ecotricity

Sent via email to RetailFinancialResilience@ofgem.gov.uk

Ecotricity Group Ltd
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3rd January 2023

Ecotricity Response to Strengthening Financial Resilience Statutory Consultation

Dear Mr Hall,

Introduction

Ecotricity were the world's first green energy company when established in 1995. We now have over 175k domestic and non-domestic supply accounts, alongside over 100MW of self-developed renewable generation capacity. We continue to invest in new sources of renewable generation, with two new solar parks recently commissioned and our first green gas mill and energy storage sites under construction.

Executive Summary

We welcome the opportunity to discuss the measures detailed in this consultation, in particular the proposal to ring fence Renewable Obligation Certificates for domestic supply and a regime of capital adequacy. Whilst we support the objectives to increase Financial Resilience, we would also highlight the need to ensure that the right balance is found between customer protection and market competition including any potential to disadvantage smaller, more innovative suppliers.

We support the principle of a more financially resilient energy supply market and understand the importance of a regulatory framework, whereby an appropriate level of financial adequacy is required to obtain a supply licence; however, it is also important that regulation facilitates a transition that aligns with the operational business plans of existing suppliers and navigates the potential challenges that regulation could have on distorting the ability to compete. This will ensure that the risk of further market failure is mitigated, and in turn would prevent further significant mutualisation costs being passed on to consumers when energy bills are at record highs.

As a result, it is important that any regulation provides a gradual increase in requirements for the level of capital, cash, effective hedging, and governance over several years.

As a small supplier in the market the impact of the proposals put forward in this consultation will have a greater relative impact and as such we would point to examples, such as the banking sector, where the Treasury has recently supported plans to establish a differentiation between large and small institutions in relation to ringfencing requirements. We would propose that a similar methodology is employed for energy suppliers.

We would also like to highlight that the level of information required within the Annual Self-Adequacy Assessment (detailed in Appendix 2) needs to be proportionate to the size of the business and should remained focussed on the deliverables of financial adequacy. We hold concerns that this self-assessment process could create wider inefficiencies in practice, leading to an increase in our cost base.

We also note the background to this consultation including an “avalanche” of recent information requests. Whilst we understand this in the context of the fallout in relation to the energy crisis, information gathering and the process of ensuring supplier compliance with the FRP must be balanced.

We also believe that all measures should be considered on an individual case by case basis as all suppliers will have different investment profiles. We welcome a bi-lateral discussion on this basis.

Our response to the questions outlined in the consultation can be found below:

Question 1: Do you agree with our package of proposals and overall approach?

We appreciate the use of reasonable short-term targets for domestic suppliers to achieve long term capital adequacy. Without suppliers being accountable for these short-term targets, the changes to capital adequacy arguably lack teeth and risk further supplier failures with avoidable mutualisation costs being passed on to other suppliers and customers during a cost-of-living crisis; that said we are mindful that proposals need to ensure that a level playing field is maintained between large and small suppliers.

We generally support such measures that restrict non-essential payments although they could make the rescue of failing suppliers by competitors or other investors more challenging, leading to more suppliers entering into the Supplier of Last Resort mechanism. We saw comparable measures introduced with government backed COVID loan schemes and we consider them proportionate insofar as they allow us to continue to operate as part of the wider Ecotricity Group.

For RO protection, we are concerned that a minimum credit reference to allow certain suppliers to use capital and liquidity free options (like parent company guarantees) will put smaller suppliers at a competitive disadvantage against larger suppliers. We point to recent Treasury support in the banking sector, to provide a differentiation in ringfencing procedures for large and small institutions. We strongly suggest that the same mechanism is adopted for small energy suppliers (below 500,000-meter points).

The exclusion or deferral of measures that require ringfencing of CCBs will have a helpful impact on working capital of suppliers although protections against the appropriation of CCBs will have to come from the other strengthening financial resilience measures, licence conditions and improved corporate governance in the sector.

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Question 2: Do you agree with our proposal to enhance the FRP to require suppliers to ensure there is no significant risk that liabilities cannot be met as they fall due?

Whilst in principle we agree, we do believe that FRP should be proportionate to the risk of each supplier on an individual case by case basis – we would welcome a bilateral discussion on this.

If a Group owns quality assets (for example generation) that should be considered as an alternative to a capital requirement. As any capital requirement for Ecotricity would directly, and adversely, impact our core mission to invest in sources of renewable energy which plays a part in the pathway to net zero.

The suggestion that each supplier should be required to present a bi-lateral action plan for how they plan to achieve the required levels of capital by March 2025 is sensible subject to getting the administrative balance right.

The definition of capital as net assets is broad but welcomed, and we agree it should be calculated net of long-term liabilities. It will incorporate the main risks associated with trading in difficult market circumstances incorporating provisions for bad debts in the calculation. We caution against any thinking that investors with "skin in the game" will improve customer outcomes as this has not worked historically to prevent supplier failures.

Given the level of intervention from Ofgem since the start of the energy crisis we would suggest a simple monitoring process to demonstrate that suppliers are meeting the staging posts using typical UKGAAP or IFRS standards for net assets to minimise the administrative burden.

We request further clarity from Ofgem on the use of enforcement and other powers to secure compliance with the FRP. We note that the proposal requires significant ongoing monitoring and processing, we would stress the need to make this work as efficiently as possible for suppliers with a reasonable level of information gathering proportionate to the deemed risk level of the supplier.

Question 3: Do you agree with our proposed approach to FRP reporting, including Trigger Points and annual self-assessment reporting?

Implementation of proactive reporting by suppliers around Trigger Points and annual self-assessment is fair and proportionate if reasonably defined. Some of the triggers identified in 2.28 are operational – it is important that triggers are set at the right level of risk and impact in the definition of what is "significant".

We do not agree with the suggestion that Trigger Points should be reportable if they are not expected to impact minimum capital requirements or an ability to ringfence.

Question 4: Do you agree with our proposal regarding the notification and monitoring approach for reliance on CCBs – including the proposed 50% of total assets threshold – or would it be more beneficial to set a prescriptive maximum reliance on CCBs?

We agree that trigger-based monitoring of CCBs should be limited to domestic CCBs but in our opinion, the test should be based on liquid assets if it is to be of value to customers in a scenario other than an administration process. In our view, reporting if domestic CCBs fall below 50% of total assets is too arbitrary and involves potential for a mismatch of long-term assets and short-term liabilities.

A recognition that the ongoing self-assessment obligation pushes the compliance burden onto the supplier, this should be accompanied by a relaxation by Ofgem of information requests, which are challenging to resource and of limited value to suppliers and detrimental to competitive markets.

Question 5: Do you agree with our approach requiring notification by suppliers ahead of non-essential payments when in breach of the FRP, and regarding the ability to direct hard ringfencing of CCBs?

We agree with this proposal where it reduces any asset stripping away from the regulated supplier, and/or supports non-essential activities related to the supply licence that prevent the company from complying with the licence conditions. It should be noted that some suppliers are part of wider Groups and may need greater operational flexibility.

Question 6: Do you agree with our proposed approach to the minimum capital requirement, including our proposed longer-term trajectory as well as our transition minimum capital requirement for 2025? What is your view on our proposed range for the 2025 minimum capital requirement amount?

We understand that Ofgem has a difficult balance to strike. As such we support the objective of setting a shorter-term minimum capital target by the end of March 2025. We broadly agree with your assessment in 3.33 that the 2-year transition period should allow most efficient suppliers to improve their capital position by then, however would highlight that continued market volatility and geopolitical events could create further challenges. As mentioned in our answer to question 2, assets should be considered as an alternative to capital to prevent detrimental impact on investment in renewable energy.

Question 7: Do you agree with our proposed approach of setting the minimum capital requirement on a per-customer basis, or do you have a preference for a volumetric approach? In the case you prefer volumetric approach, what calculation method is most appropriate?

The use of a per-customer basis is novel in comparison with minimum capital requirements that apply to other regulated industries like Banking.

On balance we are supportive as it is pragmatic - easy to calculate, will require lower comparable levels of capital in comparison with alternatives and should help reduce compliance costs. Your proposal also helps navigate the industry standard model where suppliers have domestic and business customers.

Question 8: We set out a range of issues that may need to be considered in the future as we ratchet up the minimum capital requirement, including differences between tariff types and payment types. Do you agree with our proposal to consider these in future consultation, and to treat all tariff and payment types the same in our first minimum capital requirement? Do you have suggestions on how best to reflect the different drivers in the range of competitive tariffs versus SVT tariffs? Are there other elements that you think would be a significant driver of differences in capital needs across tariff offerings that we should consider?

We agree that the focus for now should be on Pillar 1, not Pillar 2. Stabilisation of the sector, the protection of customers and a move away from fossil fuels to more sustainable sources of generation should be the short-term priorities.

Regarding the hallmarks of enhanced FRP SLC set out in 2.15 – broader, more proactive reporting, and enhanced modelling all comes with additional costs for suppliers. If phase 1 has been successful, it is questionable that this will be needed given the extra costs to suppliers and consequently customers. It is important that Ofgem get the balance right in time.

Question 9a: What is your view on our proposed approach to considering alternative sources of funding?

We welcome the flexibility that alternative sources of funding would provide. Inter-company credit or parent company guarantees would allow most flexibility and recognise that most groups operate cash pooling arrangements outside the main supplier entity.

Clearly, the defined criteria will be vital to get the balance right to ensure that the measure provides adequate protection through capital and or liquidity in the guarantor in the event of failure or an exceptional demand for repayment of CCBs in the normal course of business without being overly burdensome.

Question 9b: Do you agree that suppliers should protect 100% of their RO (attributable to domestic supply) from the 2023/24 scheme year onwards on a backwards-facing basis? If not, what do you consider to be the optimal implementation period, and why?

Whilst we support this measure, we believe that this will place significant stress on some suppliers with the potential for more failures. Recognition that the biggest impacts of supplier failures have been with Bulb and other large suppliers, we strongly advise that OFGEM implement a risk-based approach that recognises the important role smaller suppliers have to innovate and drive competition by allowing them a reduced ringfencing requirement. As detailed above we would point to the approach taken in the banking sector, whereby there is a clear differentiation between large and small institutions.

Question 10: How, and to what extent, might our proposals for RO ringfencing impact the way in which your company interacts with other Government schemes?

It is too early to say, but clearly any need to cash back ROs before buy out will reduce available short-term funds for other purposes. We would say that the greatest impact won't be on other government scheme but will be on our payment methods (to accelerate cash collection) and on investment decisions, such as investment in new diversified renewable generation capacity and customer experience innovations around flexibility.

Question 11: Would you envisage ringfencing your RO using a Protection Mechanism, protecting ROCs, or using a mixture of the two?

We buy ROs during the year, with the balance at buy-out. We have been in the industry for 27 years and have undertaken this successfully since the implementation of the RO scheme. It is possible that the proportion of ROs purchased in the year will increase with any change in the licence conditions.

In respect of the protections for the buy-out amount, our preference would be protection is provided by our parent company in the form of a guarantee.

It should be noted that the parent company does not have an external credit rating as we are a founder-owned business, and it has never been needed for any business purpose. An external credit rating should not be a requirement to demonstrate the adequacy of a parent company guarantee as it adds extra costs for us and puts us and other smaller suppliers at a competitive disadvantage with larger publicly owned suppliers.

Question 12: Do you agree that the proposed price cap allowance is appropriate to account for the costs that an efficient supplier might incur in ringfencing their RO receipts? (See appendix 1)

We expect that the costs of a supplier entering a financial guarantee should be included in the calculation of operating costs under the revised price cap calculation. Our concern is that smaller suppliers will be subject to higher operating costs than investment grade suppliers who are able to benefit from parental company guarantees.

Ecotricity Team