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Date: 14 June 2022

“Price Cap - Consultation on changes to the wholesale methodology” – So Energy Response

Dear Dan,

So Energy is a leading energy supplier providing great value 100% renewable electricity to homes across England, Wales and Scotland. We have consistently been recognised by our customers and the wider industry for our outstanding customer service since we were founded in 2015, including being a Which? Recommended Provider in 2020. In August 2021, So Energy merged with ESB Energy and our combined business now supplies over 300,000 domestic customers. As one of the last challenger suppliers left in the market, and one that is backed by ESB’s resources and expertise, So Energy are able to provide a unique view on the energy market and future reform.

So Energy believes that the price cap exposes energy suppliers and consumers to uncontrollable risks and is therefore unsustainable in the long term. We welcome Ofgem’s decision to move to a quarterly cap. It somewhat reduces risks associated with wholesale market volatility. However, substantial residual risks remain and the costs associated with managing those risks is driving up the cost of providing energy to consumers.

Backwardation

So Energy welcomes and supports Ofgem’s proposals for an ex-ante approach for its backwardation allowance.

However, we do not believe Ofgem has put forward a robust and sufficient justification for the inclusion of a deadband within the allowance. The deadband is not needed to levelise costs across seasons because levelisation can be done entirely through the recovery mechanism. Ofgem asserts that “normal market conditions” will return - and that when they do - backwardation costs will be netted off by contango benefits within the life of the cap. There is not enough evidence to suggest these assertions can be justified in the current landscape – the wholesale market has remained volatile for an extended period and they may never return to pre-crisis dynamics.

So Energy also has concerns with the treatment of backwardation allowance costs related to volume risk as a result of it being recovered up to 12 months after the actual costs were incurred. As the number of customers who are on an SVT may change significantly over the course of those 12 months, leading to under or over recovery of costs. Ofgem should commit to updating the £/per customer allowance to take account of the movement in SVT customers. In doing so, the allowance will more accurately reflect movement in SVT numbers over a twelve-month period. There may also be rationale for including a true-up element if there is under or over recovery the allowance owing to a movement in SVT numbers.

Related to the above issue, the cost of backwardation is substantial. If the allowance is going to be recovered over 12 months, then the cost of financing backwardation costs until they are recovered needs to be fully accounted for. Assumptions made in the past about suppliers' ability to access inexpensive lines of credit no longer hold true. The cost of raising money is rising across the economy, but for energy suppliers in particular, due to the large number of supplier failures in recent times. Depending on what decision Ofgem makes in the coming months, proposals around protecting RO and credit balances may exacerbate this issue. We strongly recommend that Ofgem undertake a review of the assumptions made around the cost of raising money and how this should be reflected in the price cap.

We hope you find this input helpful. As we stated at the beginning of our response, we would welcome the chance to engage and work with you on consumer protections that deliver in today's volatile markets. Please don't hesitate to contact us should you require any additional information or clarity on our views.

Yours Sincerely,

Paul Fuller
Head of Regulation

