So Energy's response to Ofgem's "Supplier Licensing Review: Ongoing requirements and exit arrangements" consultation

Background

So Energy supplies great value 100% renewable electricity and gas to homes across England, Wales and Scotland. We offer only one fixed tariff at any time and are committed to keeping that tariff within the cheapest 10% of all available tariffs in the market. We're the only renewable energy supplier that allows our customers to vote on where we source our electricity.

We have consistently been recognised by our customers and the wider industry for our outstanding service since we were started in 2015. We were the number one energy supplier five quarters in a row from Q3 2017 in the Citizens Advice supplier performance rankings and are currently second out of 40 suppliers, and are the second ranked supplier in Which?'s 2019 customer satisfaction survey.

By continually improving our operational excellence to ensure a great customer experience coupled with a low cost to serve, as well as through our close ties to the wholesale markets, So Energy has developed a strong business model within the domestic energy supply sector. We have been able to lead industry customer service levels at the same time as achieving profitability. This is in light of a highly competitive market where we have observed many suppliers pricing too aggressively and in a financial unsustainable way. So Energy has clearly shown that it can provide great service and low cost energy supply, with a track record of financial responsibility.

Executive Summary

So Energy welcomes Ofgem's comprehensive review of supplier licensing and appreciates the opportunity to respond to this consultation.

As a relatively new supplier that maintains industry leading standards on customer service and full focus on ensuring financial sustainability, we wholeheartedly support Ofgem's work to date on supplier licensing. It is essential that standards are raised across the industry to ensure that customers are properly protected and suppliers are stable, which in turn ensures trust is maintained in the energy supply market.

Broadly, we support the majority of Ofgem's proposals in this consultation, however we believe some proposals should go further. We also believe that more detail is needed in some areas before we can make definitive judgments on some of the specific policy proposals. We have answered each question in the subsequent sections, but our top line views can be summarised as follows:

- With a business model based on providing great customer service and low-cost energy, So Energy supports Ofgem's aim of ensuring appropriate protections are in place against financial instability and poor customer service in the energy market.
- The framework that Ofgem has laid out in the form of milestones, fit and proper requirements, living wills and independent audits will ensure that all of the aims of the review are met.
- Whilst we agree with the majority of the outputs of the impact assessment, we do not support the cost mutualisation proposals. We believe that the assessment significantly underestimates the financial and administrative burden it will place on the industry and the cost to consumers, whilst overestimating the benefits.
- The proposals at present would leave suppliers with unnecessarily large amounts of unused capital that could otherwise be used to invest in providing a better offer to customers.
- The proposals would disproportionally affect smaller suppliers who are trying to grow and develop, whilst the burden would be less onerous for larger suppliers who have a lower Cost of Capital.
- Instead, we believe that Ofgem should focus on the other suggested proposals and consider going further by rolling these into a single programme of regular audits; requiring suppliers to demonstrate their financial and operational capabilities to the regulator.

We look forward to further engagement with Ofgem and the wider industry on supplier licensing over the coming months.

Response to consultation questions

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?

Ofgem is seeking to ensure that 'suppliers have effective risk management processes in place, maintain appropriate governance and increase accountability, and that our market oversight is increased'. To do this, we believe the framework that Ofgem has laid out in the form of milestones, fit and proper requirements, living wills and independent audits will ensure that all of these aims are met.

We do not, however, support the proposals around cost mutualisation. This reform will result in an 'undue burden on new entrants,' something Ofgem explicitly seeks to avoid, and will unnecessarily increase the cost of consumer bills, something that has not been appropriately factored into Ofgem's impact assessment.

We do not believe there are other actions that Ofgem should take outside the proposed package. Ofgem should focus on ensuring suppliers have the governance and processes in place to manage their customers' experience and their own financial commitments. This will be achieved by the appropriate implementation of the proposals we have supported, and in some instances going further.

Question 2: Do you agree with the outputs of our impact assessment?

Whilst we agree with the majority of the outputs of the impact assessment, we do not support the cost mutualisation proposals. We believe that the impact assessment significantly underestimates the financial and administrative burden it will place on the industry and thereby increase cost for consumers, whilst the assessment overestimates the benefits.

Question 3: What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?

The average credit balance for a So Energy customer towards the end of Summer is approximately £180. Based on this, So Energy would be required to provision 50% (£90) of this sum in order to maintain the same level of working capital, and therefore financial stability. Based on an industry assessment[1] of the cost capital around 10%, this would add around £9 additional financing per customer that we would need in order to deliver this option.

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.

We disagree with the assumptions used to calculate the costs and the benefits in the impact assessment for the cost mutualisation protection proposal.

Our view is that the impact assessment does not reflect the fact that suppliers would need to seek additional financing to maintain the same level of financial stability. Any of the delivery options (PCG, third party guarantee, Escrow account) would translate into a significant financial cost to suppliers and would therefore be reflected in customer bills. It would leave suppliers with large amounts of unused capital that could otherwise be invested back into the business in order to grow and improve our offer to customers.

The cost mutualisation proposal will disproportionally affect smaller suppliers like So Energy, who are trying to provide better service and value to consumers, whilst the burden would be less onerous for larger suppliers who have a lower Cost of Capital, and easier access to centralised credit in the form of Parent Company Guarantees.

[1] https://assets.publishing.service.gov.uk/media/54edfe9340f0b6142a000001/Cost_of_capital.pdf. This assessment was juts for the Big six and therefore provides a lower cost of capital than would be achievable for smaller suppliers.

We do not believe that the 0.5% credit guarantor fee indication that Ofgem received is achievable or realistic for suppliers. For smaller suppliers like So Energy, the only viable option to maintain the same level of financial stability would be to place cash into an Escrow account and seek additional financing of an equivalent sum at a significantly higher cost than the 0.5% suggested fee. Industry estimates for the the Big Six suppliers cost of capital are around 10%. For smaller suppliers like So Energy, this will be materially higher. The cost assessment should therefore be reviewed to factor these costs into the analysis, based on customer credit balances, based on sectoral data Ofgem has previously used.

With regard to Supplier of Last Resort (SoLR) instances, we believe the assessment over-estimates the number of these future events, as well as the impact of them. The recent introduction of Ofgem's enhanced entry requirements will minimise the chances of unstable new suppliers entering the market. With the less stable medium-sized suppliers having already exited the market it is more likely that those suppliers that default in future will be relatively small. The benefits of the assessment are therefore over-estimated.

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.

We do not agree with the proposed option of cost mutualisation protections. To build on the concerns we raised about the impact assessment, the cost mutualisation proposal also fails to take into account the business model of numerous suppliers already within the market.

Many suppliers have existing, long-term (3-5 year) wholesale trading arrangements in place in order to procure energy on a forward basis that help to ensure suppliers financial stability and solvency through adequate levels of cash in the business. As many suppliers are already implicitly meeting these commitments, the introduction of cost mutualisation is likely to directly conflict with these arrangements. The proposals put forward here would therefore result in additional costs and capital requirements for prudently run suppliers who currently have appropriate financial strength and controls.

It should be further noted that this will also impact competition as new entrants and smaller suppliers will find it harder to access additional capital, and at a higher cost than the larger, more established suppliers.

The implementation of impact and milestone assessments, ongoing fit and proper requirements, living wills and independent audits would represent a significant and effective raft of reforms. These would address Ofgem's objective of raising standards around financial resilience and customer service.

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?

We support the introduction of new milestone assessments for suppliers.

As a relatively new entrant into the energy supplier market, additional measures would likely apply to So Energy more so than other, more established suppliers. However, we fundamentally support the principle that as suppliers grow and develop, customer service particularly should not be affected. As a supplier that prides itself on great customer service, we strongly believe that as we continue to grow, we will always prioritise customer service above all else and would stand up to any additional scrutiny from the regulator.

We also believe that new milestone assessments should include greater clarity at an early stage and require that suppliers are able to clearly demonstrate their financial strategy, specifically relating to hedging policy, trading relationships and tariff pricing policy. This will ensure that growing suppliers have the knowledge and capability to manage their growing financial and wholesale energy commitments.

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?

We agree with the proposal.

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?

It is worth noting that these proposals would lead to a greater level of administration for suppliers, requiring us to engage with a number of third parties to access the necessary information.

The proposed timeframe of one to two months would therefore not be adequate, with a longer period of at least three months being more appropriate.

Question 9: Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.

Whilst we support the principle of suppliers undergoing audits and assessments to ensure they are operating responsibility, both from a financial perspective as well as with regards to service they provide for customers, the measures as currently proposed are unnecessarily complicated.

We would, instead of these different strands, propose they are rolled into a single programme of regular audits that suppliers would have to undergo via a regular set of reports sent to Ofgem, demonstrating a supplier's financial stability.

We believe this would achieve the objectives Ofgem is looking to address in both the proposed measures of milestone assessments and independent audits, ensuring robust oversight from the regulator, whilst minimising the administrative burden for suppliers. We would welcome the chance to explore this proposal with Ofgem further.

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?

So Energy is supportive of the measures proposed.

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?

So Energy is supportive of the measures proposed.

Question 12: Do you think our draft supply licence conditions reflect policy intent?

As mentioned in the introduction, we are supportive of the new proposals, except with regard to the cost mutualisation protections, and are therefore broadly supportive of the proposed supply licence conditions. However, we look forward to making further comments when more details on the proposals are made available in the statutory consultation.