes in legislation since our revocation provisions were last reviewed. In particular, the requirement to serve 14 days' notice on Ofgem and BEIS before a supplier can enter into certain insolvency proceedings. Both of these issues could potentially impact the timings of us being able to revoke a licence and appoint a SoLR.

2.10. We are considering (with government) how the revocations may be updated, including to enable us to revoke a licence more quickly, where appropriate. This could include reducing the financial threshold (currently £100k) of debt before we can revoke a licence, or the ability to waive the 14 days' notice period for a supplier to appoint an administrator.

2.11. These potential changes would support us in appointing a SoLR at short notice and therefore minimise costs to industry and consumers. It may avoid the process we currently adopt, of seeking a court declaration (when necessary) that a supplier is unable to pay its debts as they fall due, which can be resource intensive and costly, and may not be a process a very small supplier would realistically be able to follow.

Points for discussion:

- **Are there any additional criteria you think should allow Ofgem to be able to revoke a supply licence or any amendments to the current criteria?**

c) Ofgem having the most appropriate process for appointing a SoLR or alternatives

2.12. Our guidelines set out the current process for how we select a SoLR.¹⁶ In summary, we collect information from potential SoLRs on various aspects of their suitability to be the SoLR in the specific case, including their intentions regarding what they intend to claim from the SoLR levy. We then assess the data and bids from potential SoLRs against our selection criteria and direct the most suitable candidate to be the SoLR. If there is no suitable volunteer we may still direct a supplier to be a SoLR (although our

¹⁴ See the revocation schedule for electricity

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

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

¹⁵ Previously, a company or its creditors would have had to apply to a court to appoint an administrator over the company that had become insolvent. The Enterprise Act 2002 amended the Insolvency Act 1986 (the principal statute governing insolvency matters) to include a new Schedule B1. Paragraphs 14 and 22 of Schedule B1 allow certain secured creditors of a company and the company or its directors to appoint an administrator without the need for a court hearing. This is what is referred to in this paper as the "Out-of-Court Route" for appointing an administrator.

¹⁶ https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf

preference is to appoint a supplier who has volunteered and SoLRs appointed to date have done so on a voluntary basis). The process usually takes at least three business days.

2.13. We have reviewed the approach adopted in other industries and countries. Some examples are set out below. We are keen to hear initial views on whether any of these merit further consideration as potential alternatives to our current approach. It is not clear to us that any are demonstrably better for consumers compared to the competitive process we follow today, but are open to hearing views on this.

- A refined shortlist of SoLRs, where suppliers have expressed a range of criteria where they would be interested in taking on customers of a failed supplier and Ofgem has done an assessment of their suitability before being confirmed on the shortlist.
- A default supplier who will act as SoLR for any supplier failure. This could be one supplier for all customers, or a variation on this, (such as in Australia,¹⁷ Belgium,¹⁸ or Germany,¹⁹ where the default supplier depends on the gas/electricity distribution area or pre-liberalisation supplier).
- Multiple SoLRs take on the customer base to evenly distribute customers. However, this would be reliant on portfolio splitting (see section d below).
- A combination of the above, or some other hybrid, until a SoLR is able to on-board new customers swiftly and effectively.

2.14. We are also open to considering alternative arrangements that don't involve the appointment of a SoLR, provided they ensure continuity of supply for consumers, while minimising any additional cost on industry.

Points for discussion:

- **What other ways could Ofgem consider for appointing a SoLR?**
- **Could different approaches to appointing a SoLR be considered for different scenarios? If so, what?**
- **What alternatives to the SoLR process could Ofgem employ?**

d) Increasing competition in a SoLR appointment: splitting the exiting supplier's portfolio

2.15. Currently when we run a SoLR process we direct a single supplier to be the SoLR for that failed company. Customers are then moved in bulk under central systems (Elexon, for electricity, and Xoserve, for gas, move the Market Participant Identifier, MPID, to the SoLR). This bulk movement of all customers in the failing supplier's portfolio allows for a quick turnaround to ensure that supplies are continued whilst minimising costs to industry. However, it may be a better outcome for consumers if the failing supplier's portfolio is split between two (or more) SoLRs as this could increase competition in SoLR bids (perhaps through joint bids), as well as enabling different types of suppliers to compete (for example, those licensed to supply only to non-domestic consumers may wish to take on only the non-domestic customers in a supplier's portfolio and the current industry systems' approach would not support this).

¹⁷

[https://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ENERGY%20RETAIL%20LAW%20\(SOUTH%20AUSTRALIA\)%20ACT%202011/CURRENT/2011.6.AUTH.PDF](https://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ENERGY%20RETAIL%20LAW%20(SOUTH%20AUSTRALIA)%20ACT%202011/CURRENT/2011.6.AUTH.PDF)

¹⁸ http://ums.zookini.nl/Cms_Data/Contents/UMSDB/Media/publications/International-comparison-SLR.pdf

¹⁹ http://ums.zookini.nl/Cms_Data/Contents/UMSDB/Media/publications/International-comparison-SLR.pdf

How it could work

2.16. In theory, customer portfolios could possibly be split along the following lines: (i) between domestic and non-domestic; (ii) between standard traditional meter and smart meter; (iii) according to the consumer's payment method - prepayment, direct debit and credit payment methods, for example; (iv) by geographic areas; (v) by fuel type - gas and electricity.

2.17. Our understanding is that this could be done for each split above if there is 'clean' and accurate matching data available from the failing supplier for its customers - Meter Point Administration Numbers (MPANs) (for electricity) and Meter Point Reference Numbers (MPRNs) (for gas) - that could be readily compared with registration data held and provided by Elexon and Xoserve respectively.

2.18. However, this would require extensive validation to avoid the risk, for example, that the wrong customers are moved over to a SoLR or some customers are not moved at all. It is extremely reliant on high-quality data being available from the failed supplier. In the absence of accurate matching data with the correct level of detail from the failed supplier, we understand that there are significant challenges with splitting customer portfolios along the lines set out above based on current systems held at Elexon and Xoserve. This could lead to customer harm if they're switched to the wrong SoLR or not switched at all (meaning that they have no licensed supplier).

2.19. Additionally, there are a number of questions around who should undertake this data validation and the time taken to do so. We would envisage this to be a time and resource intensive process which would delay our ability to run the SoLR process, during which additional cost will be accruing on industry and consumers of the failed supplier are subject to prolonged uncertainty.

2.20. There are also other potential issues, such as the additional resource required to assess joint SoLR bids, as well as unintended consequences for customers as a result of the way a portfolio is split.

2.21. Notwithstanding these challenges, we consider that this option warrants further investigation and have a number of questions about how this could be taken forward and how it might operate.

2.22. The above discussion assumes that the portfolio split is done at the time of the SoLR event. An alternative way to do this could be that at the time of a SoLR event, there is a bulk movement of all customers to one SoLR (the 'lead' SoLR), then at a later time (allowing for data cleansing, etc) a subsequent movement of a subset of the portfolio is made to another SoLR. We are concerned however that this could lead to a confusing and drawn out experience for the consumer.

Points for discussion:

- **Do you agree with our views on the current challenges to splitting customer portfolios?**
- **What would need to change to allow this to happen? How long would this take? How much would it cost?**
- **What are the risks/issues of portfolio splitting for the SoLR process?**
- **If we were to appoint multiple SoLRs, how could we avoid the risk of customers being moved incorrectly or customers not being moved (when they should have been)?**

- **What is your view on the 'lead SoLR' idea, ie bulk movement of customers to one SoLR initially then later movement of subset of customers to second SoLR at later date**

5) Improving the mechanisms to recover costs

2.23. This work package aims to review the recovery mechanism for SoLR related costs. Currently, any costs incurred by the SoLR as a result of taking on the role of SoLR are either absorbed by the SoLR (which is our preferred option as set out in our guidance)²⁰ or it may make a supplier of last resort payment claim for these costs via the Last Resort Supply Payment (LRSP). If Ofgem approves a claim, then this is recovered via the gas and electricity distribution companies and ultimately from consumers.

a) Move collection of levy to System Operators rather than distribution companies

2.24. Currently, if Ofgem consents to a SoLR making a levy claim, the SoLR must make a claim to each relevant network licensee (up to 8 for gas and 14 for electricity). The Distribution Network Operator (DNO) in electricity and Gas Distribution Network (GDN) company in gas then makes regular payments to the SoLR to make up the value of the approved claim.

2.25. There can be a reasonable time before the DNOs and GDNs begin to pay back the SoLR, and until they too, can recover these costs (by increasing their own charges). Additionally, it is quite an administrative burden for suppliers to make up to 22 claims to the network companies.

2.26. It may be appropriate for these claims to be recovered via the gas and electricity System Operators (SOs), which would mean a single claim for gas and a single claim for electricity – and the SOs may be better able to make payments quickly, ahead of being able to recover the costs through charging. The specifics of how this would operate and be recovered (e.g. which use of system charges) would need further consideration, however, we believe this could be a more appropriate mechanism in the long term.

Points for discussion:

- **Should the SOs or the distribution companies be responsible for this payment/recovery of levy claims/costs?**
- **Are there any other changes that could be made to the levy process?**

b) Accounting for costs recovered through the liquidation process

2.27. Where a SoLR honours credit balances of customers of a failed supplier, we consider this means it is in the position of a subrogated creditor on behalf of those customers, and should seek to recover these costs through the liquidation process. This should ensure any claim on the industry levy is minimised, and therefore reduce costs to consumers.

²⁰ https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf

2.28. However, we recognise that administration/liquidation processes can take time and the SoLR will want to recover its costs as soon as possible. In recent examples, SoLRs have submitted claims to Ofgem before the final payments to be made (if any) by the failed company's administrators are known. We have therefore made our final decision on claim amounts subject to reductions based on any amounts the SoLR is awarded by the administrator of the exiting company.

2.29. The framework does not currently specify how any amount paid to the SoLR via the levy (and recovered through network charges) should be adjusted when the final values paid by the administrator to the SoLR are known. We are keen to hear views on whether a methodology/mechanism should be developed in relation to this, to ensure any adjustment is done in the most economic and efficient manner, and whether it would require any code and/or licence changes.

Points for discussion:

- **Do stakeholders have any views on this option?**
- **Is this something that we should rely on industry to deliver, for example, through changes to the relevant codes?**
- **Would it require a licence change?**

c) Alternative mechanisms for recovering costs of SoLR

2.30. As part of this work package we are also considering if the costs of the SoLR approved for a LRSP (levy payment) could be recovered differently, instead of via network companies. Schemes exist in other industries, such as the Financial Services Compensation Scheme.

2.31. One option is a central 'sinking' fund. Suppliers could make regular, perhaps monthly, payments into this fund, proportional to their size/market share, which would accumulate and could be used to cover the levy payments. This could potentially be added to with additional payments such as redress payments from suppliers. This fund would need to be administered by a central body.

2.32. An advantage of a central fund like this is that the failed supplier would have contributed, slightly reducing the amount borne by other customers. Additionally, paying into these funds should be more predictable for suppliers, helping them manage their cash flow, rather than potential changes to distribution/transportation charges.

2.33. We are open to considering any other suitable approaches for suppliers recovering costs of taking on the role of SoLR.

Points for discussion:

- **Are there any other alternative mechanisms for recovering the costs of SoLR?**
- **What changes would be required to introduce any alternative mechanism?**

6) Improve the SoLR experience for consumers

2.34. This work package would look to improve the experience for customers of a failed supplier that are moved to a SoLR.

2.35. The SoLR process has worked well at ensuring customers have continuous supply whilst protecting their credit balances. However, we are keen to ensure that this process continually improves and particularly that we learn lessons with regard to customer experiences. We have identified some issues with some SoLRs for example relating to customer service and billing/returning credit balances in a timely way. We are keen to talk with industry about these and how to take these learnings forward. We welcome that industry are initiating their own discussions on this at the Energy UK workshop planned for early June 2019, and we are looking to further explore these issues in our June workshop.

a) SoLR performance

2.36. Suppliers who are appointed as SoLRs must follow existing licence conditions including rules relating to customer service, billing, etc.

2.37. Within this context, we are interested in understanding if we need any further protections to ensure continued customer service following a SoLR.

2.38. This could be done via the regulatory route of introducing standards or obligations specific to SoLRs. For example, the SoLR agreeing to enforceable undertakings at point of SoLR award setting out standards of performance they agree to meet and duties they agree to deliver. One option could be to have a maximum time period for customer accounts to be set up by the SoLR, in order to ensure customers who wish to are able to switch away quickly.

2.39. Another route to do this could be to improve the accountability of SoLRs with regard to the customer service commitments they make in their submission to be a SoLR. Customer service is an important criteria for us when selecting the SoLR, and one potential way for suppliers to differentiate their bids. We are keen to explore how we are better able to hold suppliers to account on their commitments. One way to do this could be to set out the commitments the SoLR made in their bid in the direction we issue to them to be the SoLR.

Points for discussion:

- **Are there any areas of SoLR activity that may require additional protection for consumers?**
- **What do you think of the options to protect customer service we suggest?**

b) Customers in debt to the failing supplier

2.40. When a supplier fails, there are often customers that owe money to that supplier – generally when they have not paid for all the energy they have consumed.

2.41. The failed supplier's debt book becomes the responsibility of the administrator. In some cases, the administrator may enter into commercial agreements to sell the debt book to a licensed supplier (ie the appointed SoLR of the failing company). The

administrator may instead choose to issue final bills and collect debts itself or transfer the book to a debt collection agency.

2.42. Where the debt book sits with a party that Ofgem does not licence, they are not obliged to comply with customer protections included in the supply licence aimed at protecting vulnerable consumers.²¹ Due to the scope of Ofgem's powers, we may have limited ability to influence the conduct of administrators or debt collector agencies. However, we are interested in understanding if stakeholders have any ideas on how to improve experiences for customers who are in debt to a failing supplier that is in our gift to change.

2.43. One option could be for the SoLR competition process to include criteria relating to the willingness of the prospective SoLR to buy the debt book from the administrator. Though we could not guarantee that a commercial agreement between the administrator and the SoLR could be reached.

Points for discussion

- **How might experiences for customers who owe money to a failed supplier be improved?**

c) Continuity of services to customers

2.44. Suppliers often set up commercial arrangements with third parties to provide certain services to them, for example, metering and billing. Failed suppliers can result in unpaid bills to a number of such third parties. As these are covered by commercial agreements it is the responsibility of these parties to do their own due diligence and assess any risks associated with supply business failure. In general, we do not consider it our role to ensure that third parties do not lose out in the event of failure. However there may be cases where it is in consumers' interests to minimise disruption of critical services.

2.45. For example, if there is a risk that a third party does not/is unable to continue to provide a service, which may be essential to ensure continuous energy supply in the period between when the failed supplier ceases trading and when the direction on SoLR takes effect. One possible option is to include a licence condition so that such services are maintained in the period between when the failed supplier ceases trading and when the direction on SoLR takes effect. However, these may be difficult to enforce on a third party when the licensed entity has failed and may no longer be cooperative. It would be unclear how an unlicensed third party could be held to account in this scenario. Alternatively, such measures could potentially form part of a 'living will' (as discussed above)²². Another possible option could be to introduce arrangements via industry governed processes.

2.46. Related to this issue, we note that UNC688 has been proposed to consider if any changes are needed to address the impacts of shippers' losses in the event of supplier failure, given shippers continue to ship gas to end consumers (and incur costs) in the period after a failed supplier has ceased trading.

²¹ However, if consumers consider they are being treated unfairly by a debt collection agency, they can complain to professional bodies or trade association (if the debt collection agency is a member). Alternatively, consumers can raise any complaint about harassment with Citizen's Advice and then to Trading Standards.

²² See option 3d in Appendix 1.

Points for discussion:

- **Are there risks to consumers associated with third party services we should be considering – and what types of service are the most critical, in the short and longer term?**
- **To what extent can these issues be resolved through industry governed processes or via licence conditions, where there are commercial arrangements between relevant parties?**

d) Energy Ombudsman decisions not being implemented, including compensation

2.47. Currently any consumers that have complaints against suppliers that have exited the market that are still being processed by the Energy Ombudsman, or have had complaints upheld but have not had their financial awards paid, effectively lose their right to compensation.

2.48. We are interested to understand if there is any proportionate means to address this that is within our powers. One option that may be within our power is that the SoLR accepts responsibility for outstanding cases and payments (with the ability to make a claim via the levy). However, this may also be addressed via the Energy Ombudsman's own funding arrangements it has with suppliers under its jurisdiction.

Points for discussion:

- **Is it appropriate for the SoLR process to address this or are there better means to resolve this?**