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Dear David,

Thank you for providing us with an opportunity to comment on Ofgem's revised proposals for strengthening the financial resilience of the energy supply sector. This submission is non-confidential and may be published on your website.

Consumers are facing significant costs due to the collapse of 28 suppliers in the last 18 months, resulting in at least £2.6bn in socialised costs being recovered through the Supplier of Last Resort (SoLR) process. This figure may expand by many billions if the government ultimately determines to recover the costs of the Special Administrative Regime for Bulb through energy bills.

The scale of volatility in wholesale markets has been such that, even in a well regulated market, some suppliers may have failed. But it is clear that the breadth and depth of turmoil in the retail market was aggravated by failures in the regulation of the sector, particularly in relation to lax market entry rules and deficiencies in conduct regulation and enforcement. These weaknesses are detailed in depth in multiple reports, including [Market Meltdown](#) and [Back from the Brink](#) by Citizens Advice, [The Energy Supplier Market](#) by the National Audit Office, reports by the [BEIS Select Committee](#) and the [Public Accounts Committee](#), and [Oxera](#) for the Ofgem Board. A common theme of all these reports has been that the lack of adequate controls to ensure the financial resilience of suppliers, and the ability to misuse cashflows like Consumer Credit Balances (CCBs) and the Renewables Obligation (RO) as working capital, contributed to the proliferation of unsustainable businesses, who ultimately collapsed at consumers' expense.

It is important that the regulation of the sector learns from these past failures, and we are therefore strongly supportive of the need to strengthen its financial resilience.

Your consultation presents a worrying picture of an environment where some suppliers have zero net assets, raising capital is potentially extremely difficult and expensive, and it may take many years for suppliers to be adequately capitalised. The multiple year transition approach you suggest implies that you do not think the sector would be able to withstand quicker reform; that trying to ensure its financial sustainability more quickly would, ironically, threaten its financial sustainability.

Those concerns appear to have resulted in the most substantive change since your previous consultation; the removal of requirements on suppliers to ringfence CCBs. You argue that a combination of other reforms such as the tightening of rules on the setting of direct debits (which should reduce the build up of CCBs) and the capital adequacy requirements (which should ensure suppliers have alternative sources of capital) mean that it would not be proportionate. While backing away from market wide CCB ringfencing, you propose to take 'step in' powers that would allow you to require it on a discretionary, targeted, basis if individual suppliers become overly reliant on CCBs.

This discretionary approach worries us, as it relies heavily on Ofgem's ability and willingness to identify problems and step in. Our Market Meltdown report highlighted that Ofgem reduced its enforcement headcount during the years when unsustainable suppliers were entering - and often subsequently chaotically leaving - the market. Some aspects of what you are proposing have been tried and failed in the past. For example, the second bulleted requirement in paragraph 2.16 sounds very similar to the pre-existing requirement on suppliers to maintain a living will. As we highlighted in Market Meltdown, only 1 of 20 failed suppliers had one in place.¹ Ofgem has made a number of changes in recent months to strengthen its monitoring work that we welcome, but trust needs to be earned, and it is important that Ofgem is mindful that its track record on monitoring and enforcement is not beyond reproach.

Given these concerns, our ability to support these revised proposals is entirely contingent on Ofgem demonstrating that it has and will continuously adequately resource the monitoring and enforcement of the Financial Responsibility Principles (FRP).

While you appear to see CCB ring fencing as unnecessary given separate capital adequacy requirements, you also imply in several places that CCBs could form part of that demonstration of capital adequacy.² In our view, this would be inappropriate as it would not address the problem you are trying to solve - suppliers with inadequate financial resources, and a lack of equity investment, misusing consumer cashflows to fund their business.

Noting that the arguments for a multiple year transition to new financial resilience arrangements is founded on concerns that moving quicker could cause the very financial sustainability problems they are trying to solve, we think there are also some risks that discretionary CCB step in powers may be triggered too late to be

¹ Of the 20 suppliers who failed between August and mid November 2021.

² For example, on page 12 you suggest that ringfencing CCBs '*may also result in 'inactive' capital that could be more effectively deployed - particularly in the short term - as capital reserves that would directly increase supplier resilience*'. A similar statement is made in paragraph 4.62.

used (eg that by the time it becomes obvious that a supplier is too reliant on CCBs it may not be possible to ring fence them without causing its failure). We would welcome more detail on how you will manage these trade offs to ensure timely remedial interventions under the proposed approach.

We think that one other part of your proposals allows for too much discretion. You propose to introduce a requirement into the FRP *'that if suppliers breach any of the reporting triggers set out in guidance, they must also notify Ofgem 28 days before extracting value from the business (unless the activity is essential to its operation), including, for example, paying dividends, providing loans or transferring assets to a third party. This same requirement would apply if suppliers breached the minimum capital requirement. Where we assess it requisite to secure supplier compliance with the FRP or other obligations, we may restrict them from extracting any further value from the business using our existing enforcement powers.'*

In our view, in circumstances where suppliers are breaching the triggers set out in the FRP they should not be able to extract cash from the business full stop. Either the FRP has teeth or it does not, and, noting the extractive activities of some of the management teams of failed suppliers, we are not comfortable with leaving the door open to any extraction of cash where businesses are showing signs of failing.

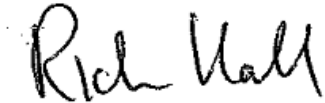
We are not privy to the same level of information on suppliers' financial stability as you are, and therefore cannot easily form a view on how quickly your minimum capital requirements could be fully introduced. We recognise that given the fragility of the sector, it may be appropriate for the transition to be staggered over several years. Notwithstanding this, the current proposals are a little vague on what comes next, with the proposal for what level of assets should be in place by 2025 covering a wide range (from £110 to £220/customer). Given the implications for supplier capital raising, we encourage you to narrow down and finalise these requirements rapidly. We think there would also be value in clarifying whether all suppliers will be set the same target or whether it will vary by supplier during the transition period; the consultation is ambiguous on this point.

We are fully supportive of your proposals to ring fence RO monies, for the reasons set out in our response to your previous consultation round.

Outwith the scope of this consultation, but similarly relating to the reduction in consumer exposure to SoLR costs, you consulted earlier in the year on proposals to retain the value of hedges in the event that customers are transferred to a SoLR. Given the majority of past mutualised SoLR costs have related to wholesale costs, that workstream could offer significant protections to future consumers if a solution

can be found. We would welcome an update on how your thinking on that matter is evolving.

Yours sincerely

A handwritten signature in black ink that reads "Rich Hall". The signature is written in a cursive, slightly slanted style.

Richard Hall
Chief Energy Economist