

Lisa Charlesworth
Industry Codes and Licensing
Ofgem
10 South Colonnade
Canary Wharf
London
E14 EPU

licensing@ofgem.gov.uk

23rd January 2019

Supplier Licensing Review

Dear Lisa,

SmartestEnergy welcomes the opportunity to respond to Ofgem's consultation on Supplier Licensing.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services and a supplier in the electricity retail market, serving large corporate and group organisations.

Please note that our response is not confidential.

We answer the questions below in the order in which they appear in the consultation document.

Section 2.12. Do you agree with the principles we have set out to guide our reforms?

We agree with the first principle that suppliers should adopt effective risk management and be adequately prepared and resourced for growth. However, we do not fully understand how Ofgem can ensure that suppliers "bear an appropriate share of the risk." Clearly, suppliers need to be encouraged to price customers in a responsible manner and have proper cashflow management in place, but at the end of the day the costs of a failing company will fall on their customers/other suppliers and/or any parties to an insurance or mutualisation scheme.

We agree that oversight of suppliers needs to be proportionate as per the third principle. We are of the view that existing non-domestic suppliers should be given a very light-touch oversight, in view of the much lower risk they represent and the fact that Ofgem's focus is on protecting domestic customers.

Under the third principle it states that Ofgem “need to ensure that arrangements are robust to protect consumers where failure occurs.” In terms of finding a new supplier we agree that the arrangements need to be robust. However, we are concerned about the financial implications of this statement. In this situation there is an irretrievable loss which needs to be recovered. We can understand the desire not to pass this on to the customers of the failed supplier by protecting credit balances, for example. However, the loss will inevitably be passed to customers either directly or by socialisation through other suppliers. In reality, given the nature of suppliers who have failed recently and caused mutualisation in the RO and FIT schemes, this has led to a transfer of the loss from the domestic market to the non-domestic market. We consider this to be an inappropriate subsidisation of the domestic market by the non-domestic market and we feel that Ofgem should address this.

We agree with and have no further comment to make on the second and fourth principles: “Suppliers should maintain the capacity and capability to deliver a quality service to their customers, and foster an open/constructive dialogue with Ofgem” and “Our licensing regime facilitates effective competition and enables innovation.”

Section 4.16. Do you agree with our proposal to introduce new tougher entry requirements and increase scrutiny of supply licence applicants? Do you agree this can be achieved with increased information requirements and qualitative assessment criteria?

Clearly, new entrants need to demonstrate an understanding of the licence obligations and present a credible business plan, but there is also an issue of timing, especially where off-the-shelf packages are used i.e. the ultimate owner of the supply business was not the one issued with the licence. In our view, the BSC and MRA already have good controls in place in terms of business readiness. However, one improvement that could be made by Ofgem is the introduction of a two-stage approach to a licence whereby a second confirmation (possibly coupled with requalification under the Codes) needs to be given by Ofgem just before live market entry after the new entrant has confirmed that they have read the licence and have appropriate resourcing in place. This arrangement would capture off-the-shelf suppliers changing hands without inconveniencing established suppliers who are modifying their systems. In terms of the options presented we would err on the side of somewhere between Option 1 and Option 2. It does not need to be too onerous because of the MRA and BSC processes which already exist.

Section 5.4. Do you agree that our proposed assessment criteria for supply licences applications are appropriate?

Yes, although we feel that Criterion 1 (The applicant has the appropriate resources for their proposal to enter the market) and Criterion 2 (The applicant understands their regulatory obligations and has appropriate plans in place to meet these) are more or less covered by the BSC and MRA controlled market entry processes and Ofgem may be able to link in to them before they start asking for more information unnecessarily in order to reduce duplication of effort.

Section 5.14. Do you agree that applicants should provide evidence of their ability to fund their activities for the first 12 months, and provide a declaration of adequacy?

We agree with this but a 12-month cut-off seems a little odd since failure typically happens well after the first year of operation. We would suggest that evidence should be provided each year for the coming year for the first five years of operation.

Section 5.15. Do you agree with the specific information we would generally expect applicants to provide (in Appendix 1)? If not, why/what would you add or change?

This information is not in and of itself unreasonable.

Section 5.23. Do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence?

In theory yes, but we can see that this in itself could be superficial, not demonstrating any true understanding, as it could easily be bought in from consultants, and would ultimately be worthless.

Section 5.24. Do you agree with the areas we would generally expect applicants to cover (in Appendix 1)? If not, why/what would you add?

These are not in and of themselves unreasonable.

Section 5.29. Do you agree that we should ask additional 'fit and proper' questions as part of the application process (as set out in Appendix 1)?

Yes

Section 6.8 Do you agree that Ofgem's licensing process should be undertaken closer to proposed market entry? Do you identify any barriers to this approach or any adverse impacts of this change?

We would suggest a two-tier process. It would be unreasonable to reject an application closer to proposed market entry if facts emerged that could have been established using some desk research on, for example, directors' histories. Criterion 3 should be conducted earlier in the process, as could an initial session to impress upon the prospective supplier what would be expected before a licence is ultimately granted.

Section 7.14. Do you consider that suppliers should report on their financial and operational resilience on an ongoing basis? If so, do you have any initial views on the content of these reports/statements?

To a certain extent, we fear that such reporting would be overly burdensome and ultimately of little value as suppliers who were in difficulties may try to hide the fact. As an

aside, we take a lot of comfort in the fact that Ofgem say that they already monitor customer growth, tariff pricing, dependency on the balancing mechanism, as well as external factors such as wholesale price spikes, payment deadlines for Government schemes, and other intelligence they have available including evidence of non-compliance with licence conditions.

Having said that, in an ideal world it would be useful if Ofgem could see information that demonstrates that suppliers have sufficient cash/stock to trade for a forward period (12 months) to cover such expenses as RO obligation, FIT and VAT etc, (i.e. anything that could cause a sudden exposure.) We would have no problem if Profit (PAT) and cashflow (FCF) forecasts were requested from all suppliers and (from newer suppliers) plans on how they intend funding early year losses; there has to be substantial equity/debt funding in place. Information on energy exposure would also obviously be desirable as this is something which less established suppliers seem not to understand.

Section 7.18. Do you have any initial views on the potential introduction of targeted or strategic monitoring/requirements on active suppliers?

A targeted risk-based approach is more sensible. We think that Ofgem could be able to request further information should any of the indicators we mention in the previous question give cause for concern.

Section 7.22. Do you have any initial views on the potential introduction of prudential/financial requirements on active suppliers?

It occurs to us that Ofgem's concern here is for domestic customer credit balances. If so, we would have no concern with such requirements being placed on domestic suppliers, but it would be pointless to request such information from non-domestic suppliers.

Section 7.31. Do you consider that Ofgem should introduce an ongoing requirement on suppliers to be 'fit and proper' to hold a licence?

We have no strong opinions on this. If Ofgem feel that this could have prevented issues escalating in the past then it is probably a good idea. If not, Ofgem should consider whether it is worth pursuing.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
Head of Regulatory Affairs