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20 August 2020

Sent by email to: Licensing@ofgem.gov.uk

Dear Licensing Frameworks team

Centrica response to 'Statutory Consultation – Supplier Licensing Review: Ongoing requirements and exit arrangements'

We welcome the progression of the Supplier Licensing Review (SLR) as it is a programme that has the potential to address a significant source of consumer harm - namely the excessive risk taking of some suppliers that results in their failure and the consequent mutualisation of costs, costs which are ultimately picked up by consumers.

The mutualised costs of recent supplier failures to date is estimated at £255m[1] and it is imperative that Ofgem puts strong measures in place to prevent this number from growing through future supplier failures.

We continue to consider that a requirement for suppliers to protect 100% of potentially mutualised costs should they fail, supported by targeted milestone assessments and audits, will be the most effective package of reforms in meeting the objectives of the SLR.

We have two key recommendations that address our significant concerns with Ofgem's statutory consultation:

1. Ofgem should expedite its work on prescriptive regulation to prevent mutualisation of costs, by requiring all suppliers to protect 100% of potentially mutualised costs should they fail. Ofgem's proposed principles-based requirement will be ineffective absent of any prescriptive regulation to support it.
2. Ofgem should remove proposed licence conditions that will be ineffective or are unnecessary, and alter the licence conditions of the proposals that are not drafted to meet their policy intent. Some of the licence drafting by Ofgem is too broad and not proportionate to the aims of the SLR. The aims of the SLR should be limited to supplier licensing and the prevention of mutualisation of costs.

[1] Citizens Advice: Picking up the pieces analysis: https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/picking-up-the-pieces-updated-analysis/

Preventing mutualisation of costs

We do not consider that a principles-based requirement will be effective, without accompanying prescriptive regulation. A prescriptive requirement to prevent 100% of mutualised costs when a supplier fails - we refer to this as the "100% requirement" – will be significantly more effective at preventing mutualisation of costs.

Mutualisation of costs is the largest source of consumer harm that has resulted from recent supplier failures and it is imperative that this risk is addressed.

We are concerned that Ofgem has stepped back from its original proposal[2] of requiring suppliers to protect 50% of mutualised costs should they fail. 50% would not be as effective as 100% but would be more effective than the proposed principles-based requirement.

Ofgem has previously stated that principles-based regulation (PBR) requires "a significant culture change where suppliers place consumers at the heart of their business, watch for any areas where they may not be getting things right for consumers and, if this happens, put them right quickly[3]".

It is clear from recent events that those suppliers that have failed do not meet these criteria. Consumers were not at the heart of their businesses and therefore any PBR would have been unlikely to prevent the mutualisation of their costs once they failed.

Furthermore, Ofgem has stated that prescriptive regulation should apply to 'prohibition of a specific detrimental practice[4]'. Lacking the means to prevent mutualisation of costs upon supplier failures demonstrates a specific and significant customer detriment. Therefore, prescriptive regulation is better suited than PBR in addressing this specific cause of detriment.

Placing a new PBR on suppliers is likely to be ineffective on suppliers that are willing to gamble with customers money and mutualise their costs when they fail. Such suppliers will aim to evade this requirement, unless there are strong prescriptive requirements in place that prevent them doing so.

Ofgem's update letter on the SLR refers to preventing cost mutualisation and states "we need to strike a careful balance between raising supplier standards without setting barriers to entry, innovation and expansion too high[5]". Entry, innovation and expansion should not come at the cost of a significant consumer detriment. The entry of smaller suppliers that subsequently failed may have offered some short-term benefits to competition. However, this was significantly outweighed by the customer detriment of the mutualised costs that was picked up by all consumers and the detriment to the customers who had to go through a SoLR process.

Any responsible supplier that operates a sustainable business model should be supportive of the 100% requirement, as it is an appropriate and reflective cost of being an energy supplier. A responsible supplier will be able to innovate and expand under a 100% requirement.

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[2] Ofgem's Supplier Licensing Review: Ongoing requirements and exit arrangements, Oct 2019: https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-ongoing-requirements-and-exit-arrangements

[3] Ofgem's Future of Retail Market Regulation consultation, December 2015: https://www.ofgem.gov.uk/sites/default/files/docs/the_future_of_retail_market_regulation.pdf

[4] Ibid, paragraph 2.6

[5] Update on timing and next steps on Supplier Licence Review, February 2020: https://www.ofgem.gov.uk/system/files/docs/2020/02/170120_-_cost_mutualisation_-_update_letter_on_further_policy_consultation_v.2_0.pdf

The 100% requirement backed up by the milestone assessments and Ofgem's ability to require financially unstable suppliers to conduct independent audits, is the only suite of measures that will be effective at preventing supplier failures that result in the mutualisation of costs. The package we are proposing will negate the need for all other proposals within Ofgem's statutory consultation. It will also deliver Ofgem's four themes for the SLR[6].

The NERA report we submitted with our previous SLR consultation response concludes that Ofgem should prevent suppliers from placing credit balances and the unmet costs of government programmes at risk, and that the most effective way of doing so is through our 100% requirement. We are resubmitting the NERA analysis as part of this response.

We are heartened to read that Ofgem will continue its 'thinking in relation to additional prescriptive requirements to minimise the need for cost mutualisation in the event of a supplier's failure'[7]. This work package should be expedited to bring in additional prescriptive requirements in line with our 100% requirement as soon as possible. However, we request a commitment to a date for when this thinking will take place - it's an important policy and we ask that it be taken forward within the next few months.

A combination of the financial impacts upon energy suppliers of the COVID-19 pandemic and the late payment deadline of the Renewables Obligation (RO) in October means it is likely that we will see further supplier failures before the end of the year. The economic impact of the pandemic is likely to highlight those suppliers that lack robust business plans and therefore present a greater risk of supplier failure and mutualisation of costs. Without our 100% requirement in place, these failures will likely lead to further mutualised costs – strengthening the case for expediting the introduction of the 100% requirement to prevent mutualisation of costs from future supplier failures.

It is critical that Ofgem uses the limited tools it is introducing to ensure enforcement action is taken on suppliers who follow reckless business models long before they demonstrate signs of potential failure. Otherwise Ofgem's proposals will only address the symptom, and not the cause, of the mutualisation of costs.

Licence drafting

We have significant concerns around Ofgem's wording of its proposed licence conditions as they are not specific to the aims of the SLR. They are not proportionate and place an undue regulatory burden on financially responsible suppliers.

In keeping with the principles of better regulation, it is imperative that Ofgem redraft the following licence condition to ensure it is proportionate:

- Condition 5B: Independent audits – should be redrafted to ensure it is only used by Ofgem where there are reasonable grounds to suspect that a supplier may fail, resulting in mutualisation of costs or significant consumer harm. It is not good practice and unwise to propose licence conditions that are not targeted at the consumer harm that the policy is aiming to address.
- Condition 19D: Trade sales – should be redrafted to ensure Ofgem's intervention in a trade sale is limited to when there is an overall consumer detriment, taking into consideration whether a trade sale would result in lower mutualisation of costs.

[6] Ofgem statutory consultation – page 9.
[7] Ofgem's statutory consultation: https://www.ofgem.gov.uk/system/files/docs/2020/06/240620_-_slr_statutory_consultation_final.pdf

The following licence conditions overlap with existing requirements or other requirements set out in the statutory consultation. Therefore, we strongly oppose these licence conditions as they are unnecessary and not proportionate to the policy intent:

- Condition 4A: Operational capability – Ofgem already has these powers through the standards of conduct.
- Condition 5A.1: Open and co-operative – it will be ineffective and duplicates Ofgem's existing information gathering powers. Furthermore, the drafting is not specific to licensing and preventing mutualisation of costs.
- Condition 19C.1: Customer supply continuity plans – it will place additional regulatory burden on responsible suppliers and should instead be used by Ofgem as part of its proposed milestone assessment; targeted at the suppliers who are at risk of failure.
- Condition 27.8A: Customer interactions with administrators – placing a requirement on administrators should be done directly through legislation applicable to administrators and not through the supplier licence as a proxy. The licence condition is also drafted incorrectly, so that it places unintended requirements upon suppliers.

Licence conditions place an obligation on suppliers and provide Ofgem with the means to enforce them. Therefore, they must be designed to address a specific policy consideration or objective and give effect to that policy. The non-specific and disproportionate wording that has been proposed by Ofgem is in contradiction to Ofgem's duties, which state that "regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed[8]".

We have a wider concern that Ofgem is proposing a package of measures to "reduce the likelihood of disorderly market exits and ease disruption caused to consumers", assuming all the proposals will work in conjunction. However, there has not been enough consideration as to whether the proposals overlap with existing supplier obligations, or with each other thereby negating the benefits case of each individual proposal.

Some of Ofgem's package of reforms are intended to counter-act the consumer harm caused by 'bad actor' suppliers who have exited the market. Ofgem has acknowledged this is only the actions of a limited pool of suppliers and states that "our proposals have been designed in a targeted way to enable us to take action against poor supplier practice, without placing significant extra burden on suppliers that are already operating in a responsible manner".

Therefore, it is disproportionate to put broad and potentially expensive requirements on all suppliers. Instead Ofgem's proposed measures should be specifically targeted, potentially as part of a milestone assessment, at those suppliers that are likely to fail and mutualise costs that will be picked up by all suppliers and ultimately consumers.

Many of Ofgem's proposals present an additional compliance burden that:

- Places an unnecessary burden on suppliers at a time when regulatory compliance is a significant cost and at a time when suppliers are constrained by the price cap, and
- Adds unnecessary conditions to a lengthy supplier licence whose complexity is already seen as a barrier to entry for new suppliers.

[8] Gas Act 1986 and Electricity Act 1989: https://www.legislation.gov.uk/ukpga/1989/29/section/3A

Ofgem has previously acknowledged that the "supply licences are now long and complex[9]" having grown from "64 pages in 2007" to 486 pages[10] today. Adding unnecessary licence conditions is worsening an Ofgem identified issue that exists for suppliers today, with no regulatory grounds for doing so.

Our proposal to remove the ineffective and unnecessary elements of Ofgem's proposals will maintain the effectiveness of the package of remedies while avoiding the need for unnecessary regulation.

We have set out our views on each specific proposal in Appendix 1 to this response.

In Appendix 2 of this response we have proposed alternate wording to the licence conditions that will ensure Ofgem only applies these licence conditions in matters relating to preventing the failure of suppliers and the consequent mutualisation of costs.

We have also proposed alternate wording on licence conditions that we do not support as the drafting is disproportionate. This does not mean we support these licence conditions. Our proposed wording is designed to ensure that, should these licence conditions be implemented, that they match the policy intent.

If you have any questions, please contact me on 07789 575 665 or Tabish.khan@centrica.com.

Yours sincerely

Tabish Khan
Centrica Regulatory Affairs, UK & Ireland

[9] Ofgem's Future of Retail Market Regulation consultation, December 2015
[10] Current electricity supply licence.

Appendix 1 – assessment of Ofgem's proposals

In this appendix we set out our views on each of Ofgem's proposals in the statutory consultation, grouped within the three categories in said consultation.

Promoting more responsible risk management

A principles-based requirement for suppliers to take action to minimise costs that could be mutualised in future.

We do not consider that a principles-based requirement will be effective, without accompanying prescriptive regulation. A prescriptive requirement to prevent 100% of mutualised costs when a supplier fails - we refer to this as the "100% requirement" – will be significantly more effective at preventing mutualisation of costs.

Centrica has made a strong case in our previous consultation response[11] for the 100% requirement. The 100% requirement would address both the moral hazard and adverse selection that has resulted in supplier failures and the consequent mutualisation of costs. It would resolve both the consumer harm and the adverse impacts of competition of the current regulatory framework surrounding supplier licensing.

The most important goal of Ofgem's supplier licensing review should be to address the distortions that allow suppliers to fail and mutualise costs across the industry. If Ofgem addresses these distortions it will protect customers from the avoidable cost mutualisation that customers are currently exposed to when a supplier fails. Our 100% requirement would meet that goal more effectively than the full package of proposals within Ofgem's statutory consultation.

Ofgem's previous SLR consultation[12] proposed an alternative that protected 50% of mutualised costs and we made a case for why this should be increased to 100%. We are concerned that the policy has changed significantly, from 50% to the FRP, at such a late stage in the SLR. This late change in policy means there is no ability to compare the costs and benefits of the FRP versus the 50% and 100% requirements to determine if it will be effective.

Ofgem's themes for the SLR state that "suppliers should … bear an appropriate share of risk" and the "licensing regime should facilitate effective competition". At present irresponsible suppliers are not bearing an appropriate share of the risk they present to the market and this is having an adverse impact on competition, as it is responsible suppliers and their customers who are bearing the risk. This results in a 'free rider' effect where irresponsible suppliers profit from exposing all consumers to a risk they should bear. Our 100% condition would address these concerns more effectively than the measures proposed in Ofgem's statutory consultation.

It is unclear how Ofgem's proposed 'Financial responsibility principle' (FRP) could be effective without being backed up by prescriptive elements and clear enforcement guidelines on how Ofgem would identify and take enforcement action against suppliers engaging in excessive risk taking, before they display signs of supplier failure.

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[11] Centrica response to October 2019 Ofgem consultation: https://www.ofgem.gov.uk/system/files/docs/2020/01/centrica_ongoing_requirements_and_exit_arrangements_response.pdf

[12] Supplier Licensing Review: Ongoing requirements and exit arrangements, Oct 2019: https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-ongoing-requirements-and-exit-arrangements

Ofgem's consultation sets out accurate expectations of how a financially responsible supplier should behave. Financially responsible suppliers are most likely to already be meeting these expectations. However, it is the financially irresponsible suppliers that have failed in the past, resulting in mutualised costs.

A supplier that is not complying with the FRP is unlikely to be identified until it is already displaying overt signs of failure, e.g. non-payment of industry charges and / or declining customer service. At that point enforcement action is unlikely to prevent mutualisation of costs and may only expedite the supplier's failure.

Once a supplier is already failing, there is limited action that Ofgem may take to remedy the mutualisation of costs. Actions such as preventing the supplier taking on more customers or requiring the supplier to pay outstanding debts, is likely to be ineffective or unenforceable respectively – at least not without expediting the supplier's exit and mutualisation of costs.

Ofgem acknowledges that the principles-based requirement 'is a significant change'. For any significant change of policy Ofgem should conduct an impact assessment alongside a policy consultation, followed by a statutory consultation. Circumventing this policy process risks introducing licence requirements that have not been properly assessed as to whether they will deliver consumer benefit and rushed licence drafting that may not meet the policy intent.

While there may be some consumer benefit to an FRP, without an impact assessment it is impossible to see how it compares to a prescriptive requirement – which is likely to deliver a far greater consumer benefit.

As a minimum we would expect Ofgem to require all suppliers to demonstrate adherence to the licence condition once it is active, through an Ofgem issued information request. Where suppliers are unable to demonstrate compliance with the FRP, Ofgem should place the supplier under greater scrutiny and use dynamic milestone assessments and independent audits where relevant. Should a supplier be non-compliant, Ofgem should place sanctions on the supplier immediately including restricting its ability to take on new customers.

Ofgem should publish clear enforcement guidelines that set out potential scenarios and the actions Ofgem would take against a supplier, illustrating how the proposed licence conditions may have prevented previous supplier failures.

The FRP should not act as a substitute for the prescriptive elements Ofgem is still pursuing. The FRP sets out what is expected of suppliers, the prescriptive elements to follow will be the effective means of ensuring suppliers comply with the requirement to prevent mutualisation of costs should they fail.

Stakeholder responses to Ofgem's previous consultation suggested that a 12-month implementation timescale may be needed for any prescriptive regulation on preventing mutualisation of costs. By not landing on a position around prescription in this consultation there is a risk that it could be 18 months before we have a prescriptive licence condition in place. 18 months presents a significant risk to consumers, given how many suppliers could fail in that time.

***A principles-based requirement to ensure suppliers have sufficient operational capability and adopt overall better risk management practices**.*

We strongly oppose this principles-based requirement as:

- It is unnecessary and will be ineffective at preventing the mutualisation of costs when a supplier fails; and
- It overlaps with the existing requirements placed upon suppliers through the standards of conduct; and
- The licence drafting does not mirror the policy intent as it is not targeted at those suppliers who are at risk of failing and mutualising costs.

In Ofgem's consultation it is noted that some respondents stated that "most suppliers already had sufficient operational capability to meet the needs of their customers[13]". We agree with this and would go further and state that any supplier who cannot demonstrate this should not have been granted a licence initially.

It is also unclear how this proposed licence condition does not overlap with the standards of conduct, specifically c.iii which requires that suppliers "otherwise ensure that customer service arrangements and processes are complete, thorough, fit for purpose and transparent".

It is unclear how a supplier who is lacking operational capability and adequate risk management practices could also be treating customers fairly, as they are required to under the standards of conduct. A risk-taking supplier that is gambling with customers' money and risking the mutualisation of its costs is by its very nature not treating customers fairly, and therefore should be subject to Ofgem enforcement under existing regulation.

Ofgem's consultation states this principle is "filling any gaps that might otherwise exist with prescriptive rules". Yet Ofgem has not provided any evidence of what these gaps are and how these gaps have prevented Ofgem from acting in the past.

This suggests that a new licence condition is not needed, rather stricter enforcement of existing licence conditions would be more effective. The Standards of Conduct enable Ofgem to act against any supplier which does not have adequate capability, processes and systems in place. Ofgem's guide to the standards of conduct is clear in covering the areas that Ofgem's proposed operational capability would seek to address.

The intent of this proposal and the SLR is to prevent supplier failures and the consequent mutualisation of costs. There is nothing in the drafting of the licence condition to suggest this is the intent of the draft licence condition. Therefore, we propose this licence condition is removed.

However, should this licence condition be retained, the drafting should be amended to reflect that the licence condition only applies to the aims of the SLR – namely to prevent supplier failures and the subsequent mutualisation of costs. We have included our proposed alternate licence drafting in appendix 2 of this response. Our proposed alternate drafting should not be interpreted as support for a licence condition that we consider to be unnecessary.

[13] Statutory consultation - Paragraph 2.31.

Milestone and dynamic assessments

We are supportive of the milestones proposed by Ofgem and the dynamic assessments where suppliers demonstrate financial instability. Furthermore, we agree with Ofgem's stance to use independent audits where Ofgem has concerns around a supplier's financial stability – though only if the audits are targeted at those suppliers at risk of failing.

Of the recent supplier failures in the past few years many have been suppliers that grew quickly and, as proved by their subsequent failure, unsustainably. The milestone assessments are a means to stop unsustainable growth, without placing an onerous burden on those suppliers with a sustainable business plan. Other SLR proposals, including the fit and proper persons test and customer supply continuity plans should not be part of the milestone assessment and not separate licence conditions.

We see milestones working effectively alongside a prescriptive requirement for suppliers to prevent mutualisation of costs should they fail. Furthermore, other elements of Ofgem's suite of measures could be included within the milestone assessments – namely the requirement to produce a Customer Supply Continuity Plan and a Fit and Proper persons test.

Improved governance and increased accountability

A requirement for suppliers to ensure that relevant individuals with significant influence in the business are fit and proper to occupy their role

We are concerned this requirement may place an additional regulatory burden on suppliers who operate in a fit and proper manner while being ineffective against suppliers who are engaging in excessive risk taking.

Centrica has robust recruitment processes in place that we consider meet the intent of Ofgem's fit and proper proposed licence condition.

We have FCA/PRA regulated entities within the Centrica Group and therefore already operate initial and ongoing fit and proper checks on our senior management. We consider these already exceed Ofgem's requirements and will alleviate any need to place additional regulatory burden on companies that are both regulated by the FCA/PRA and Ofgem.

Ofgem's proposed 'risk-based approach to assessing compliance' provides some comfort that financially responsible suppliers will not be unnecessarily burdened by this requirement.

We propose that Ofgem target this requirement solely at those suppliers where there are concerns that the supplier may fail and subsequently mutualise costs across the industry. Our proposal would demonstrate a proportionality that would be in line with the policy intent of this consultation – the prevention of supplier failures and subsequent mutualisation of costs.

For financially irresponsible suppliers it is unlikely they would carry out such robust checks on their staff, given that suppliers that fail are often already lacking in many other areas of energy compliance.

The fit and proper requirement will be effective as a test at market entry to prevent unfit and improper persons gaining a licence to run an energy supply company. As an ongoing test it's likely to be most effective when targeted at those suppliers most at risk of failure and Ofgem should apply a similar rigour to these tests as those applied by the FCA.

For suppliers that have existing checks and processes in place these should be deemed sufficiently robust, thereby not placing an additional burden on financially responsible suppliers.

A principles-based requirement for suppliers to be open and cooperative with the regulator.

We oppose this principles-based requirement as:

- It is unlikely to be effective at preventing the mutualisation of costs when a supplier fails; and
- The licence drafting does not mirror the policy intent, as it is not targeted at those suppliers who are at risk of failing and mutualising costs; and
- It duplicates Ofgem's existing powers to utilise information requests[14] that require suppliers to be open, and where a supplier is non-cooperative Ofgem can use enforcement action to ensure a supplier is fulfilling its duties.

Financially irresponsible suppliers are likely to be non-compliant with other supplier licence requirements once they are showing potential signs of failure. Therefore, non-compliance with an open and cooperative licence condition is unlikely to be of concern to financially irresponsible suppliers. At this point any enforcement action by Ofgem is likely to expedite supplier failure and unlikely to reduce mutualisation of costs.

Responsible suppliers already meet the intent of Ofgem's proposed open and cooperative principle. Where suppliers are not open and cooperative, Ofgem has powers through information requests and enforcement action to ensure that suppliers do cooperate.

In the statutory consultation Ofgem states that the proposed condition will "encourage a behavioural shift among poor performing suppliers by ensuring issues did not go unreported for an extended period of time". However, there's no clarity as to a scenario where this outcome could not be achieved through an information request using Ofgem's existing powers. Unless Ofgem can clearly demonstrate where there is a gap in their capabilities, which would be filled by this proposed licence condition, this proposed requirement should not be placed into licence.

A new licence condition is not needed, rather stricter enforcement of existing licence conditions would be more effective – i.e. through targeted reporting and enforcement on non-cooperative suppliers. There are strict reporting requirements on larger suppliers and yet we are not aware of these being mirrored for smaller and medium sized suppliers – who have been the sole cause of mutualisation of costs over the last three years.

In our view Ofgem has not made a case for an open and cooperative principle and therefore it should be removed from the SLR instead of adding unnecessary regulation to a sizable supplier licence.

Ofgem has stated: "However, for the avoidance of doubt, this requirement would not restrict suppliers' ability to express concerns about, or challenge, any policy development, decision, or other activity that Ofgem is undertaking". We fully support this stance of a supplier's right to challenge Ofgem's decisions and policy development as a vital part of effective regulatory decision making.

[14] Standard Supplier licence condition 5 – Provision of Information to Authority

The intent of this proposal and supplier licensing review is to prevent supplier failures and the consequent mutualisation of costs. There is nothing in the drafting of the licence condition to suggest this is the intent of the draft licence condition.

While we do not support this condition, we have offered alternate wording for the licence condition in Appendix 2 so that should the licence be implemented it would be in line with the intent of the proposals in the SLR. Our proposed alternate drafting should not be interpreted as support for a licence condition that we consider to be ineffective and unnecessary.

Increased market oversight

A requirement to maintain "Customer Supply Continuity Plans".

We recognise the perceived benefits of suppliers having a customer supply continuity plan (CSCP) in place, but in practice it's likely to be impractical given a failing supplier is unlikely to keep an up to date CSCP to hand.

For larger suppliers, we believe that this requirement is unnecessary as a special administration regime (SAR) will be enacted when a large supplier fails. Should a large supplier fail a SAR would be used to run the company as a going concern. A SAR will most likely involve staff, systems and process remaining in place, thereby negating the need for a CSCP that would only duplicate requirements fulfilled by a SAR.

Our personal experience with taking on Breeze Energy's customers makes the case for a CSCP in theory. When we took over Breeze Energy's customers there were no staff present in the Breeze Energy office over Christmas to help with migration of customers. In this case a CSCP may have been useful, but it is highly unlikely that a failing supplier will spend time on keeping their CSCP up to date. In truth it's likely to be a plan that the gaining supplier will likely discard as irrelevant or untrustworthy, as it will be unclear if it is up to date and rigorously put together.

The only practical use for a CSCP we foresee is for Ofgem to request it as part of a milestone or dynamic assessment for suppliers below the SAR threshold. We propose that the licence condition is removed and the CSCP moves into the 'toolbox' for Ofgem to use when conducting a milestone or dynamic assessment.

A requirement to conduct an independent audit of their financial position and/or customer service systems and processes.

We strongly support the independent audit requirement, provided it is targeted solely at those suppliers that are likely to fail and mutualise costs.

A requirement to conduct an independent audit will be a powerful tool to investigate any supplier that Ofgem suspects are engaging in excessive risk taking and are therefore likely to fail and mutualise costs.

The requirements to conduct an independent audit would be a far more effective measure than the open and cooperative principle, such that it negates the need for Ofgem's proposed open and cooperative principle.

We have material concerns that, as currently drafted, the licence condition is not targeted specifically at behaviours that could result in supplier failure and the mutualisation of costs. An independent audit is an expensive undertaking and therefore should only be requested by Ofgem in meeting the policy intent of the SLR, including when a supplier has failed to provide the necessary information in a milestone or dynamic assessment.

Ofgem's policy is designed specifically to "ensure appropriate protections are in place against financial instability and poor customer service" as has been seen in the recent spate of supplier

failures. Therefore, any proposed licence condition should also specifically apply to such circumstances.

Ofgem's proposal states: "We would seek to use this requirement in a proportionate way. We would use it only where we had significant concerns about a supplier's financial resilience or customer service arrangements[15]".

Our concern is that suppliers are beholden to the supplier licence and not the statutory consultation document. Therefore, any comfort provided in the consultation document must be replicated in the proposed licence conditions to provide any comfort to suppliers that it will be used proportionately.

Furthermore, the current drafting places no limits on how often potentially expensive audits may be requested. Coupled with the non-targeted wording of the licence condition, this proposal is not proportionate to the aims of the supplier licensing review in preventing supplier failures and the mutualisation of costs.

On the above grounds, we have redrafted the licence condition in Appendix 2 so that it only applies to the specific instances of supplier failure that are covered in the SLR.

Additional reporting requirement

We understand the intent of the additional reporting requirement, but it remains unclear as to what this means in practical terms. Ofgem's proposed licence condition uses the term 'Person with Significant Managerial Responsibility or Influence' and it's unclear who this would apply to.

A large company has effective and rigorous governance processes to ensure all decisions that are made are responsible and accountable. Our understanding is this rigorous process is unlikely to be in place for smaller suppliers, where for example one person may be the key decision maker on business strategy. Therefore, we propose that enforcement of this licence condition is largely targeted at smaller suppliers.

Centrica has an open relationship with Ofgem and our relationship manager, and therefore we envisage we would meet this licence requirement through our regular engagements with Ofgem where we can notify Ofgem of any changes in our management structure. Ofgem should set out guidance on how suppliers could meet this requirement through their regular engagement with Ofgem to lessen the burden on suppliers.

Final proposals for exit arrangements

Ofgem to take steps to ensure administrators are held to some of the same standards as suppliers when they assume responsibility for a failed supplier's debt book.

It is perverse to seek to address the deemed unfair treatment of customers by insolvency practitioners by placing a requirement on energy suppliers.

It is clear from Ofgem's letter[16] that its concern is around irresponsible debt collection by administrators. Therefore, Ofgem should work with the Insolvency Service to address this shortcoming. Furthermore, Ofgem should use its existing powers under Consumer Law to address any poor behaviour by administrators.

[15] Ofgem 2019 consultation – page 38.
[16] Ofgem open letter to insolvency practitioners: https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_to_insolvency_practitioners_appointed_to_failed_energy_supply_companies_.pdf

Ofgem has stated in its consultation that it will "continue to engage with the relevant insolvency regulatory bodies, and where possible to work together where there are concerns regarding behaviour having consumer detriment." This would be a far more effective route at addressing Ofgem's perceived consumer harm, than a change to supplier terms and conditions.

In Ofgem's letter to insolvency practitioners[17] it acknowledges that "We recognise that an insolvency practitioner has its own obligations and regulatory framework" and that in cases of consumer harm caused be administrators Ofgem will "consider a referral to the Insolvency Service or other appropriate regulator".

This letter suggests that any enforcement action on an administrator would be most effective should it be conducted through its own regulatory framework. Ofgem should work with relevant regulators and use its Consumer Law powers to enforce against administrators when there are signs of consumer detriment. Ofgem working with other regulators would also avoid the need for a time consuming, unnecessary and ineffective change to a supplier's licence conditions.

We remain of the view that placing a new term in supplier terms and conditions will not be enforceable upon the administrator, should a supplier fail, and the administrator will not be held to them.

The proposed change in terms and conditions will thus require suppliers to amend their terms and conditions, at significant cost to the supplier, with no noticeable customer benefit. Any change in terms and conditions can be lengthy and greater notice than 56 days is required to change our terms and conditions.

For the reasons set out above this proposed licence condition should not be implemented.

The draft licence conditions in Ofgem's statutory consultation are incorrect and place new requirements on suppliers. Our understanding from a telephone conversation with Ofgem[18] is that this is not the intent of the licence drafting. Therefore, we have submitted alternate drafting in Appendix 2 of this document. Our proposed alternate drafting should not be interpreted as support for a licence condition that we consider to be unnecessary and costly to implement.

As a principle a new proposed licence condition that is referencing other licence conditions, should refer directly to those conditions rather than trying to repeat what is already covered by another condition. This is what we have proposed in our alternate drafting.

Our alternate drafting references existing licence conditions, in line with policy intent, and is aligned with the ongoing work by Ofgem within its self-disconnection and self-rationing consultation[19].

The licence drafting differs between the consultation document and the separate attachment with the proposed licence conditions. In our response we have assumed that the drafting in the separate attachment is the version we should be responding to.

[17] Open letter to insolvency practitioners – November 2019: https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_to_insolvency_practitioners_appointed_to_failed_energy_supply_companies_.pdf

[18] Conversation on 29 July with Tricia Quinn, James Proudfoot and Vlada Petuchaite.

[19] Self-disconnection and self-rationing final proposals – statutory consultation: https://www.ofgem.gov.uk/publications-and-updates/self-disconnection-and-self-rationing-final-proposals-statutory-consultation

A requirement for suppliers to notify Ofgem if they are engaging in a customer book sale.

We support the requirement to notify Ofgem if a supplier is about to engage in a commercial transaction to transfer customers. This is a part of our internal processes and is something we imagine all responsible suppliers engaged in a trade sale or purchase will do.

Ofgem should use this requirement to prevent suppliers 'cherry picking' customers from a failing supplier and allowing the remaining customers and the failing suppliers liabilities to enter the SoLR process.

The licence condition has a requirement that 'prevents licensees from engaging in commercial transactions that subvert or distort … a supplier of last resort'. It's unclear when this will be enforced given that any trade sale will subvert or distort a SoLR, as by its nature a SoLR is an alternative to a trade sale.

It is unclear how Ofgem would enforce against a breach of this licence condition, as we do not believe Ofgem has the vires to prevent a merger or an acquisition. If Ofgem intends to enforce after a customer book sale through a financial penalty then this penalty should be commensurate with the level of resulting cost mutualisation and the level of consumer harm, accompanied by an uplift to serve as a deterrent to suppliers engaging in behaviour that would subvert or distort a SoLR.

Ofgem should publish guidance that sets out scenarios on when and how Ofgem would enforce against this new licence condition.

The largest potential consumer gain from a trade sale is that it can avoid the need for a SoLR and therefore prevent the mutualisation of costs. Should a trade sale in Ofgem's view distort or subvert a SoLR yet also prevent mutualisation of costs, Ofgem should have to weigh up these two aspects and allow a trade sale to go through if the overall consumer benefit is greater than the potential level of consumer harm.

In line with our counter proposal we have proposed alternate wording to Ofgem's proposed licence conditions in Appendix 2.

Appendix 2 – alternate licence condition wording

In this appendix we have proposed changes to Ofgem's licence drafting to reduce uncertainty and reflect the intent of the SLR. Our amendments are in blue, proposed text to remove has been struck through.

We have an additional concern that the licence drafting in the statutory consultation document and that in the gas and electricity notices do not match – most notably for condition 27A. This is concerning as it will cause confusion for those responding to the consultation. For the purposes of our response we have assumed that it is the notice that we should be referring to when proposing our changes to the drafting.

We re-iterate that we oppose proposed conditions 4A, 5A and 27A. However, should Ofgem go ahead with implementing these conditions, the alternate wording below would better meet the objectives of the SLR. Our proposed alternate drafting should not be interpreted as support for a licence condition that we consider to be ineffective or unnecessary.

Centrica is supportive of condition 5B and 19D if they are implemented with the alternate wording proposed below.

Condition 4A. Operational capability

4A.1 For the purposes of responsibly managing costs that could be Mutualised, or where Ofgem has reasonable belief that there is a risk of mutualised costs, the licensee must ensure it has and maintains robust internal capability, systems and processes to enable the licensee to:

a) efficiently and effectively serve each of its Customers;

b) efficiently and effectively identify likely risks of consumer harm and to mitigate any such risks; and

c) comply with relevant legislative and regulatory obligations.

Condition 5A. Principle to be open and cooperative

5A.1 For the purposes of responsibly managing costs that could be Mutualised, or where Ofgem has reasonable belief that there is a risk of mutualised costs, the licensee must be open and cooperative with the Authority.

5A.2 In complying with paragraph 5A.1, the licensee must disclose to the Authority in writing or orally any circumstance relating to the licensee of which the Authority would reasonably expect notice in order to perform its statutory functions, particularly actions or omissions that give rise to a likelihood of detriment to Domestic Customers. Such disclosure should be given as soon as the circumstance arises or the licensee becomes aware to it.

5A.3 The licensee is not required to comply with paragraphs 5A.1 and 5A.2 if the licensee could not be compelled to produce or give the information in evidence in civil proceedings before a court.

Condition 5B. Independent audits

5B.1 After receiving a request from the Authority to commission an Independent Audit that the Authority considers may be necessary for the purposes of responsibly managing costs that could be Mutualised, or where Ofgem has reasonable belief that there is a risk of mutualised

costs, ~~performance of any functions given or transferred to it by or under any legislation~~, ~~including any functions conferred on the Authority by or under the Regulation~~, the licensee must commission such an Independent Audit and provide to the Authority, in the form requested by the Authority and by the date set by the Authority, a copy of the full audit report.

5B.2 The Independent Audit is limited to ~~may include~~ the following areas of the licensee's business:

a) Financial stability;
b) Customer service systems or processes.
~~c) Where a licensee cannot provide adequate information under condition 28C.~~

Condition 19D. Trade Sales

19D.1 The licensee must not undertake a Trade Sale or Trade Purchase that may make it more likely, in the Authority's reasonable opinion, that costs will be Mutualised.

19D.2 The licensee must seek approval from Ofgem if a Trade Sale or Trade Purchase may subvert or distort, or is likely to subvert or distort, the Supplier of Last Resort process.

Condition 27A Payments, Security Deposits, Disconnections and final Bills

27.8A The licensee must ensure that the terms and conditions of each Domestic Supply Contract or a Deemed Contract comply with the provisions of paragraphs 5 to 8 of standard condition 27 (inclusive) and paragraphs 5 and 6 of standard condition 28B.

For clarity the above condition would negate the need for all three bullets proposed under Ofgem's drafting for condition 27.8A, including 27.8A1 and 27.8A2.

Other licence drafting issues

5B.5: 'senior management team' is not defined. This could lead to uncertainty/debate at enforcement as to who should be considering the audit reports.

8.3 "…steps to honour any commitment made…" should be redrafted so it is specific to the commitments made in the SoLR bid by the parties to the SoLR.

19AA.2 (h): the reference to Customers should clarify whether this relates to both Non-Domestic and Domestic customers only, in line with. part (d) of 19AA.2 Ofgem which states Domestic Customers and/or Non-Domestic Customers.

Gas Notice only:

8.1 (a) "a circumstance has arisen that would entitle it to revoke the Gas Supply Licence of an Gas Supplier…" the 'an' just needs to be 'a'.

At 8.6 in part (c) at the end, Ofgem has included "Note: Consolidated conditions are not formal Public Register documents and should not be relied on." This appears to be a copy and paste error.

At 8.6 in part (e) at the end, Ofgem has included “Charges under Last Resort Supply Direction.” We believe this is meant to be the heading for the next section above 8.7 as opposed to being a sentence at the end of 8.6(e).

19AA.3 the ‘f’ is missing from the beginning of the clause “or the purposes of this condition:…”