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Dear Lesley

Supplier Licensing Review: Ongoing Requirements and Exit Arrangements

We're Green Network Energy, part of a vibrant and growing Italian energy company that supplies over 300,000 domestic customers and 4,000 non-domestic meter points in Great Britain.

Thank you for the opportunity to respond to the above consultation. Our summary is below with our detailed response in Annex 1.

Summary of response

We support the need to reduce the impact of supplier failures. We consider the best way to achieve this is by Ofgem aiming for the following outcomes and the combination mechanisms that we've suggested:

Outcome	Mechanisms
A) Reduce the number of exits by promoting sustainable companies	• New entry requirements • Milestone assessments • Principle on protecting credit balances (short term solution) • Credit balance protection (long term) • Closer monitoring of low cost tariffs and those which require material upfront payment • Increased payment frequency of government schemes
B) Reduce the impact of failures through better management of suppliers exits	• Better monitoring of low-cost tariffs, missed financial commitments and poor customer service • Independent audit powers to enable Ofgem to quickly intervene • Powers to restrict growth • Continued use of orders and quicker revocation of licences

We strongly oppose the proposal for suppliers to protect 50% of customer credit balances and a proportion of government scheme costs. While we support the notion to reduce the cost of supplier failure, it is essential that this isn't achieved by placing additional ongoing costs on sustainable suppliers and higher overall costs on consumers. The mechanisms proposed for protection are impractical, based upon an unrealistic impact assessment and will restrict the ability of suppliers to operate resulting in more supplier failure. A much more practical and low-cost solution would be to simply increase the frequency of payments for government schemes. This would promote better management of funds and restricts the ability for suppliers to use accrued funds when cash is low. It would also act as an early indicator of possible supplier failure as Ofgem would identify sooner if a company was in stress as it would be a monthly/quarterly payment missed rather than an annual payment.

We oppose the proposal to create two new principles as we believe these are duplicating other provisions and will not enhance Ofgem's ability to act.

We are supportive of the premise of the other proposals (milestone checks, ongoing 'fit and proper' requirement, independent audits, living wills and improved administrator processes), but all of these need more development by Ofgem to determine whether they are practical.

If you have any questions or wish to discuss any of our response in more detail, please contact Samuel Arnold on 07468 494 721 or S.Arnold@GreenNetwork.co.uk.

Yours sincerely

Pietro Di Maria

Pietro Di Maria

Chief Operating Officer

Annex 1

Overarching question

1. **Do you think the proposed package of reforms will help to reduce the likelihood of disorderly market exits, and the disruption caused for consumers and the wider market when suppliers fail? Are there other actions you consider we should take to help achieve these aims?**

We consider that some of the proposed reforms will help reduce the likelihood of disorderly market exits. We strongly believe that the focus of the review should be on reducing supplier failure in the first instance and reducing the impact of failure. Therefore, in designing these packages it may be useful for Ofgem to consider its proposals by focusing on two key outcomes:

A) Reduce the number of exits by promoting sustainable companies; and
B) Reduce the impact of failures through better management of suppliers exits

We have outlined these packages below using a combination of mechanisms that Ofgem has put in place or suggested, along with other areas that we believe will achieve these objectives.

A) Reduce the number of failures by promoting sustainable companies:

- **Entry requirements** - the barrier to entry has been raised, which should promote more sustainable businesses entering the market in the first instance. Ofgem should assess what effect this has had so far in terms of the numbers of licences it has granted and the behaviour of the companies that are entering the market.
- **Milestone assessments** - Ofgem's proposal to assess companies once customer thresholds have been reached promotes companies to be ready for when they meet key milestones and to engage with Ofgem at trigger points such as system changes and trade sales.
- **Principle on credit balances and schemes** – we believe a principle rather than prescriptive requirement to protect a specified amount is the best way to reduce costs of failure in the short term. This would enable suppliers to determine their own method to meet payments and they would need to demonstrate that they are managing credit and finances in an appropriate way. This would not represent a significant disruption or ongoing cost compared to the 'menu of options' to protect 50% of credit balances currently proposed. It would also not constrain competition when compared with the current proposal. A more fundamental reform, such as the requirement to protect 50% of credit balance needs a much longer consideration and implementation period as discussion below.
- **Credit balance protections –** We agree that the mutualisation mechanism needs to be reviewed to reduce the cost of failure being unfairly borne by sustainable suppliers. However, we believe that Ofgem needs to do this in a separate long-term project. The current proposals have vast and differing consequences for existing suppliers as well as significantly raising the barrier to entry further. It also needs to be considered in conjunction with the Future of Retail Energy Markets review that may see the removal of the supplier hub principle. It is therefore vital that Ofgem considers these fundamental reforms in more detail and allow a long implementation period (several years) to enable suppliers to implement these changes with minimal disruption. During this review, Ofgem should consider all different possible mechanisms and look at how this is achieved in other industries and countries e.g. ATOL scheme, FSCS, bonds for their failure or even through customer choice.

- **Closer monitoring of low-cost tariffs -** sustainable businesses are ‘paying twice’ for poor business models as they lose customers who are attracted to below cost propositions and then pay the costs for mutualisation when these companies fail. Ofgem should monitor the market and require suppliers to provide details of how their tariff strategy is sustainable. Ofgem also needs to closely monitor propositions where high credit balances are required or encouraged, such as where inflated direct debits are levied, or credit balance interest is paid.
- **Increase the payment frequency of RO** – this promotes better management of funds as this would prevent suppliers from using cash accrued for these schemes for other purposes.

B) Reduce the impact of failures through better management of suppliers exits

- **Better monitoring** - Ofgem must intervene more quickly when a company is struggling. Most SOLR events were expected and could be easily identified as at high-risk of failure using the following metrics:
  - Low cost or high payment in advance tariffs
  - Missed financial commitments (this would be enhanced by increased payment frequency of government schemes)
  - Poor customer service
  - Major staff change – increases in recruitment, redundancy and board level changes
- **Independent audit powers** - Ofgem already has access to data related to the factors listed above that are common to suppliers at risk of failure. Where Ofgem identifies a company at risk, it should compel the company to undertake an audit and act on those recommendations. This allows Ofgem to act quickly without the need for a long investigation where an unsustainable business is growing, reducing the impact of any subsequent failure.
- **Powers to restrict a company from acquiring customers** - to enhance the monitoring and audit power, Ofgem needs powers to prevent companies acquiring more customers or to only allow the company to price at the Price Cap while the audit is ongoing. This would prevent the supplier growing unsustainably when it may not have operations or finances in place to support the growth. This would then reduce the impact of failure or would represent a quick way to assess areas for the company to improve.
- **Continued use of Orders and quicker revocation of licences** - using Orders, Ofgem can compel companies to act on the recommendations in the audit or face licence revocation. This would either result in the company improving or failing sooner with lower cost to industry.

We believe that these objectives and proposals will promote more responsible risk management while also ensuring competition continues by keeping the barrier to entry at a rational level and not placing undue new burdens on independent suppliers. This will improve the reputation of the industry and lead to greater confidence in the energy market as fewer suppliers will fail and those that do fail, it will be low numbers of customer with minimal impact on the wider industry.

Questions for the impact assessment

2. Do you agree with the outputs of our impact assessment?

Cost mutualisation protections

We strongly dispute the benefits case for cost mutualisation protections as the figures used to attain net benefit are unreasonable. The notion of 40 supplier failures over the next 10 years is excessive. Since the energy market was liberalised ca.20 suppliers have failed and GB Energy in 2016 was the first to fail in eight years. We believe that we are currently at peak supplier failure. While it is likely that there will continue to be failures over the next couple of years, the ongoing monitoring requirements and the increased barrier to entry should result in more sustainable business entering the market reducing the number of failures. Indeed, Ofgem's own analysis suggests this is an overestimate. Paragraph 2.43 states that Ofgem's expects there to be a turnover of suppliers of 10% over the next 3.5 years, so it unclear how 40 suppliers failing over the next 10 years can be a fair assessment. It's therefore important that a policy isn't set today that will only benefit in the short term and then continue to add an unnecessary ongoing cost to suppliers in the long term.

We also perceive that the rate of 0.5% for the cost of credit insurance is unrealistic. It is unlikely that all suppliers would get this rate and it is more likely that suppliers won't be able to insurance at all. We have engaged with several insurance providers to gauge their view of the feasibility of this requirement for the supply market sector. They independently and unanimously agreed that it was extremely unlikely that a credit protection product would be made available due to ongoing sector wide risks. Vertically integrated companies are more likely to obtain protection secured against physical assets (for example generation or network assets), but supplier only businesses will find it difficult to find a product in the next 12 to 24 months. Moreover, if suppliers are able to get insurance, as soon as other suppliers with insurance fail, this rate would significantly increase, or the product would be withdrawn. Having just one rate from one provider for this impact assessment is therefore not robust. Ofgem need to speak to more providers with examples of companies of different size, age and business models to find out how many would provide insurance and at what rates. We also need transparency on what factors were used to calculate the rate of 0.5%.

We also have great concern with the value of potential benefit the proposal would bring. The benefit of £1.36 per customer over a 10-year period is far too low to be a credible solution. For this low level of benefit that is reliant on 40 suppliers failing, it makes more sense to continue with the current mutualisation arrangement. This is especially true when taken in view of the high hard-to-monetise costs of increased supplier failure due to suppliers being unable to attain credit protections and decreased competition as the barrier to entry would be too high.

In the absence of being able to attain a Letter of Credit or insurance, a company would have to use an escrow. Ofgem has not full assessed the impact of restricting the use of these credit balances or the cost of using an escrow (set up and ongoing costs). Potential impacts would include supplier failure as it would represent a huge restriction of working capital and it is unlikely that suppliers would have the cash available to put into an escrow if this was to be implemented. It could also restrict innovation as suppliers would only be able to afford to deliver the bare minimum and it may also result in a lowering customer service as delivering a good service would simply be unaffordable.

There is also a need for Ofgem to fully assess the impact on customers of returning the credit balances where protections are in place before deciding on the best policy option. While Ofgem has flagged the potential risk of protections, it needs to be explored further. It would be an extremely poor outcome for customers if they had to contact the credit insurance company to claim rather than the SOLR returning the credit balance.

These mechanisms also need to be considered in the wider context of other ongoing industry changes for credit arrangements. For example, modification CMP311 is reassessing supplier credit arrangements under the CUSC and may require suppliers to attain a line of credit – this would make attain protections for credit balances more difficult. Numerous uncoordinated changes to supplier credit will significantly impact cash flow and will make suppliers more likely to fail.

We find it strange that Ofgem hasn't considered options around government schemes and changing the payment frequency. This represents an option that would not be a significant or ongoing cost and would significantly reduce the impact of mutualisation. It would promote better management of funds and restricts the ability for suppliers to use accrued funds when cash is low. It would also act as an early indicator of possible supplier failure as Ofgem would identify sooner if a company was in stress as it would be a monthly/quarterly payment missed rather than an annual payment.

Overall, we consider the option to protect 50% of credit balances fails to meet the SLR principles as it significantly reduces competition and restricts innovation.

Milestones/trigger points

We agree with the analysis in general. However, we need details of what will be included in the assessments and a further impact assessment once these details are finalised.

Ofgem also needs to assess impact of assessing at other trigger points such as billing system migrations, restructuring and customer losses.

Principles for operational capability and to be open and cooperative with the regulator

As Ofgem considers there is no need to assess these, including assessment of hard to monetise benefits, this suggests that there is no benefit to introducing either of these principles so they should be removed from the proposals.

Living will

Whilst it is likely that the first copy of the living will would be the highest cost, the same specialists would be required to update it and a failing supplier would not provide resource to undertake this activity.

It would be beneficial for Ofgem to precisely state what data it needs to support SOLR events to enable industry to create a workable solution and provide quantitative figures for this impact assessment.

3. **What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?**

We are currently investigating the potential cost of attaining insurance for our credit balances, but general sectoral discussions with providers indicate that there is a lack of risk appetite for the magnitude of cover the sector requires.

For some of the other proposals such as the living will and milestone assessment, we need greater clarification before we can provide data.

4. Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? If not, please provide evidence to support further refinement.

We strongly disagree with the assumptions used for credit balance protections. We do not believe the benefits case of £1.36 per customer over 10 years with 40 suppliers failing is credible. Paragraph 2.43 states that Ofgem expects there to be a turnover of suppliers of 10% over the next 3.5 years, so it is unclear how 40 suppliers failing over the next 10 years can be a fair assessment. Moreover, if there were 40 supplier failures as suggested, it will be extremely difficult for suppliers to attain any credit insurance, and if they were able to, the rate of 0.5% is unrealistic as it is not commensurate to the risk. Ofgem needs to get a range of credit insurance costs for a range of suppliers and explore situations where suppliers fail e.g. if 10 suppliers failed, what impact would that have on the products that insurers would offer.

Promoting better risk management

5. Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible, any evidence, to support your position.

Cost mutualisation protections

No – we strongly disagree with the proposed cost mutualisation protections. We agree with the principle of reducing mutualisation costs, but the current proposal to protect 50% of credit balances only delivers benefit if suppliers fail which is nonsensical i.e. for this mechanism to be cost effective there needs to be supplier failure. It creates a perverse situation where this policy may not deliver benefit if not enough suppliers fail. This puts it in tension with the other proposals that seek to reduce the need mutualisation in the first place by reducing supplier failure. The focus should be on reducing supplier failure through monitoring and reduction of mutualised costs through methods that have little cost to implement such as changing the timings of government schemes.

We believe that we're at "peak" supplier failure. Since the energy market was liberalised less than 20 suppliers have failed and GB Energy in 2016 was the first to fail in eight years. While it is likely that there will continue to be failures over the next couple of years, the ongoing monitoring requirements and the increased barrier to entry should result in more sustainable business entering the market reducing the number of failures. It's therefore important that a policy isn't set today that will only benefit in the short term and then continue to add an unnecessary ongoing cost to suppliers in the long term.

The new monitoring could be reinforced with low cost mechanisms for reducing the mutualisation amount through greater scrutiny of credit balances to ensure reassessments and refunds are occurring, and increasing the frequency of payments for government schemes. It's therefore better to continue mutualising costs rather than have a policy for protecting credit balances that may only be beneficial in the short term.

It remains extremely unclear what would Ofgem do if a supplier was unable to protect its credit balances. For example, if a company was unable to secure insurance and was unable to put money into an escrow, would Ofgem revoke its licence? In this scenario, a company would end up failing and the credit balances would still need to be mutualised.

Overall, we strongly oppose the mechanism proposed in this consultation to restrict use of credit balances. These proposals would make the barrier to entry far too high and established sustainable suppliers such as ourselves would struggle to make a fair return on capital. Only asset backed suppliers will be able to continue pushing the market back 10 years. Focus should be on reducing supplier failure in the first instance and changing the timings of government schemes.

Any mechanism that does come into force needs to have at least a two-year implementation period.

We disagree with the statement in paragraph that there was “almost universal support at our June 2019 workshop for suppliers to have provisions in place to prevent the need for customer credit balances to be mutualised in the event of their failure” – there agreement of the need to reduce mutualisation costs but the exact mechanism and whether there is a better situation than the current mutualisation regime is undecided.

Operational capability

We oppose the creation of this new principle. We do not see how this strengthens existing licence conditions or would enable Ofgem to act more quickly. The Standards of Conduct already require us to ensure that our “customer service arrangements and processes are complete, thorough, fit for purpose and transparent”. The principle proposed seems to be a duplication of this existing condition. It would be useful for Ofgem to specify how this would improve its ability to intervene beyond the existing conditions.

This was not considered in the impact assessment so there is no clear benefit of introducing this condition.

6. **Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider helping us to identify where suppliers’ may be in financial difficulty?**

We agree with the proposal in principle but believe that there are some key risks:

- The assessments could lead to Ofgem “deciding what’s good” – suppliers should be free to determine how they run their business and meet their obligations.
- Does Ofgem have the expertise to review suppliers’ operations, commercial strategy and finances?
- Could Ofgem restrict growth e.g. if several suppliers are approaching thresholds, Ofgem may have to prioritise and suppliers wouldn’t be able to continue growing

We believe that there are other trigger points for assessment . We consider that assessments should be retrospective – suppliers that have already passed a threshold should be assessed. There also shouldn’t be upper limits and there may be a need for suppliers that are losing customers to have checks to ensure that they are making adequate arrangements to reduce their operations to meet the number of customers they are serving.

We consider that it's important that these assessments are light touch and complimented by engagement. It would be onerous to go through a similar assessment as at supplier entry. There are some Key Performance Indicators focused on outcomes that Ofgem can use as a proxy to determine the health of the operation (e.g. first contact resolution) and discussions with management should provide confidence on the company's plans for growth. If this assessment is too detailed, it risks restricting growth, especially as several companies may be passing milestones at the same. Further, a supplier could pass through several milestones in a year.

We consider that the implementation period of 56 days is too short – suppliers may be close to the threshold as the licence condition comes in so may not have time to prepare.

Dynamic assessments

In addition to the milestone assessments, we believe that Ofgem needs to enhance the use of dynamic assessments. This could be for situations where there are signs of financial stress such as missed obligations, low cost tariffs or high payment upfront tariffs. It could also be used where there is poor customer service, major system changes, mergers and customer book sales. Combined with use of independent audits, Ofgem will be more readily able to intervene in situations where a supplier is likely to fail, and this will reduce the impact on industry.

More responsible governance and increased accountability:

7. **Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?**

Ongoing fit and proper requirement

We agree that it makes sense to continue monitoring this. There is some monitoring that Ofgem can easily do by following Licenced Companies on Companies House. Any changes in directors will appear here.

There is a need to be clear what staff are included as this is open to interpretation. It is also not clear if criteria are to be considered in the round e.g. person may have history in a company that failed or faced compliance action, but this needs to balance with the experience that this has given them or the cause of the issues.

Ofgem also needs to set out what it would do if a company had a staff member who didn't meet these requirements.

Open & Cooperative Principle

The need for this principle is not clear. Ofgem already has several mechanisms that it uses to compel suppliers to act such a Request for Information under SLC 5 and using Orders. There are

Enforcement Guidelines that set out how a supplier's behaviour impacts whether Ofgem takes enforcement action such as opening an investigation and what level of action would be taken e.g. failure to cooperate may result in increased level of penalty.

If suppliers have previously disregarded these other mechanisms, it is unlikely that a new principle would change behaviour.

Increased market oversight:

8. Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?

We agree with the principle of making the SOLR process as easy as possible. However, we are unsure if a living will be the correct mechanism to support this aim. It would be difficult to keep updated as data and information is constantly changing. In the event of a company failing and the chaos that ensues, it is unlikely that they would follow the plan in the living will and would instead follow whatever action would be best to keep the company going. It is also unlikely that the living will would be updated so when the company fails, the information may not be useful so this requirement would simply act as a regulatory burden on sustainable companies.

There may be some quick wins that Ofgem may be able to identify from previous SOLR event by engaging with suppliers to find out what information would be useful if this was more readily available.

9. Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.

We fully support the need for independent audits. These give Ofgem a way to quickly intervene where a supplier is struggling and either help them to recover or to fail earlier reducing the impact on wider industry.

We believe that these audits should be enforced with a power for Ofgem to restrict ongoing growth by preventing the company from selling or to restrict it only offering Price Cap SVT. This will help minimise the impact of any subsequent failure.

Exit arrangements:

10. Do you agree with the near terms steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?

Administrators

We agree with the need to improve protections for customers involved in a SOLR event. However, we are unsure if the proposal for suppliers to include references to licence conditions in their Terms and Conditions will have any impact on the sharp practices by administrators. We have requirements to include back-billing in our terms and this has had no effect on administrators so it is unlikely that they would follow the rules around ability to pay. It would be useful for Ofgem to provide the legal basis for this requirement.

11. **Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?**

We agree with the idea of portfolio splitting in principle. However, this needs to be fully assessed as it currently seems impractical and could result in poorer customer outcomes. For example, if the SOLR process takes longer or if there are pots of customers that are more desirable than others.

It is important that Ofgem take a more active role in trade sales of failing suppliers, by helping to facilitate customer book sales ahead of licence revocation. Ideally, the SoLR process would be overhauled, lengthened and standardised to allow for a more orderly migration and reduction in the costs and debts.

While there have been some trade sales that have resulted in poor customer outcomes, it's important that any future proposals do not hinder a natural part of a competitive market.

Appendix 1

12. **Do you think our draft supply licence conditions reflect policy intent?**

Principle to be open and cooperative

We believe that "engaging" should be used instead of "cooperative". Cooperative suggests that suppliers shouldn't challenge regulatory or enforcement decisions which wouldn't be a good outcome for the industry.

Independent audits

The drafting of the licence conditions for the independent audit does not reflect the intention of the policy wording. The current drafting leaves Ofgem able to issue audits freely rather than restricting to the specific scenarios outlined.

Other improvements to exit arrangements

Condition 8.3 has not been consulted on so we cannot tell if this reflects the policy intent. In general, the wording of "any commitment" is too loose and could result in suppliers not bidding to be SOLR.