Supplier Licensing Review: Ongoing requirements and exit arrangements

Executive Summary

Since the start of 2018 there have been 16 Suppliers of Last Resort appointed. Prior to that, the last Supplier of Last Resort was appointed in 2005. Ofgem has been far too slow to investigate why there has been this sudden increase in the number of supplier failures and take appropriate action; this has resulted in disruption for consumers and additional costs for suppliers, some of which will be passed on to customers. It was clear to suppliers and key stakeholders, such as Citizens Advice, long before these market exits started occurring, that some new entrants had poor risk management processes and were not treating customers fairly, not least because the prices they were charging were unsustainably low. Ofgem preferred to believe that these low prices were evidence of large suppliers being inefficient, and that this competition would drive them to improve. In fact, it started a price war that resulted in more and more market failures, and put considerable strain on established suppliers despite their good risk management processes; the problems have been exacerbated by the imposition of price caps.

The regulations for operating in the energy market are extremely tough, but up until July this year, anyone could, at very low cost, obtain a supply licence and start to trade with little or no understanding of the rules they were expected to abide by. It was possible for a third party to meet the entry requirements and obtain a supply licence and then sell that on to anyone who wanted to operate in the energy market; the operator need have no knowledge or skill at all in energy supply. Ofgem has now made that more difficult, but not impossible. It remains to be seen whether the new rules it has introduced for market entry help ensure that new energy suppliers are genuinely prepared for the market they are entering and reduce the number of suppliers just looking to make easy money by using sharp practices.

With the strict regulations in place, it is surprising that many suppliers have got away with very poor customer service for a long period of time, without any apparent compliance or enforcement action by Ofgem, before failing. Had Ofgem addressed some of the issues that were obvious to anyone operating in the supply market, they could have supported some of the failed suppliers to adopt stronger risk management processes, prevented them from growing too quickly and minimised the market disruption from supplier failures. Having belatedly acknowledged there was an issue, Ofgem is now attempting to adopt stricter regulations that impact not just those new entrants who are at the heart of the issues, but also every other supplier, even those who have always adopted strong risk management and customer service principles. We firmly believe that Ofgem's proposals should be applied to suppliers on the basis of risk, ensuring that those suppliers who have operated for many years and have good risk management strategies do not pay a price for those suppliers who adopt risky business processes.

We believe that a strong market entry regime, coupled with close monitoring of new entrants until they become established, is what is needed to address the issues we have seen over the past two years.

Ofgem's consultation looks at four over-arching proposals: we discuss these below.

Promoting more responsible risk management

The consequences of making barriers to entry in the energy supply market too low, followed by an enforcement regime for poor new suppliers that was often too lax, could be expected to play out for the next couple of years or so.

However, with a strong market entry regime, we believe the number of Supplier of Last Resort events should eventually decline. This should mean that mutualisation of government schemes occurs less frequently and to a lesser extent, as schemes like the Renewables Obligation have a threshold below which under-payments are carried forward rather than being mutualised. However, the issue of credit balances will remain. Ofgem's proposal for suppliers to protect a percentage of credit balances comes at a price and thus should encourage suppliers to minimise the amount held. It might be expected that suppliers will therefore be discouraged from requiring payment in advance; if that is Ofgem's objective, a simple licence condition would suffice. Licence conditions could also limit the amount of credit balances that could be held on a domestic account. However, we acknowledge that this would be difficult to monitor.

Over the next few years, with less supplier failure as a result of stricter entry requirements, and an increase in the number of smart meters which should make billing more accurate, it is to be expected that credit balances will mainly only occur where a customer pays by fixed monthly Direct Debit.

It is our view that suppliers who present little risk of failing should not have to provide protection for credit balances, or at least only provide it for a nominal amount, and those who properly accrue for government schemes should not be required to obtain additional protection for them. Ofgem's cost mutualisation should be applied on the basis of risk; thus, a new entrant or a supplier who has been in the market for less than three years should be required to protect 100% of credit balances and government schemes. Providing that, during those three years, they pay into government schemes on time, do not require advance payment for more than four weeks, have not been subject to compliance or enforcement action and can show they have good risk management processes, the amount of cover required could be reduced, potentially using a sliding scale over a number of further years.

We welcome Ofgem's proposals with respect to milestone assessments and trigger points for suppliers of domestic customers. We agree it would not be proportionate to extend this to non-domestic customers at this time; should Ofgem consider doing so it would need to consult again on appropriate milestones, which are likely to be significantly different in the non-domestic market. The milestones proposed are the right ones as there are times when additional regulations become effective, and Ofgem's proposals will serve to make sure a supplier understands and abides by those additional rules. However, we do consider an additional milestone might be of value, say at between 1.5-2 million customers, as at this stage it might be expected that the number of vulnerable customers supplied is more significant, and a reminder of the specific regulations that apply would be useful.

More responsible governance and increased accountability

We support Ofgem's proposals for ongoing fit and proper assessments; however, we believe the current licence condition wording needs adjusting. In a large business, decision-making is nearly always a joint process with referral to the Board for significant decisions. Where a non-Board member makes a decision without following due process, the supplier will almost certain have processes to take an individual to task. Ultimately, decision-making is the responsibility of the Board, and therefore we believe the fit and proper requirement should apply to a company's Board representatives only.

We believe that Ofgem's requirement for suppliers to be open and cooperative is unnecessary and will not deliver the results Ofgem hopes for. Ofgem already has powers to compel a supplier to provide information where it suspects non-compliance with regulations. The proposed licence condition will not make any supplier who wants to be secretive any more open than it already is.

Suppliers' willingness to be open and cooperative might be improved if Ofgem became more supportive; for example, where a supplier seeks help understanding whether action it proposes is likely to be compliant, Ofgem should work cooperatively with that supplier to help them understand the rules, rather than just hiding behind the wording in the licence and protecting Ofgem's future legal position.

We do believe that the second part of Ofgem's proposed licence condition is too broad and have proposed a minor amendment.

Increased market oversight

We see no value in Ofgem's proposal for suppliers to have living wills. When a supplier starts to fail, little heed is likely to be paid to any promises made in a living will, and if the supplier fails to honour its promises there is little Ofgem will be able to do about it. Ofgem should instead make use of its proposals to undertake milestone and trigger point assessments, together with other information already collected from suppliers, to support suppliers who are struggling to try to help them remain compliant and exit the market, if that is the only option, in an orderly fashion. Part of that help could be to help that supplier put a package together to help any future Supplier of Last Resort.

We do not agree with Ofgem's proposal to introduce a licence condition compelling suppliers to undertake independent audits. Ofgem already has such powers when it is undertaking compliance and enforcement processes, and an independent audit should only be required where Ofgem has reason to suspect a supplier is non-compliant with one or more licence conditions. If Ofgem does include this licence condition, it must reflect its policy intent to only do so where it has significant grounds for concern: that control does not currently appear and we have proposed some wording in our response to question 12.

Exit arrangements

Ofgem does not have any powers to regulate administrators and therefore, while we welcome the open letter issued on 5 November 2019[1], we do not anticipate any change in the way administrators behave. The emphasis must be, therefore, on preventing market exits and encouraging trade sales.

We have seen how the Supplier of Last Resort process can be abused, allowing suppliers to obtain a failing supplier's customer portfolio at minimal direct cost whilst paying for other elements of the company's assets (e.g. in Ovo's appointment of Spark Energy Supply Limited in November 2018, where on appointment it immediately put into place plans to acquire Spark Energy's operating company and the Spark Energy brand). Ofgem states its preference for trade sales over the Supplier of Last Resort process; however, it has not suggested any proposals to encourage suppliers to purchase failing businesses or their portfolios, nor to discourage suppliers from taking advantage of the Supplier of Last Resort process to grow their own portfolios on the cheap.

While we do not agree with Ofgem interfering with commercial transactions between suppliers, we do believe it should take action to prevent suppliers who remain in the market being saddled with costs that should have been picked up as part of a trade sale, or conducting partial trade sales where the customers remaining with the failing supplier and becoming the subject of the Supplier of Last Resort process are unattractive and so do not attract bids.

While we agree that being able to split portfolios would make Supplier of Last Resort more attractive, particularly where the split is between domestic and non-domestic customers or to package off a very large customer portfolio, it should only be considered if the costs are reasonable. Suppliers are already subject to significant costs due to industry change, including smart metering, faster switching and half hourly settlement; further costs, particularly in a market that is price-capped, could result in even further market exits. There is also the possibility of supplier administration orders in the case of larger portfolios and players.

Ofgem must take account of the costs of its proposals and the impact of those costs under the price caps. There are already substantial amounts that suppliers are expected to fund out of headroom under the price caps; each additional cost makes it more difficult for suppliers to properly fund their operations. We strongly urge Ofgem to review its methodology to allow for at least some of these costs to be included within specific elements and not be left to be covered under headroom. Although beyond the scope of this consultation, Ofgem should also adjust the price cap to allow for the recovery of mutualisation sums, which clearly were not a "one-off" last year.

[1]https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_to_insolvency_practitioners_appointed_to_failed_energy_supply_companies_.pdf

Question 1

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

1. It is to be hoped that the high supplier failure rate we have seen in the last two years will be stemmed, or at least reduced, due to the new rules for market entry introduced by Ofgem in July this year. Ensuring that suppliers are aware of their responsibilities and can pay their way when they start up should prevent so many issues occurring as they grow, and prevention is always better than cure. A cure there needs to be, however, in the short term. That cure must be proportionate and must not impact those that behave properly, with good risk management and treating customers fairly.
2. We therefore believe Ofgem's package of measures must be applied on a risk-based basis. Suppliers who have not given cause for concern should not have to pay for the poor behaviour of those suppliers who treat their responsibilities to customers recklessly or negligently.
3. We comment on the individual proposals in our response to Ofgem's questions below.

Question 2

Do you agree with the outputs of our impact assessment?

4. In respect of cost mutualisations, Ofgem appears to have considered only the costs related to credit balances, with no account of the costs relating to mutualisation of government schemes. Indeed, the options are not clearly stated and it is not clear what each represents. Ofgem states that 'a proportion' of government schemes should be covered; what proportion is never discussed.
5. Ofgem is overly optimistic in respect of the benefits it anticipates from its proposals. Prevention is better than cure; only by ensuring those entering the market and operating in the early years are well prepared for the market they are entering, and that they are monitored closely during that time, will fewer Supplier of Last Resort events be seen. Three examples are given below, but there are several other benefits which we believe are over-stated.
6. For the milestone assessments/trigger points analysis, Ofgem considers there would be a benefit in terms of better-quality data from failed suppliers. When a company is struggling it often looks to reduce staffing and cut corners; we therefore do not believe this proposal would have any impact on the quality of data.
7. While there is likely to be a benefit of suppliers reducing credit balances to minimise the cost of protections, at times of stress, a supplier is likely to hold onto those balances in an attempt to survive. Therefore, the benefit is unlikely to be of significant value at the point a supplier fails.
8. There is an additional cost for cost mutualisation we do not believe Ofgem has considered. Some suppliers may make fixed monthly Direct Debit a more expensive payment method, in order to minimise the amount of credit balances they hold. This would be detrimental for all customers, particularly those in vulnerable circumstances.

9. We do not believe the proposals are likely to have any impact on the competitiveness of SoLR competitions; as we have stated above, a failing supplier is likely to take whatever steps are necessary to survive; only if Ofgem can act speedily could it prevent the quality of data declining or the value of credit balances increasing.

10. The mutualisation of costs relating to government schemes has cost E.ON and other prudent suppliers that reliably pay these bills on time significant sums over the last few years. These sums are not accounted for in the default tariff cap methodology, driving a distortion in the retail market that results in bad behaviour being rewarded while good behaviour is punished. Ofgem should review what powers it has to mitigate this issue for suppliers during winter 2019/20 on the expectation that further supplier exits will occur.

Question 3

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

11. Ofgem already has a considerable amount of data from suppliers. However, in our response we have suggested some alternative proposals which may require further information to inform the costs and benefits.

12. Ofgem should carry out more research on the indicative cost of protecting credit balances. We believe that for some suppliers, particularly smaller independent ones, this could be considerably greater than 0.5%.

13. Energy companies which can evidence effective risk management and who do not misuse credit balances to fund their operations should not be required to provide additional credit support.

Question 4

Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? Please provide evidence to support further refinement.

14. As stated above, we believe that for some suppliers, particularly smaller independent ones, this could be considerably greater than 0.5%.

15. Please also see our response to question 2.

Question 5

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

16. Cost mutualisation is imposed on energy suppliers to avoid direct impact on individual customers of a failed supplier, and to avoid under-recovery of government schemes. The recent excessive spate of supplier failures has put undue pressure on suppliers who continue to trade.. Indeed, it might be expected that the cost mutualisations themselves are sufficient to be the final straw for some struggling suppliers.

17. While socialisation of costs may seem fair, the burden falls more heavily on vulnerable consumers who are *"less likely to engage in the market for a better deal"* as noted by Ofgem in its State of the Energy Market Report 2018[2]. Active customers who have switched to a cheaper supplier that subsequently fails not only had the benefit of lower prices, but any credit they had with that supplier is covered by all consumers, including those who are vulnerable and were therefore paying higher default tariff prices. There may be an argument, therefore, for customers of failed suppliers to bear some of the risk themselves.

18. Since privatisation and up until the end of 2017, supplier failures were rare; those operating in the market had good risk management strategies and took their regulatory responsibilities seriously. The sudden increase in supplier failures may have come about largely as a result of the creation of the 'supplier in a box' model, making market entry too easy for those looking to make easy money. Recent failures, as Ofgem notes in the draft Impact Assessment[3], are due to some suppliers taking excessive risks in their purchasing strategies, failing to accrue for government schemes, offering cheap prices into the market and requiring payment in advance. Their concern has not been to provide a good service to customers, but to make money as quickly and easily as possible. These suppliers often face little or no personal loss if their business fails. Consumers choose to be supplied by these companies attracted by low prices and the knowledge that, ultimately, they themselves bear little or no financial risk.

19. Ofgem's cost mutualisation proposals merely serve to deal with the aftermath of the problem it has created by having lax market entry procedures which it has taken Ofgem far too long to address. It is to be hoped that the new measures put in place on 5 July 2019 will resolve the issue going forward, making many of the ongoing and exit proposals Ofgem is proposing to introduce largely superfluous and certainly unduly onerous. Proposals such as cost mutualisation will add to suppliers' costs and so to tariff prices. To minimise the impact of that, we propose that Ofgem's cost mutualisation proposal be applied on a risk-based basis.

20. For new entrants, and those who have not been operating in the energy market for long, we agree with proposals to require them to protect both credit balances and government schemes. In addition, suppliers who require payment in advance of more than one month's energy should

[2] https://www.ofgem.gov.uk/system/files/docs/2018/10/state_of_the_energy_market_report_2018.pdf, P59

[3] https://www.ofgem.gov.uk/system/files/docs/2019/10/191021_-_draft_impact_assessment_final_new_updated.pdf (para 1.7)

also be required to provide protection, and those that fail to make a payment into a government scheme on time should provide protection for the next few years.

21. In the first year of operation, protection should be required for a nominal amount: say, £10m for credit balances and £4m for government schemes. In the second and third year, there could be a requirement for protection of 100% of the average credit balance in the previous year and 100% of government scheme costs.

22. For each year after that, the amount of protection required could be reduced subject to the supplier not being involved in compliance or enforcement action, paying into government schemes on time and not giving cause for concern that they cannot finance their operations.

23. If a supplier fails to pay into a government scheme on time, the interest rate for late payment should be a deterrent to deferment (i.e. the interest payment should be higher than the cost of borrowing).

24. There are a number of alternative proposals Ofgem could consider:

    - 100% cover for all credit balances in excess of a given percentage of turnover;
    - All but the largest suppliers could be required to cover the lower of 100% of credit balances and government schemes or £100m (this represents more than the sum of the highest amount of credit balances for any failed supplier so far (Spark, November 2018, £34m) and the highest amount of unpaid Renewables Obligation (Economy Energy, January 2019, £38m). Larger suppliers would be too large to go through a Supplier of Last Resort process and instead would go into supplier administration, where the administrator would be required to keep the business running until all customers had been found a new supplier, thus there is no necessity for credit balance protection;
    - As there is already a mutualisation process for credit balances that shares the costs more equitably amongst consumers, it could be argued that there is no need to protect these. Government schemes, however, should require 100% protection, or the government could change the rules to require more frequent payment be made, or Ofgem could require suppliers to pay quarterly into an escrow fund to ensure all suppliers contribute more regularly.

25. At its workshop for this consultation on 26 November 2019, Ofgem suggested that the intention was for a monthly assessment of credit balances and adjustment of the amount to be protected. This makes it difficult for the cost of protection to be accurately recovered through tariffs as prices are revised at much less frequent intervals. In addition it is likely that there will be additional costs each time the value of protection required is revised or updated. One alternative would be for suppliers to calculate the average value of credit balances over a 12-month period; the problem with this is the amount of protection may not reflect the actual level of credit balances at any point in time, particularly where a supplier is growing. Another possibility is to reflect the level of credit balances held at a particular time of year, for example before winter starts.

26. One drawback of protection of mutualised costs is that, when a business starts to fail, it may have nothing to lose by disregarding its regulatory obligations, and therefore may be inclined to

remove or reduce any protections it has in place, or at least not increase them to the level required. This proposal, therefore, may have little positive impact on the value of mutualisations and points again for the need for stronger protection at market entry. Ofgem acknowledges this in paragraph 2.18 of the consultation. A stricter entry regime is therefore essential alongside any ongoing or exit proposals.

27. Paragraph 3.9 of the Impact Assessment states that Ofgem *"assume[s] that consumers will bear the cost of introducing these new protections through increased tariff prices."* This will only be possible for customers on default tariffs if full recovery of the costs is properly allowed for under the price cap methodologies and not merely required to be accounted for under headroom. It should not be part of headroom as the cost would not be a one-off, it would recur annually. The Licensing team must work closely with the Retail Price Regulation team to ensure the cost is accounted for under the tariff caps. Failure to do so could result in increasing the number of market exits.

28. Ofgem has not yet been able to develop a mechanism for returning customer credit balances or paying unpaid amounts into government schemes. It is difficult to see how this could be done, unless all mutualised costs are in the control of Ofgem.

29. Some suppliers may have difficulty obtaining guarantees, insurance or other protections, or the cost of these may be prohibitive and force them out of the market. If this impacts a number of suppliers at the same time forcing them to exit the market *'en masse'*, this could cause considerable disruption.

30. We believe there is considerably more work for Ofgem to do in developing this proposal; it was clear from the workshop Ofgem held on 26 November 2019 that they did not have answers for many of the outstanding questions and had not fully considered all of the issues. It therefore seems far too early for Ofgem to move to statutory consultation in relation to cost mutualisations. Stakeholders need to have sufficient information to enable them to make an intelligent response; we therefore urge Ofgem to undertake further consultation before adopting this proposal; indeed, it may be that this proposal should be dropped altogether.

Question 6

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

31. As Ofgem states in paragraph 2.29, it already monitors supplier growth and has existing compliance and enforcement tools to act where detriment or potential detriment to consumers is evident. We believe, however, that the ability to monitor suppliers at times where they are about to become subject to additional regulations is a sensible proposal and will enable Ofgem to take action where it appears that a supplier does not have sufficient plans or resourcing in place.

32. The proposal has minimal cost impact for affected suppliers, and therefore is unlikely to be the cause, or part of the cause, of subsequent failure. Also, we do not believe it should be a barrier to entry. We therefore fully support this proposal. It has the added benefit of making sure suppliers are aware of the additional regulatory burdens and are prepared for them.

33. While the customer number thresholds proposed are sensible, relating to where additional energy regulatory requirements become effective, we consider that there should be an additional threshold, at 1.5 – 2 million customers. While there are no new regulatory requirements at this stage, the number of vulnerable customers in any portfolio is likely to be more significant (in the early years, most customers will be active in the market), thus it would be an opportunity to remind the supplier of its obligations.

34. Consideration needs to be given as to whether an assessment should be time-constrained. A supplier may be approaching a milestone and be given permission to exceed it by Ofgem; however, due to unforeseen circumstances, the supplier may not exceed that milestone for a considerable amount of time. Also, some suppliers may exceed the milestone then suffer customer losses that take it below the milestone. If there were a time constraint, the supplier could grow above the milestone again without undertaking a further assessment, provided it did so within the given timescales.

35. We agree with the proposal for additional assessments if there are signs of financial difficulty. We also believe that assessments should be required where a supplier consistently offers exceptionally low prices; history has shown that these prices are unsustainable and has led to several suppliers either failing to pay their share of the costs of government schemes or exiting the market, or both. A prolonged period of exceptional growth should also be a dynamic trigger (expanding a customer portfolio by more than a certain percent within a given period of time); fast growth is a huge strain on any organisation, and needs to be managed carefully.

36. The impacts of this proposal on mergers and take-overs, including the Supplier of Last Resort process, must also be considered.

Question 7

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

37. We have significant concerns about the definition for “Significant Managerial Responsibility or Influence”. For a larger supplier, this definition covers too wide a group of people, given the nature of such an organisation. Responsibility should sit with the Board; this is consistent with the approach Ofgem has taken into account in its compliance and enforcement activities. An organisation must be able to show it has good reporting lines to the Board and that there is a culture of reporting risks and issues up the chain of command. We propose alternative wording in our response to question 12.

38. Our change to the above definition has a knock-on impact for part e. of the proposed licence condition; we explain that in detail in our response to question 12.

39. Providing the changes we propose in question 12 are made, we have no concerns with this proposal. However, we believe the benefits will be minimal and could be negative: someone who has experience of compliance or enforcement action is far more likely to understand and respect the rules and the way the regulator applies them. Only where non-compliance is shown as being the result of reckless or grossly negligent decisions should an individual be considered as unfit and improper.

Question 8

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

40. Unlike the rules for living wills that banks and public contractors will have to develop and publish, the living wills Ofgem is proposing are not backed by appropriate support, monitoring or sanctions.

41. *Support* Preparation of a living will takes a certain level of expertise that many suppliers are unlikely to have. For banks, the Bank of England has stated that it will support bank in creating their living wills; it is not clear what support will be available to energy suppliers from Ofgem or any other body.

42. *Monitoring* Other than determining whether a supplier has a living will that, at least nominally, meets its requirements, it is unlikely Ofgem has the expertise to assess whether a living will is adequate or whether a supplier has the necessary pre-requisites to put it into operation.

43. *Sanctions* If a bank fails to meet the requirements of its living will, individuals responsible for the will can be sanctioned. For energy supplier living wills, Ofgem's powers only allow them to sanction the supplier itself by imposing penalties (which a failing supplier is unlikely to be able to pay) or licence revocation (which negates the whole purpose of the living will). A living will would not bind an administrator or a Supplier of Last Resort.

44. A supplier that is struggling to keep afloat is unlikely to pay any heed to the requirements of its living will, and therefore the value of the will is negligible. This consultation is looking to address the issues relating to market exit, both in terms of the number of exits and the orderliness of them. This proposal serves neither function and therefore should not be considered as part of these proposals.

45. There would be a cost to suppliers for putting a living will in place and maintaining it, and this cost would impact consumer prices. We do not believe the cost is justifiable, given the limited value as explained above.

46. At Ofgem's workshop in June 2019, when it was consulting on proposals for changes to the market entry regime, there was little support for living wills, as demonstrated by the voting at the end of the session. We agree with Ofgem's statement in paragraph 4.9, however, that there was support for policies that address data quality and interactions with administrators. Data quality could be dealt with by suppliers being required to provide regular reports on their portfolio, with Ofgem challenging any questionable or poor quality information. We believe this is more likely to achieve the results Ofgem is seeking than a living will. Interactions with

administrators are not within the remit of Ofgem to resolve: any change to the administrator regime must come from insolvency regulations.

47. Ofgem considers (paragraph 4.12) whether living wills should only be required of larger suppliers. Larger suppliers are already required to provide significant reporting on their portfolios, operations and finances. The risks these proposals are designed to address are seen at the lower end of the market, where far less reporting is required. We believe that some of that reporting requirement should be extended to all suppliers, thus providing Ofgem with as much information about smaller suppliers, who from historic evidence are far more likely to fail, as they currently have about larger suppliers.

48. It should also be noted that for the largest suppliers, it is highly unlikely that Ofgem would be able to use the Supplier of Last Resort process. Instead, it would almost certainly use the supplier administration process, which would require an administrator to continue to trade until all customers of the failed supplier had been taken on by another supplier. For these suppliers, a living will has even less value and should not be required.

49. Should Ofgem decide to proceed with this proposal it should be on a risk-based basis, for example for suppliers who are showing signs of financial stress – though its value is likely to be limited in such circumstances, as discussed above.

50. No legal drafting, or indeed details of minimum information requirements, have as yet been provided to suppliers. Should the proposals Ofgem makes in its statutory consultation be subject to significant challenge by stakeholders and thus require significant change to the proposal before a decision is made, Ofgem should consult further before adopting this proposal, in order to ensure stakeholders have sufficient information to enable them to make an intelligent response.

51. Significantly more time would be needed for suppliers to develop living wills. For banks, the initial announcement that living wills would be required was in 2018, with the wills not required to be published until 2021. Whilst the living wills for even the largest suppliers are likely to be less complex than bank living wills, at least nine months should be allowed from the time Ofgem publishes its decision on the statutory consultation.

52. Ofgem suggests that suppliers should be required to publish some parts of its living will. We do not believe there is any value in this. We would remind Ofgem of the requirement it introduced with the Standards of Conduct that suppliers should publish a Treating Customers Fairly statement on their website, indicating how they would meet their obligations. After a few years, it was recognised that these statements had no value for consumers and the obligation was removed. We believe publication of living wills would be similarly of little interest, particularly given that they are likely to be irrelevant where the supplier is struggling to remain in business, which is the only time at which this information would have any value.

Question 9

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

53. Ofgem already has powers to request an independent audit where it has compliance concerns[4]. We therefore do not believe there is any need for a licence condition for this purpose.

54. At Ofgem's stakeholder event in June, the final survey indicates that suppliers neither considered this should be a priority nor that it would deliver most benefits. Suppliers were, however, generally supportive of measure to increase oversight of poor performing suppliers (paragraph 4.16); this is better achieved through regular reporting than through audits.

55. Commissioning an independent audit is expensive; at a time where a supplier is already struggling, it could be the final nail in the coffin. We therefore do not see this as a sensible solution. Costs of audits are particularly high for larger suppliers, for whom there is likely to be a limited number of auditors from whom to choose and who are likely to have higher costs than average.

56. Requisitioning, carrying out and reporting on an independent audit takes time; it is therefore not the best solution where urgent action is required to address an issue where a supplier may be failing.

57. Ofgem should rely on regular reporting and requests for information to determine whether a supplier is non-compliant and then work closely with that supplier to help it both to improve and continue to trade. It should not engage in actions that could force a supplier into exiting the market.

58. We accept that there may be instances where Ofgem does not have sufficient expertise due to the technical nature of a particular issue. In such cases it should take a proportionate view and consider the impacts of requesting an independent audit: its powers should be used sparingly.

59. Ofgem states (paragraph 4.17) that it would not make use of this requirement unless it had significant grounds for concern. This is not reflected, however, in the wording of the proposed licence condition. Should Ofgem consider that there is a genuine necessity for this licence condition, we have proposed alternative wording in our response to question 12; we strongly urge Ofgem to adopt this wording, or similar, to give effect to their policy intent.

[4] https://www.ofgem.gov.uk/system/files/docs/2017/10/enforcement_guidelines_october_2017.pdf, para 3.30

Question 10

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

60. We note Ofgem's recent open letter to insolvency practitioners appointed to failed energy supply companies[5]. Insolvency practitioners have a responsibility to creditors; any concern for customers will be secondary to that. We therefore do not anticipate that Ofgem's open letter will have a significant impact in improving customers' experience of the Supplier of Last Resort process.

61. For the same reason as above, we do not believe that insolvency practitioners would have much, if any, regard for the terms and conditions of the contract a customer had with their client. The proposed new licence condition is therefore likely to have minimal impact for customers whose supplier has become insolvent. Suppliers' terms and conditions are already lengthy due partly to the number of regulatory requirements; this results in few customers taking time to read them. We therefore do not agree with Ofgem's proposal to introduce a requirement for suppliers to include references in their terms and conditions of supply to debt recovery as outlined in relevant licence conditions. We do agree, of course, that suppliers' terms and conditions should not contradict the intent of any licence conditions.

Question 11

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

62. The ability to split portfolios may encourage more suppliers to bid to be a Supplier of Last Resort. However, the process will add to the complexities and potentially the costs for industry. We anticipate a high price tag on making the necessary change to industry systems, and if investigations show that to be the case, we would not support those changes.

63. Ofgem needs to do more to encourage trade sales and discourage suppliers from abandoning their responsibilities to the Supplier of Last Resort process and for other suppliers to pick up their bills; however, we agree that partial trade sales involving a supplier in distress are undesirable as they amount to asset stripping of attractive customers. We agree, therefore, with Ofgem's proposal to proceed to the Supplier of Last Resort process to avoid such sales.

64. Requiring suppliers to obtain approval before proceeding with book sales, however, may interfere too far in suppliers' commercial decisions, and should only be pursued if other steps do not deliver the required results.

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5 https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_to_insolvency_practitioners_appointed_to_failed_energy_supply_companies_.pdf

Question 12

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

65. Not in all cases. We discuss the licence conditions for each proposal below.

66. *Operational capability:* We do not have any issues with the intent of this licence conditions or the wording. However, we do believe it is unnecessary: a supplier who is not serving each of its customers or complying with relevant legislative and regulatory obligations is already not complying with the Standards of Conduct and potentially other licence conditions. This merely adds to the number of licence conditions Ofgem can deem a supplier to be non-compliant with, while adding no value. We strongly believe this licence condition should not be adopted.

67. *Ongoing 'fit and proper' requirement:* As discussed in our response to question 7, we have concerns about the definition for "*Significant Managerial Responsibility or Influence*". We propose that the words "*at Board level*" be added after "*where a person plays a role*":

> *"**Significant Managerial Responsibility or Influence** means where a person plays a role **at Board level** in –*
>
> *"(a) the making of decisions about how the whole or a substantial part of any undertaking's activities are to be managed or organised, or*
>
> *"(b) the actual managing or organising of the whole or a substantial part of those activities."*

68. Part a. of the licence condition should exclude motoring and other minor offences.

69. Given the change to the definition of Significant Managerial Responsibility or Influence, we believe that part e. is not required.

70. *Principle to be open and co-operative with the regulator:* This licence condition needs to be proportionate. We propose adding *"material"* after *"anything"* – Ofgem cannot expect to be informed of every small problem in an organisation:

> *"1.1 The licensee must be open and cooperative with the Authority.*
>
> *"1.2 The licensee must disclose to the Authority appropriately anything **material** relating to the licensee or which the Authority would reasonably expect notice."*

71. *Independent audits:* The licence condition does not reflect Ofgem's policy intent to not make use of this requirement unless it "had significant grounds for concern." (paragraph 4.17). We therefore propose the following wording.

> *"1.1 After receiving a request from the Authority to conduct an Independent Audit that it may reasonable require or that it considers to be necessary to enable it to perform any functions conferred on the Authority by or under the Regulation, **and has reasonable course to believe that the audit is required to address a material breach of a standard condition of the supply licence,** the licensee must provide that Independent Audit to the Authority when and in the form requested.*
>
> *"1.2 The licensee is not required to comply with paragraph 1.1 if the licensee could not be compelled to produce or give the information in evidence in civil proceedings before a court."*

We have no concerns with the definition of *"Independent Audit".*

72. *Other reporting and notification – change of control:* We have no concerns with this proposed licence condition.

73. *Other improvements to exit arrangements:* We have no concerns with this proposed licence condition, although we believe there should be an additional bullet point, as follows:

    - *"The types of costs for which the Licensee expects to make a claim for a Last Resort Supply Payment and the upper limit of any such claim."*

    This would not prevent a Supplier of Last Resort from making claims for additional payments and Ofgem agreeing to such payments in exceptional circumstances. However, a bid to be a Supplier of Last Resort must take into consideration that the quality of data received from a failed supplier is likely to be poor. Ofgem will take the amount to be claimed from the industry levy into account as part of its decision to appoint a Supplier of Last Resort and must be sure it can deliver the best value for consumers and the industry.

74. *Customers in debt to the failing supplier:* As we stated in our response to question 10, we do not believe that insolvency practitioners would have much, if any, regard for the terms and conditions of the contract a customer had with their client. We therefore see no value in this new licence condition; indeed, it will only serve to make suppliers' terms and conditions of supply even longer, making them daunting for customers to read. Ofgem already has powers to take compliance action where a supplier does not adhere to the relevant licence conditions, and we believe this is sufficient.