20 August 2020

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Dear Vlada,

RE: Statutory Consultation - Supplier Licensing Review: Ongoing requirements and exit arrangements

Thank you for the opportunity to comment on the above consultation. Utilita welcomes the aims of Ofgem in undertaking this work. We believe it is extremely important that as well as entry to the industry, ongoing operations and exit requirements are fully considered. However, we also believe that in a competitive industry, Ofgem should always strive for light touch, proportionate regulation.

Utilita is a smart prepayment specialist, offering high quality, prepay services to the prepay sector. Utilita has been selected as a Supplier of Last Resort (SoLR) twice following our successful submissions. Prepayment is an area of particular concern during a SoLR, where data issues as well as industry process can create significant risks for consumers who may face supply interruption if the SoLR fails to adequately respond to their needs.

While we are generally supportive of the overall objectives in the consultation, we have serious concerns at a detailed level. Some of the proposals are complex, and they will be costly and resource intensive to implement based on our understanding of the document. In addition, the remedies set forward are disproportionate to the detriment targeted, increasing burdens on all suppliers for the risk presented by a few. We believe that a more targeted package of measures would meet the need.

Although the overall package proposed could help reduce the likelihood of disorderly market exits in the long run, in the short run, the proposals are likely to drive additional market exit. The proposals will add to costs of operation for all suppliers, including the most efficient.

Ofgem believes that the package will impose minimum impact and cost on suppliers; this is not the case. The proposals suggest suppliers will need to provide extensive plans and evidence on a range of principles to Ofgem proactively, and may also be subject to extra requirements, for example, additional audits. While responsible suppliers will all have relevant internal documentation (appropriate to their scale and circumstances), maintaining such materials continuously in a state suitable for regulatory submission will be a major burden. This is in addition to the resources we have assessed as being required to deliver the related Consolidated Segmental Statements (CSS).

Suppliers currently operate under the Prepayment and the Default Tariff price caps. The financial restrictions on suppliers are extreme, and in the case of prepay specialists, rely on an embedded cross subsidy to enable suppliers to cover efficient costs. These proposals (in combination with the CSS) will impose significant resource overheads on all suppliers, which were not considered when the price caps were set. On this basis it is essential to ensure that prior to implementation, the extra costs have been factored into the price caps.

The new requirements to be followed in updating the framework must be reduced so that they are proportionate, simple to apply and cost effective. Wherever possible requests should be standardised, and potentially verifiable by external data, where needed. In addition, there will need to be a lead time prior to implementation to ensure suppliers can meet requirements for regulatory submissions if requested.

We support the approach of open, co-operative engagement with the regulator, but oppose introduction of this principle into licence. There is further work that can be done by Ofgem under existing provisions to encourage openness and transparency, this should be undertaken before further obligations are imposed. In order for the full benefit of open and co-operative regulatory engagement to be realised, suppliers need to gain confidence that this will be constructive and two-way engagement. For example, suppliers disclosing minor infractions or issues (especially on a first occurrence) need to be confident that a constructive and proportionate approach will be taken by Ofgem. This is an important tenet of principles-based regulation.

We agree Ofgem should continue to monitor supplier pricing under the price caps, in particular, where prices are below efficient cost. However, changes to regulations which have a disproportionate effect on specialist suppliers must be properly evaluated and cannot simply be adjusted for by reliance on cross subsidy over a dynamic customer base. Such approaches have the effect of distorting the market and preventing competition as suppliers will align resources to the most profitable customer segment or product. Long term, this will reduce innovation and choice for arguably the most vulnerable customers.

Our response comprises this letter and the attached appendix, in which we set out our detailed review of the proposed licence conditions. If you would like to discuss any of the points raised, we would be happy to help.

Yours sincerely,

By email only

Faye Widdowson
Senior Regulatory Manager

Appendix 1: Utilita's response in respect of the new proposed Principles

This appendix sets out Utilita's views on each of the new Principles proposed in the Statutory Consultation. While we do support Ofgem's overall aim, as we have stated in the letter above, we have a number of concerns about the proposals.

The Financial Responsibility Principle

We fundamentally disagree with the notion that suppliers should manage their costs to be mutualised in the event of their failure where the current price caps do not adequately allow suppliers to do so. In free markets, market participants would price to allow for the associated risk of bad debt and other demands on supplier resources, and therefore a mechanism for mutualisation would not be needed.

We note and support Energy UK's response regarding Ofgem's introduction of a significant new principles-based requirement at the Statutory Consultation phase. This does not allow us to consider the impacts of this proposal in the time allowed. In addition, such a substantial new proposal should be the subject of a robust impact assessment, which should be published to assist consultees in responding.

We question the basis on which Ofgem believes that having this new principle will equip it to intervene early and particularly, how it would enforce suppliers to pay industry obligations on time. We seek clarity from Ofgem on what success criteria would apply for this principle. The remedies proposed such as limiting customer growth and preventing bad repayment strategies suggest that the supplier would already be showing signs of failing and thus, such remedies would come too little, too late.

The policy intent behind this new proposed licence condition is for suppliers to effectively demonstrate to Ofgem that they have robust financial and operational plans in place to meet their financial obligations. We would like additional clarity on how Ofgem expects to gather evidence from suppliers to monitor this new obligation – for example, is the intent for this to be gathered under the new CSS?

We support an inclusion criterion for outline plans on sustainable pricing models, noting that the recent supplier failures have been largely due to below-margin pricing models. Such models encourage an escalated customer growth which some suppliers have not been equipped to handle.

By requesting this information via a licence condition, Ofgem state that they will have improved visibility of a supplier's financial position and may be able to identify, at an early stage, financial warning signs. We would like to understand how this would differ from information requested via RFI, how often information will be requested, and in what format and frequency? For example, does Ofgem propose an appropriate time for requesting information would be a few months before large industry payments are due – or at regular intervals?

We ask that Ofgem takes a proportionate approach to requesting this information, noting that increased reporting requirements will place an additional burden on suppliers and increase operating costs. Any information requested should follow definitions and assumptions in previous relevant requests, to ensure consistency of reporting, and to minimise resource and development time on internal teams. In addition, Ofgem must ensure there is no duplication of requests. For example, Ofgem already monitors a supplier's performance in returning credit balances under the recent Guaranteed

Standards Regulations, and debt performance under the Social Obligations Reporting. There is already some duplication of these data in the COVID-19 reporting.

Any approach to proportionality could consider a tailored reporting schedule for suppliers seen to be at most risk, based on their business plans and quality of reporting. It would also be reasonable for suppliers who may have been under 'special reporting measures' to seek relief from the requirements if they have new evidence to demonstrate the reporting is no longer required, or to appeal such decisions if they believe them to be unjustified.

Under these new proposals, we note that Ofgem expect suppliers to communicate to them at an early stage where there are any changes to the financial position of the company, or their approach to financial management. This is an unduly broad statement that may cover a considerable range of areas of varying materiality. It would be more appropriate to stipulate the requirement where the changes pose a potential or actual risk to the financial viability of the supplier. If this is the case, unless the impact is immediately critical, we consider that the expectation would be to notify Ofgem at the next planned reporting period, rather than on an ad hoc basis. Where suppliers do not notify Ofgem of substantial changes, we would like to understand what recourse Ofgem has to identify the failure (if such information is not publicly available) or to penalise the supplier?

We note from the new proposals, that where Ofgem is concerned with a supplier's financial responsibility, they can take preventative action such as restricting supplier growth or preventing the supplier from changing payment collection patterns. These actions may well contribute to a supplier's potential failure and increase the costs to be mutualised in that event. We do not consider such restrictions appropriate, providing, for example, that changes are underpinned by fair and robust operational processes. We do not believe the current proposals are strong enough to limit those costs to be mutualised in the event of a supplier failure.

The costs to be mutualised are also defined as "may include customer credit balances", but this is entirely determined by the SoLR bid. If a supplier chooses not to have funds in place to cover all credit balances, are they considered in breach? This is not stated in the document, and should be clarified.

Operational Capacity Principle

We consider that the principle for suppliers to have sufficient operational capability is a duplication of existing licence conditions. The duty to put things right when they go wrong is an obligation under SLC 0.3C (ii) and a duty to ensure we have complete, thorough, fit for purpose and transparent customer service arrangements and processes is under SLC 0.3C(iii). Ofgem already has sufficient powers to investigate operational capability and prevent customer harm through these conditions. We do not see how the introduction of new conditions and consequent duplication will add additional benefits.

Equally, suppliers (and in particular specialist suppliers) are limited in their capacity to innovate, drive efficiencies and improve upon their operational capacity due to the price caps, which in the case of the prepay cap does not allow recovery of efficient costs. In order to implement proposals such as this, Ofgem must factor the costs into the price cap allowances prior to implementation.

We support the view that suppliers should have appropriate data management systems and processes in place to manage their customer base, however, we consider this can be achieved under existing licence conditions and is clearly in suppliers' interests. Having a clear picture of customer data is key to a successful business. In the event of a supplier failure, the additional costs to the appointed SoLR will be mitigated by having a good data set to close accounts and issue final bills. It will also mitigate against any customer harm from having inaccurate or incomplete data about a customer's account.

We support the view that suppliers should have appropriate risk management strategies in place. We consider that this is best placed to be monitored under a reduced Financial Responsibility Principle, to minimise duplication of effort, and reduce the supplier administrative burden.

We note that Ofgem may take action against any supplier that demonstrates poor risk management or data management. For such an approach to be implemented, Ofgem should set out in advance clear criteria on which the assessment will be made, a detailed process to be followed and a mechanism to raise concerns with findings. Ofgem should also set out clearly what proposed actions or remedies Ofgem envisages.

Milestone Thresholds and Dynamic Assessments

We have no further comment on this proposal. We agree with Ofgem's policy intent to minimise any gaps in customer protections between the milestone thresholds using the dynamic assessments.

These dynamic assessments are not mentioned within the proposed new licence conditions and we would therefore question the legitimacy of their use. In any event, we welcome Ofgem's commitment that dynamic assessments are to be used proportionately. This is essential, given the burden such assessments can be expected to place on the supplier.

Any concerns or questions that Ofgem may have with a supplier's performance should always be first raised in open, informal contact, with the supplier, to understand the situation. Ofgem seek understanding of and take into account the supplier's unique business model, business ethics, and prior conduct before considering any escalated course of action such as issuing a formal RFI or requesting the supplier undertake an independent audit. Any formal RFI or audit should be as focused as possible to support Ofgem's investigation of the specific area of concern only. Such RFI's or audits should not be used as information gathering tools resulting in scope creep or wider remits, which could impose a disproportionate burden on suppliers, without justification.

Fit and Proper Requirement

We agree in principle with the new licence condition, however the proposed drafting is unduly prescriptive. This diverges from Ofgem's intent to move to principles-based regulation. We ask Ofgem to amend the drafting to reflect more principles-based regulation to allow for suppliers' differing corporate structures, HR processes and business models. The proposed prescriptive rules are covered by Companies Act and employment law legislation and duplication is unnecessary.

We agree that there should be robust recruitment and vetting procedures for staff at any level and we consider this best practice in any appropriately governed organisation.

Background checks for senior positions are sensible and common practice before an offer of employment is made. These background checks do include, as standard, bankruptcy or criminal activities. However, once an individual is employed, most organisations have strict HR processes for monitoring an individual's performance.

We question how a background check of an existing employee based on their possible contribution to a supplier failure would bear any relevance in their role – particularly from a supplier failure that may have occurred up to 12 months after their employment start date. Energy professionals are a limited pool of resource and restrictions of this type may unfairly limit employment opportunities for experienced and valuable individuals. We echo Energy UK's point that this may "lead to unintended consequences of discouraging suppliers from retaining experienced individuals at the Supplier of Last Resort, meaning operational expertise and the opportunity for learning from failure is lost".

We agree that employees' performance should be continuously monitored to assess they remain fit and proper to be able to carry out their duties. Established organisations have appropriate and effective HR processes such as disciplinary procedures, performance management practices and regular performance reviews.

We seek clarification on how such matters can reasonably be monitored by Ofgem, without breach of individual confidentiality. We would also like to understand Ofgem's proposed approach to if they consider a supplier has personnel that Ofgem assess as not fit and proper, and how this might relate to employees who may have been in post for a number of years?

Open and Cooperative

While we appreciate the objective underlying the proposal, we do not consider this condition will have the intended outcome Ofgem seeks. Suppliers who are committed to open and transparent engagement already engage appropriately. It is not clear how inclusion as a licence obligation will drive culture change in suppliers who do not engage. Co-operation and openness to Ofgem is already a mitigation or penalty in enforcement decisions and influences the penalty costs. This is a large incentive for suppliers who may not otherwise engage cooperatively with Ofgem in an investigation or compliance case. Adding this into licence adds no additional benefit, unless there are direct consequences.

Ofgem can already compel suppliers to provide information. We seek greater clarity on how this new licence condition would grant additional powers to the ones already in existence.

In any event, we disagree with the proposed drafting of the licence condition. It currently states that the licensee must "disclose to the Authority… circumstances relating to the licensee of which the Authority may reasonably expect notice", the burden of proof being on the licensee to make judgements on what the Authority would consider disclosable or not. This would be an impossible test for suppliers to apply consistently in practice.

Customer Continuity Plan

We agree, in principle, with the perceived benefit that the proposed Customer Continuity Plan ("CCP") will bring for the Supplier of Last Resort inheriting the customer base of a failed supplier. A CCP could theoretically help the SoLR to efficiently find all of the details required to minimise any disruption the customer may face as a result of the move. In practice, we

cannot see how this can be robustly monitored and enforced. We echo Energy UK's view that potential at-risk suppliers who are approaching failure may not maintain their CCP and indeed may not be able to do so. As a consequence, far from providing help, this would cause further confusion where a SoLR may be relying on out of date information.

Ofgem proposes that it is for suppliers to keep the CCP updated "at all times". We seek further clarity on how this would translate into practice, without placing an unreasonable burden on suppliers. Items such as third-party arrangements, billing system information, key staff, business processes and methodologies will not change much over time and could reasonably be expected to be reviewed once every 6-12 months. Whereas customer numbers, PSR entries and payment methods change daily. The benefit of such fluid and constantly changing data for any SoLR, will only be of use if this is a refreshable dataset. Any requirement to update the latter information inside a CCP will place an administrative and cost burden on suppliers for little benefit.

We suggest removal of this proposal, and with SoLR suppliers, drawing up a reduced template, that would provide the basics on an easily updateable basis.

Requirement to compel suppliers to undertake an Independent Audit

It is not clear why this requirement needs to be transposed into Licence. Ofgem have previously imposed the requirement for suppliers to commission and fund independent topic-based audits without the licence obligation and already have powers to request information and audit suppliers. The proposed licence conditions do not appear to add significantly to the existing powers or to specify the circumstances under which they would apply, which is essential to avoid uncertainty.

While we welcome Ofgem's intent to only use a proportionate approach we share Energy UK's concerns with the current licence drafting.

The current drafting of the licence condition states the audit "may" cover certain aspects of a supplier's business. This creates a position where scope is uncertain and mutable. Audit requests should follow a formally documented procedure with clear parameters to give confidence to all parties in the process.

The drafting also states that the audit should be completed by a "date set by the authority… in line with the terms of reference supplied by the Authority". Audit timescales are more appropriately determined by the appointed auditors based on the terms of reference. While Ofgem will naturally have input, we would prefer to see a commitment by Ofgem to take a proportionate approach to agreeing reasonable timescales according to the defined audit scope. We believe it would also be appropriate that Ofgem discuss the terms of reference with the supplier and auditor to determine viability and confirm scope of the proposals.

We also challenge Ofgem to justify, in each case, the legitimate basis and consequential impact of requiring an independent audit of a supplier's financial status, in addition to the that carried out under the provisions of the Companies Act 2006. This financial audit is carried out by Registered Auditors who are required to form an opinion of the truth and fairness of the Company accounts and inter alia form an opinion on whether the organisation is a going concern.

As we understand the document, the proposals is for the additional financial audit requested by Ofgem to sit outside the normal reporting and audit cycle. We therefore

wish to understand both the potential outcome and vires of these audits. For example, what would happen if the additional (non-cyclic) audit considers there is a question over whether the company is a going concern? If so, would this call into question the parameters and governance of the previous Companies Act audit. Were this to be the case, there would be serious implications for all parties, including shareholders and the auditors.

As set out above, Ofgem should not seek to duplicate existing requirements, in particular where these may conflict with the current framework under the Companies Act. ARGA (Audit Reporting and Governance Authority) is set to replace the Financial Reporting Council in April 2022 as a direct response to corporate failure. We believe that Ofgem should be gaining assurance from these approaches rather than seeking to impose additional, poorly defined requirements.

Ofgem should set out how it will incorporate the findings of the ongoing reviews around audit practices currently taking place? For example, the CMA, Kingman and Brydon have already published clear recommendations on the extension of Public Interest Entities, which is likely to extend to many energy companies that are not currently included. We consider Ofgem may benefit from interacting with these reviews, or the new licence requirement may risk undermining or conflicting with them. The duplication or potential conflict of differing legislative vs. licence requirements could cause wider political and economic concerns.

Additional Reporting Requirement

We do not see that this requirement has any additional benefit, as it is drafted. However, we agree that it would be reasonable for a licensee to have a simple obligation to notify such matters, but only where that obligation is not already extant in legislation or licence. We suggest that changes to a supplier ownership, changes of Companies Act Directors and proposed book sales could reasonably be included.

The proposed licence drafting, is unduly prescriptive and wide-ranging, covering changes to regulatory personnel, registered office address and changes of personnel with significant managerial responsibility, among other things. The last requirement is a catch-all which stipulates any other "significant change that may affect how the licensee operates". This will be an extensive and burdensome list of notifications for suppliers and Ofgem to manage with a process that is not clear. Other than corporate sales or major restructuring, an annual or quarterly update or notification of no change would be manageable and sufficient.

New terms in customer supply contracts

We do not believe that requirement to amend supplier terms and conditions as an attempt to constrain the behaviour of legally appointed Administrators will be efficacious. Suppliers' terms and conditions are already compliant with the Licence, and we do not understand how a change to these conditions can be expected to bind a third party, especially not one with clearly defined legal duties to act in the interests of the defunct company's creditors.

Where Administrators are willing to observe such constraints, without being conflicted in their legal duties, they can do so.

Ofgem should not seek to regulate companies that are beyond their remit by proxy through the supply licence conditions. Ofgem should instead seek to work with the appropriate regulator to address any instances of consumer harm.

In addition, we have concerns with the current drafting of SLC 27.8A, which states:

> *(ii) charges may not be demanded or recovered unless and until it can be established that such steps to ascertain a domestic customer's ability to pay have been taken and instalments set accordingly.*
> *(iii) charges may not be demanded or recovered unless and until it is established that all reasonable steps to issue a final Bill have been taken*

In both clauses, the requirement goes further than the current licence, without appropriate consultation or consideration of the impact. Suppliers are not required to ascertain ability to pay before demanding a payment. This would mean that any bill, Direct Debit payment or top up would become non-compliant, unless we seek to proactively contact each customer to ascertain their ability to pay prior to issuing a bill. Equally, suppliers are not required to issue a final bill before charges can be demanded or recovered. How would this work for Direct Debit payments that are taken on a set date each month? How would this work for any bill that incorporates any charges rolled over from a previous bill? Would this mean we would not be able to demand the balance of any previous bill prior to the final bill being issued?

We believe these impacts to be unintended and ask Ofgem to review and update the drafting to ensure it appropriately aligns with the existing licence provisions.

<u>Customer Book Sales</u>

We echo Energy UK's comments on customer book sales; while we recognise the rationale for this measure, commercial exits should be preferred to SoLR events, and will usually have clear commercial benefits for both the company and the customers. The creditors benefit from the company and the customers move to a supplier who has a clear vested interest in looking after them, having made a commercial investment to secure their supply. Ofgem should be careful not preclude the ability to make orderly, responsible market exits.