Consultation response: Supplier Licensing Review: Ongoing requirements and exit arrangements

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?

Whilst we see the proposed reforms as positive, they are unlikely to have a significant impact on costs created to industry participants and/or consumers through mutualisation as a result of "moral hazard" without more stringent requirements particularly aimed a scheme costs.

Do you agree with the outputs of our impact assessment?

Broadly agree. However the complex relationship between cash liquidity and trading arrangements was not considered. The demand on cash for growth and securing any scheme costs create a perverse incentive for good hedging practices.

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

There is a clear correlation between rapid growth and failure. The analysis could be extended to calculate how the scheme liabilities accumulated. Overlaying the proposed thresholds on a timeline of failed suppliers may offer further insight to the potential effectiveness of them.

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.

Broadly. There are many significant unknowns, enough to accept that the cost and benefit analysis cannot be precise. Perhaps more qualitative analysis of scenarios could add value.

We believe there is weakness in the assumption that mutualisation costs will be passed to consumers in a relatively orderly fashion. Suppliers will inevitably seek to pass costs onto consumers but we believe Ofgem should give consideration for the timing of recovery of these costs to minimise the end consumer impact, a raising of the mutualisation ceiling or a weighting towards larger suppliers to prevent a domino effect.

There is a further extreme scenario that is not obviously considered in the impact analysis but should be recognised and determined as in or out of scope. The Renewable Obligation of every supplier exceeds their operating profit and as most have no assets, there exists a potential economic benefit for the parent companies to "cast off" a supply subsidiary leaving all their respective scheme liabilities. Taken to the extreme, mutualisation will fail or at the very least lead to unacceptable end consumer cost increases.

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

We believe the cost mutualisation protections should go further. Security provision should become more stringent following a failure to meet an obligation, for example a quarterly payment obligation following breaches and growth should be restricted to prevent the liability growing. The correlation between rapid growth and failure is obvious. In addition most failed suppliers offered "discounted" tariffs (vs annualised cost for typical customer) for a significant period of time during their existence, and whilst this is a commercial decision for the business it does so at the potential cost to consumer and/or industry. We would propose that a combination of "discounted" tariff monitoring and independents audits (assessing hedging practices and cash forecasting for industry payments amongst broader customer performance measures) at more regular customer thresholds be used to determine the risk a supplier presents and any requirement to provide financial collateral towards its scheme costs. Customer acquisitions should be controlled or disposals enforced unless adequate provision is made. The working capital benefit provided by the Renewables Obligation alone can support a business operating at greater than 15% loss provided growth rates are maintained. Once either the growth rate or cash collection (one of the observed customer service failings) cannot be maintained the business will run short of cash. If the business is unhedged it will fail in a rising commodity market. If good hedging practice exists the business will likely be left with no alternative but to stop hedging to free up cash creating a sitting duck for the rising wholesale market scenario.

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 to help us to identify where suppliers' may be in financial difficulty?*

See above. We would propose more regular thresholds for example 20,000 increments to 100,000, incrementally higher beyond, in order that the supplier cannot build a significant unsecured position to scheme costs. There is a real danger of a domino effect when a number a small suppliers fail in close succession creating mutualisation costs for other suppliers.

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?

Generally agree. It is already common practice in many regulated industries.

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?

Agree with the concept, although practically difficult to standardise the quality across many suppliers with a spread of resources and experience. The minimum requirement should be to maintain information to enable a commercial solution prior to a SOLR event.

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

Agree if methodology is standardised or controlled in some manner.

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?

We agree with observations and agree that, whilst practically it may be difficult, administrators of a licensed business should operate to the same principles.

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 believe this is absolutely necessary to produce a more competitive and commercially satisfactory solution prior to, or at SOLR.

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

We agree the draft conditions reflect the consultation intent.