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Dear Cathryn,

We support Ofgem's ongoing work on energy supplier resilience, following the unprecedented turmoil we saw in the market in 2021. With over 4 million customers affected directly by supplier failures, and a total cost to bill payers of at least £2.5 billion, it is vital that reforms are put in place that rebuild consumer trust and prevent a similar crisis in future.¹

At this stage of the policy development our key views are that:

- We continue to support policies that reduce the risk of these mutualised costs, and reduce the cost of supplier failures more widely by preventing risky business practices. Various options for reform have been looked at extensively since 2018, and should not be delayed further.
- Ofgem should seek to limit the costs of these reforms while maximising consumer benefits. We look forward to an impact assessment of options at the next stage of consultation, taking account of the costs to different types of suppliers, impact on prices, and direct and indirect benefits to consumers.
- We would also welcome more detail on why previous options to protect credit balances have not been taken forward. Of the options presented at this stage we are minded to support Ofgem's preferred approach, subject to a detailed impact assessment.
- Ofgem should ensure the reforms incentivise suppliers to improve their billing practices, and we also support consideration of new rules on billing. This should form part of a larger review to improve standards and introduce a new FCA-style Consumer Duty.
- Ofgem is simultaneously progressing various reforms with somewhat overlapping impacts on supplier resilience, though other measures are currently at a more nascent stage. Ofgem should use the proposed transition period before its mutualisation protections are implemented to assess the appropriate combination of enduring measures.

Our view of the problem

We strongly agree with Ofgem's analysis that mutualisation of credit balances and the Renewables Obligation incur direct costs to consumers, but also introduces moral hazard that enables risky practices and unsustainable pricing. This increases the risk of supplier failures, with the disruption and wider mutualised costs these entail. These costs can be

¹ Citizens Advice (2021), [Market Meltdown](#)

significantly larger than the value of credit balances and Renewables Obligation payments, as we've seen in recent failures. These issues have already been considered in depth over a number of years, with Ofgem first proposing to tackle them when it launched its supplier licensing review in 2018, and it is very disappointing that reforms were not taken forward in a more timely manner.

Appropriate management of credit balances - and good billing practices more generally - are also vital to consumers. Fundamentally, this money is held by suppliers for the purpose of helping their customers manage their energy bills. This carries an implied cost to consumers as the same money could be put to use elsewhere, for example earning interest via savings or spent on other goods and services. Consumers temporarily forgo this money primarily in return for the benefit of consistent energy costs across the year, though we're aware that some people also prefer to have additional credit as a 'buffer' in case of unexpectedly high bills or price rises.

Smart metering and modern digital billing platforms mean it should be easier than ever to accurately bill customers and manage credit balances. This should include regularly reassessing Direct Debits to ensure they remain appropriate and/or warning customers if their credit balance is too high. Any changes to protect credit balances should aim to also incentivise better billing practices.

We note that the open letter also sets out that Ofgem is considering 'strengthening requirements for more accurate billing by direct debit'. Ofgem's current Market Compliance Review into Direct Debits should help to identify any issues with current supplier practices, and we support action to improve billing protections in general.

We recently called for a new overarching Consumer Duty in energy, supported by new underlying rules.² This would be similar to the one being introduced by the FCA in the financial retail market, and should act to raise standards and fill protection gaps. In relation to billing, these underlying rules could include requirements for more regular assessments of direct debits and strengthening the back billing rules for customers with smart meters to guarantee they get the benefit of more accurate bills.

Our current view of reform options

We recognise that any changes to require protection of credit balances and Renewables Obligation payments may incur some costs for companies if they need to recapitalise in order to protect credit balances. This impact is likely to heavily depend on which mechanisms are available to the company to protect balances, and the extent of the protection required by Ofgem.

These costs are likely to flow through to consumer prices -though, to the extent that it reduces the scope for the unsustainable pricing offered previously by some companies, this should not be a cause for concern. Ofgem is right to focus on the impact on otherwise efficiently run suppliers in its analysis, and should accept that some inefficient business

² Citizens Advice (2022), [Raising the bar](#)

models may be adversely affected by any reforms, including to the extent that they exit the market.

In relation to the options for scope of the credit balance protection, we are keen to understand why Ofgem now considers the previous model it consulted on in 2021 (targeting 'surplus' credit balances) to be inappropriate, as there is no supporting analysis provided for this position in the open letter. However, of the options that are presented we are currently minded to support Ofgem's preference for protecting credit balances net of unbilled consumption.

We are less comfortable with the option of also netting off debit balances from the amount that needs protection. The practical result of this approach may be suppliers protecting no credit balances whatsoever - particularly at points in the year where debit balances are likely to be highest. It could also suggest that a legitimate function of credit balances of some customers is to help service the debit balances of others. We think this is unlikely to align with consumer understanding of the purpose of their credit balance, and may create poor incentives on suppliers in relation to managing balances. However, we are keen to understand the costs of each option before making a final determination.

We don't have good insight into the operational benefits and risks related to different ring fencing approaches and the options for insolvency remote mechanisms. We generally support the criteria by which Ofgem is assessing the mechanisms, but would urge careful use of the competition criteria. Some of the competition enabled by the current rules was based on suppliers making inappropriate use of credit balances, and so any reforms may be likely to result in less new entry than would otherwise be the case. It may also be reasonable for some suppliers to face higher costs of credit balance protection if this is a fair reflection of the additional risk they pose, similar to an insurance mechanism. However, we recognise this may be less fair if these costs are instead based only on supplier type and size.

The impacts of credit balance protection

While we are able to make some qualitative judgement about the various options at this stage, an impact assessment will be needed to support any final proposals. This should be clear on the costs of different options, the impact on different types and sizes of suppliers and any price impacts for customers. It should also account for the full benefits of each option, including reduced credit balance mutualisation directly, but also the extent to which it reduces the risk (and costs) of supplier failure more widely, as well as the benefits that may accrue to consumers if suppliers are incentivised to improve billing practices and prevent excessive credit balances being built up.

Ofgem should also be clearer about how seasonal changes in the amount of credit that needs to be protected under a dynamic approach may interact with requirements to protect funds for Renewables Obligation payments, where liabilities grow throughout the year. This may mean the impact on supplier costs and incentives, and ultimately to consumer prices, fluctuates across the year in a manner that impacts competition.

More broadly, Ofgem should also set out how it expects suppliers might respond to the changes. For example, the reforms may disincentivise practices which lead to higher credit

balances, like paying in advance rather than arrears and providing credit 'bonuses' for customer referrals. As mentioned earlier, suppliers may seek to improve management of balances, by assessing Direct Debits more regularly and refunding excessive credit balances.

Suppliers may also prefer to offer different payment methods, including Direct Debits which have a seasonal adjustment or fluctuate based on the actual amount used, in order to limit credit balances. While more choice of payment options is likely to be beneficial, we would be concerned if changes reduced access to fixed Direct Debits, which are the most popular option for customers currently.

In some previous supplier failures, mutualisation of credit balances has been avoided by gaining suppliers offering to make these payments as part of their supplier of last resort (SoLR) bids. However, the recent market turmoil demonstrated that this cannot be relied upon at times of wholesale market volatility, when the risk of supplier failure is greatest.

If credit balance protections are implemented we would expect bids during competitive SoLR processes to be based on offering other customer benefits. This could include covering the failed supplier's undelivered ECO obligations, Warm Home Discount Industry Initiatives obligations, or unpaid scheme payments, or offering lower-cost tariffs to customers of the failed supplier. Ofgem should confirm in its statutory consultation how it expects SoLR bids might adapt under the proposed reforms. It should also examine the impact on failures of larger suppliers that go through the special administration process, where we might expect the protection mechanisms to reduce the liabilities of the failed company and increase the opportunity for the Treasury to recover funds via an eventual sale of the company.

Implementation of reforms

We recognise the need for a transitional period if suppliers need to recapitalise to meet any new requirements. There may also be short term challenges to protecting credit balances due to the Government's Energy Bills Support Scheme which will artificially increase credit balances by £200 in October, with the effect then declining over time and returning to a more 'steady state' by the end of March 2023.

There are also overlapping impacts between different policies within Ofgem's resilience action plan, which make it harder to assess the additional benefit of each independently. New rules that stop growth at 50,000 and 200,000 customers to do a supplier assessment may offer more opportunity for Ofgem to ensure credit balances are not being used inappropriately by growing new entrants, though we think there would still be scope for poor practice to emerge after these checkpoints have been passed and especially if suppliers started to struggle.

Planned rules on hedging and capital adequacy could also reduce the additional benefits of protecting credit balances, by separately tackling risky business practices. However, it is challenging to assess their impact as these are at an early stage of development, unlike credit balance protections which have been considered by Ofgem a number of times in recent years.

Ofgem's new stress testing may enable identification of problems at suppliers and action to tackle them at an earlier stage, though this may still come too late. We also remain concerned by Ofgem's ability to monitor financial risk and enforce requirements in a timely manner. Evidence at the BEIS Select Committee from both Bulb and Avro Energy suggested that previous Ofgem monitoring had not identified problems at these firms before they failed.³ We continue to call for Ofgem to be more transparent about how its compliance and enforcement functions performed prior to the recent crisis, and to set out how these functions will improve in future.

To manage the risks of policies significantly overlapping and 'overcorrecting', Ofgem should monitor the impact of stress testing and rules on capital adequacy during the credit balance implementation period, and make a judgement as to whether credit balance rules also remain necessary. It could do so by including a mechanism to make implementation subject to a decision of the Authority.

Protection of Renewables Obligation payments

We have generally focused in this response on the protection of credit balances, but we also strongly support action to tackle Renewables Obligation mutualisation. This has been a much larger direct cost of supplier failures than credit balance mutualisation in the past, with no option to recover these costs via the competitive SoLR process. The annual payment point for the RO has also been a trigger for multiple supplier failures, with affected customers seeing disruption and higher prices just at the start of winter.

We continue to support legislative reform as the best option to deal with RO risks, and will engage with the forthcoming work by BEIS on longer term reforms to the scheme. However, we recognise this may take time and we support new requirements by Ofgem to protect RO payments until that is in place. Given this is likely to be a stop-gap measure, it's particularly important for Ofgem to set the transition timeframe appropriately to ensure meaningful benefit is delivered.

Protection of RO payments is likely to deliver other benefits aside from avoided mutualisation costs, including more rapid payment by suppliers at the end of the scheme year, less administrative burden for Ofgem and fewer enforcement cases required to deal with non-payment.

Please let me know if you would like to discuss this response in further detail.

Yours sincerely,

Alex Belsham-Harris

Principal Policy Manager, Energy Retail Markets

³ BEIS Select Committee (2022) [Formal meeting \(oral evidence session\): Energy pricing and the future of the Energy Market](#)