Department for Business, Energy & Industrial Strategy

ofgem
Making a positive difference for energy consumers

Addressing supplier payment default under the Renewables Obligation (RO)

Summary of consultation responses

April 2022

Any enquiries regarding this publication should be sent to us at: RO@beis.gov.uk

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Introduction

A joint public consultation by BEIS and Ofgem on addressing supplier payment default under the Renewables Obligation (RO) ran from 10 August to 9 November 2021. Within this consultation, a range of options were presented to address the issue, outlining some of the main approaches available for lowering both the risk and the extent of payment default, whilst identifying some of the likely benefits and risks associated with each option.

These approaches were as follows:

- **Option 1: A legislative requirement for suppliers to settle their RO more frequently to lower the amount that they can default on.** This considered both a monthly and a quarterly arrangement and also considered the case for compressed settlement timeframes, i.e., shorter than the existing 7-month settlement period that follows each obligation year;
- **Option 2: A licence-based requirement for suppliers to protect their accruing obligation against the risk of default**. Under this arrangement, suppliers would be given the choice of which protection measure to put in place. Should a supplier exit the market or fail to put additional protections in place when required to do so, any existing protection measures would be put towards settling that supplier's obligation; and
- **Option 3: Continuing with existing policy.** Allowing the recently introduced legislative changes (i.e. the raising of the mutualisation threshold) and license changes (i.e. those which aim to increase supplier standards of financial resilience) to take effect.

With reference to addressing the issue of supplier payment default, the consultation also asked for views on switching the RO to a Fixed Price Certificate (FPC) based system, something the 2011 Government of the day said would happen from 2027.

Why we consulted

Electricity supplier payment default under the RO support scheme has emerged in recent years. The scheme features a mutualisation mechanism which requires all suppliers who met their obligation to make additional payments to cover the shortfall from defaulting suppliers, once the total shortfall exceeds a threshold. Government recently legislated[1] to increase the level of the mutualisation threshold (England and Wales only), fixing it at 1% of the value of the scheme's cost. This makes it harder

[1] Renewables Obligation (Amendment) Order 2021 (SI 2021/415).

for mutualisation to be triggered, but it does not address the underlying causes of payment default.

The consultation was prepared jointly between the energy regulator, Ofgem, and BEIS, focusing on supplier payment default under the RO. It considered the main options available for addressing it, through both legislation and the electricity supply licence, and qualitatively addressed the likely impacts of each. It sought the views of stakeholders on these options and their preferred way of proceeding.

40 responses were received. A detailed summary of the responses is in the section below titled ‘A summary of responses’.

Our response to the consultation

BEIS and Ofgem are grateful to all those who submitted their views as part of this consultation. Upon consideration of the responses, industry have made it clear that there are a wide range of differing views on how best to address supplier payment default under the RO.

Responses to the consultation were mixed and whilst they indicate a preference for addressing supplier payment default through a version of Option 1, the detail provided in some cases explained that moving to more frequent settlement would have a negative effect on some supplier’s business. Furthermore, whilst some suppliers highlighted the positive impacts of more frequent settlement, others showed support for Ofgem introducing a licence-based requirement or introducing a combination of a legislative and licenced-based approach. Finally, there was also support for continuing with existing policy.

In addition to this, since consulting on the issue in August 2021, the energy market has changed significantly, with many suppliers exiting the market following a spike in gas prices, which made continuing to operate unviable for many energy suppliers.

As the market has changed so much in recent months, BEIS need to take some time to consider the wide range of complex issues affecting the market and establish how to productively address them whilst making schemes like the RO a better fit for today’s market.

The change in the market, as well as a wide ranging mix of views and in some places unclear steers from stakeholders, means BEIS does not think introducing a legislative requirement in the short-term to move to more frequent settlement is the right approach. Instead, BEIS will come back to industry later this year to gather more evidence to further develop policy thinking around the RO in a way that not only supports industry and the consumers that it serves but delivers against our Net Zero targets.

Additionally, BEIS and Ofgem will continue to work on improving supplier financial resilience, feeding into an updated Retail Market Strategy.

Short term interventions

Following a year-on-year trigger of mutualisation since 2017/18, BEIS and Ofgem listened to stakeholder requests and adapted both the way in which the RO is run and the licence conditions under which suppliers must operate.

To address stakeholder concerns, BEIS and Ofgem have taken a two-sided approach:

- In March 2021[2], BEIS amended the RO for England and Wales, changing the mutualisation threshold from a fixed level of £15.4m to 1% of the RO scheme's cost. This means that for the 2021/22-year, mutualisation will only be triggered once supplier payment defaults reach £64m rather than £15.4m;
- Ofgem published its decision on the Supplier Licensing Review (SLR) in November 2020[3]. The changes are designed to strengthen the regulatory regime, drive up standards among energy suppliers and minimise industry and consumer exposure to financial risks and poor customer service. The Financial Responsibility Principle (FRP) introduced under the package is a principles-based requirement for suppliers to make sure that they are managing their finances effectively and actively managing the risk of leaving costs to be mutualised in the event of their failure.

The changes to the mutualisation arrangements have not had the chance to take full effect yet, with the mutualisation threshold amendment only taking effect from 1 April 2021. It should be noted however that had the mutualisation threshold always been 1% of the scheme's cost, mutualisation would only have occurred twice, for 2018/19 and 2020/21.

The SLR measures were introduced by Ofgem in January 2021 to lower the likelihood of suppliers defaulting on their obligations by preventing those operating with unsustainable business models from entering or re-entering the market. However, it was noted by Ofgem that the FRP, may not, by itself, provide certainty that suppliers have in place appropriate protections to prevent the need for cost mutualisation in the event of their failure. It is therefore important to explore the case for introducing binding conditions to further reduce the likelihood and scale of cost mutualisation.

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[2] The Renewables Obligation (Amendment) Order 2021
[3] Ofgem's Decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements

Furthermore, Ofgem published an action plan[4] on retail financial resilience in December 2021, stating that Ofgem will consult on detailed policy options tackling mutualisation risks associated with RO payments and credit balances in Spring 2022.

In addition, and with a focus on evolving the RO to fit today's market, BEIS will be issuing a call for evidence on Fixed-Price-Certificates (FPCs). Moving the RO to an FPC based system is a change that would see generators receiving more frequent payments for their certificates and as a result, more frequent payments by suppliers towards the cost of the RO. FPCs are discussed later in this document in the section titled 'long term interventions'.

BEIS acknowledge that with the recent market rationalisation, many suppliers who have now exited the market will have left an RO accruing for the 2021/22 year, risking the trigger of mutualisation once more. However, BEIS are of the view that moving to more frequent settlements under the RO is not a quick fix and any change to do so would not have had an impact on the 2021/22 year, or likely the 2022/23 year as a legislative change of this scale can take years to take hold. BEIS and Ofgem also acknowledge that this makes business planning much harder for the remaining suppliers. That is why, in addition to the recent changes to the RO and licence conditions, BEIS and Ofgem:

- Have consulted on reducing thresholds for the Warm Homes Discount from 2022/23 and again in 2023/24;
- For the Energy Company Obligation, BEIS recently consulted on reducing thresholds, should BEIS get primary powers to enable smaller suppliers to meet their obligations without incurring disproportionate costs;
- Will implement the December 2021 action plan, to strengthen the financial resilience of suppliers so that risks are not passed on inappropriately to consumers – including reducing risks of mutualisation of RO payments and customer credit balances; and
- Will, where possible, work with administrators of exited suppliers to make claims for missed RO payments, recycling these payments back to compliant suppliers.

Long term interventions

Whilst the short-term interventions are taking effect, there are a number of longer-term considerations that Government must take into account when making any changes to the RO, such as:

[4] Ofgem's Action plan on retail financial resilience, 15 December 2021

- The potential to bring Fixed Price Certificates (FPCs) into force sooner than the previous commitment of 2027;
- The potential option to move policy costs away from electricity bills over the 2020s;
- The outcome of the Summer 2022 update to the Retail Markets Strategy (more information is in the ‘updating the retail markets strategy’ section below); and
- Considering stakeholder views on how the mutualisation amount is calculated.

Moving to an FPC based system

In the 2011 Energy White Paper[5], the Government of the day committed to moving the RO to an FPC based system in 2027 and Primary powers to enable this transition were provided in the Energy Act 2013 (EA2013). This was originally proposed to address the ROC price volatility that was expected to emerge as large generators retired from the scheme from 2027 onwards. However, once the closure of the RO was announced in 2011, there was a steep increase in the number of generators joining ahead of its closure to most new capacity in 2017. This increase has delayed the anticipated ROC price volatility, previously expected in 2027. However, there could be significant benefits to an FPC based system.

Under the envisaged FPC based system, generators would receive more frequent payments for their certificates from a newly established certificate purchasing body. In turn, this would likely require suppliers to make more frequent payments to the purchasing body.

Whilst it was not the stated intention of the FPC based system, BEIS notes that the arrangements envisaged in 2011 would deliver a scenario that is very similar to that of Option 1 of this consultation, increasing the frequency of payments by suppliers under the RO and lessening the likelihood and extent of supplier payment default.

Despite the driver behind the commitment of moving to FPCs potentially no longer being as significant, there may potentially be several benefits to moving to an FPC based system that exist in addition to the movement to more frequent settlements. As such, BEIS believe that investigating a move to FPCs would not only satisfy those who selected any of the variations presented under Option 1 but may also provide the following additional benefits:

- Providing generators with greater certainty of income and making business planning easier for suppliers by increasing settlement frequency;

[5] Planning our electric future: a white paper for secure, affordable and low-carbon energy. July 2011. https://www.gov.uk/government/publications/planning-our-electric-future-a-white-paper-for-secure-affordable-and-low-carbon-energy

- Supporting the commitment[6] to look at options to reduce electricity costs. For some options under consideration, moving to an FPC based system would make any potential move away from electricity bills significantly easier.

Moving the RO to an FPC based system is not a simple task and so BEIS need to consider the responses to this consultation, the practicalities of moving to an FPC based system, whether the Primary powers under EA2013 remain fit-for-purpose and whether this can be delivered any earlier than 2027, alongside the realities of today's market. To do this successfully, BEIS intends to publish a call for evidence later this year on moving to FPCs.

Moving policy costs away from electricity bills

As set out in the 2021 Heat and Buildings Strategy[7], current pricing of electricity and gas does not incentivise consumers to make green choices, such as switching from gas boilers to electric heat pumps. Government wants to reduce electricity costs and so will look at options to shift or rebalance energy levies and obligations (such as the RO) away from electricity over this decade.

Updating the Retail Markets Strategy

In line with the December 2021 statement from the BEIS Secretary of State[8], Government acknowledges the unprecedented increases in the levels and volatility of wholesale gas prices across the globe and how this is affecting the stability and effectiveness of our energy retail market.

BEIS are taking account of the lessons of recent months to ensure that the energy retail market is resilient, sustainable and continues to protect consumers as we move to a net zero energy system. We will therefore be working to refresh the current Energy Retail Market Strategy, aiming to publish an updated Strategy as soon as possible once the market has stabilised.

BEIS ran a call for evidence between 21 December 2021 and 16 January 2022[9], inviting views on how future Government policy can best achieve the vision set out in the retail energy market strategy published in 2021, and how the lessons from recent market developments should inform this, particularly:

- How the retail market can help achieve the best outcomes for consumers, no matter how they engage;
- How energy companies can help drive the private investment needed to achieve Net Zero; and

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[6] 2021 Heat and Buildings Strategy – Pg 21, Point 5 of the Ten Point Plan
[7] 2021 Heat and Buildings Strategy – Pg 21, Point 5 of the Ten Point Plan
[8] BEIS update, 15 December 2021
[9] Future of the energy retail market: call for evidence

- How the retail market, its underpinning regulatory framework and the energy price cap, may need to evolve to enable a lowest-cost, flexible and resilient energy system that continues to protect consumers.

BEIS are currently analysing feedback to this call for evidence and a response will be published in due course.

How mutualisation is calculated

In December 2020, BEIS consulted and subsequently linked the mutualisation threshold for the England and Wales RO to the annual cost of the scheme. At the same time as inviting stakeholder views on the mutualisation threshold, BEIS also issued a call for evidence on a revised approach to the way in which the mutualisation amount is calculated once mutualisation has been triggered[10].

The responses to this call for evidence will be considered in the round, alongside both the short and long-term interventions listed above.

Next steps

BEIS will be returning to stakeholders later this year, issuing a call for evidence on moving the RO to an FPC based system, the answers to which will form a crucial part of the next steps to addressing supplier payment default under the RO.

BEIS will consider the responses to the call for evidence on FPCs alongside those from the supplier payment default consultation and the earlier call for evidence on the way in which mutualisation is calculated. That will allow us to establish a fully informed approach to the future of the RO. It will also enable us to understand whether a move to FPCs can suitably address some of the issues raised by stakeholders whilst allowing Government to consider a potential move of policy costs away from electricity bills, ultimately benefitting suppliers, generators, and consumers alike.

Ofgem will consult on detailed policy options tackling mutualisation risks associated with RO payments and credit balances in Spring 2022.

[10] Renewables obligation: changes to mutualisation arrangements

A summary of responses

We received 40 responses to the consultation from:

- Electricity suppliers;
- Renewable electricity generators;
- Energy industry trade associations;
- ROC brokers;
- Power Purchase Agreement (PPA) off-takers;
- Consultants/advisers;
- Financiers/investors;
- Agents for micro stations in NI;
- A consumer group; and
- The Balancing Settlement Code managers.

Some respondents had an interest in more than one category. A list of respondents is at Annex A. We are grateful to all the respondents for their comments.

The responses and main points made under each of the questions are summarised below. The table for each question categorises the overall view of each respondent (e.g., those who agreed, disagreed or were unsure, or those who saw positive impacts, no difference, or adverse impacts etc). In most cases, this came from the respondent ticking the relevant box on the response form. Where responses were submitted as free text, an assessment has been made of which box they were likely to have ticked had they used the form, based on the overall theme of their comments. In most cases, it was clear what their view was. If not, they were allocated to the "Unsure/don't know" category.

Of the respondents who indicated their preference (i.e. excluding those who indicated unsure/don't know and no comment), a summary is then given of the category of response by type of respondent. This divides the respondents into the following 4 categories (no category has less than 3 respondents to prevent responses from being attributed to a specific company or organisation): those interested solely in generation; those interested in both generation and electricity supply; those interested solely in electricity supply; and those with other interests.

Text comments are then summarised and grouped according to the overall category of the response. The key themes from the responses are summarised first. Other specific points are then summarised. But in most cases, these were made by only a few respondents.

Not all respondents answered every question, and not all those that gave an overall view via the tick boxes provided comments to explain or elaborate on their position. In addition, both positive and negative comments were made by some respondents. For example, some who considered that the proposals would have a positive impact overall also recognised some adverse impacts. Some of those who saw no overall difference, or an adverse impact, also acknowledged some positive aspects.

Some respondents made comments under one question that referred to an issue covered by another question. Those comments are summarised under the question to which they most closely relate.

The majority of respondents supported action being taken to tackle supplier payment default but there was a wide range of preferred options to take that forward (see the summary in Q12). An analysis by type of respondent is difficult as some covered multiple categories. But overall, small and medium suppliers were split mainly between supporting more frequent settlement under Option 1c or the "do nothing" of Option 3; most large suppliers supported Option 1c; those who were both suppliers and generators or solely generators were spread across the board, with almost equal support for Option 1c, Option 2, a combination of Option 1 and 2, or the do nothing of Option 3. The other types of respondents were spread across option 1, a combination of Option 1 and 2, or the do nothing option.

Questions on Options 1a, 1b and 1c

Q1. How, and to what extent, would a requirement for more frequent (and therefore earlier) settlement impact any commercial arrangements you have in place for the supply/receipt of ROCs?

Summary of responses

A summary of the responses to question 1 is as follows:

Responses to Q1	Number of responses
Positive impact	6
No difference	6
Adverse impact	8
Unsure/Don't know	3
No comment	17

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q1	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	2	3	Small supplier: 1	-
No difference	2	1	Small supplier: 1 Large supplier: 2	-
Adverse impact	-	2	Small supplier: 3 Medium supplier: 1 Large supplier: 2	-

Main messages from the responses

Respondents who thought there would be positive impacts from frequent settlement saw these benefiting suppliers, generators and Ofgem. It was thought that it would reduce the risk of supplier default and failure, reduce the cost and uncertainty of mutualisation, and make the value of the recycled payments from the buy-out fund more predictable. More frequent settlement would give Ofgem an earlier indication of suppliers who might be struggling financially. For generators, it was seen that it would improve cashflow, and reduce the risk of them losing income due to suppliers collapsing before paying for the ROCs.

Some thought the arrangements would make little or no difference to them as they already made or received frequent payment for ROCs. The ability to swap buy-out payments, letters of credit and ROCs would allow those arrangements to continue.

Adverse impacts focussed on the need to renegotiate contracts if they did not currently facilitate frequent settlement. This would increase costs and suppliers would need sufficient lead-in time to complete the work. Ongoing admin costs would also increase due to the increased frequency of ROC transfer and settlement. Additional resources would be required if delays resulted in the process for two quarters being run together. Some thought it might be possible to continue with an annual payment structure but with quarterly delivery of ROCs, although that would increase ROC prices. Overall, some thought there would be a significant increase in costs. However, others thought the increase would have a minimal impact, and might be offset by the reduced risk of mutualisation. More frequent settlement could also change the economic basis for electricity supply contracts and suppliers might need to recover some of their additional costs.

The seasonality in the issue of ROCs was also noted as potentially causing problems, with ROC shortages early in the obligation year, and a surplus at the end of the year, particularly for those buying ROCs from microgenerators who are issued ROCs annually by Ofgem. There was also a risk that suppliers who currently used monthly settlement might move to quarterly settlement instead, which was seen as potentially adversely impacting cashflow for generators.

Q2. Do you foresee any difficulties in how suppliers might comply with the quarterly deadlines as set out in the Option 1a – 1c proposals and if so, can you suggest how these might be mitigated (e.g., through scheme design or by change in supplier practice)?

Summary of responses

A summary of the responses to question 2 is as follows:

Responses to Q2	Number of responses
No, do not foresee difficulties	9
Yes, foresee difficulties	14
Unsure/Don't know	1
No comment	16

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q2	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
No, do not foresee difficulties	3	3	Large supplier: 3	-
Yes, foresee difficulties	2	3	Small supplier: 5 Medium supplier: 1 Large supplier: 2	1

Main messages from the responses

To a large extent, the issues raised were similar to those raised under Q1.

Those who did not foresee difficulties thought that complying with quarterly deadlines should be straightforward for well capitalised and responsible suppliers. Suppliers operating their business in a financially responsible and sustainable manner would offset their liabilities as uniformly as possible throughout the year, either through purchase of available ROCs and/or putting funds aside to cover the cumulative liability. As a letter of credit was an irrevocable undertaking given by a bank, and provided the bank was of good standing, it was thought to offer reasonably sufficient security. It was thought suppliers could use the cash collected from customers to collateralise letters of credit or bank guarantees to give them the flexibility to purchase ROCs later on. It was noted that Option 1c would enable suppliers to manage the likely shortfall of ROCs in the early quarters and would ensure there was a continued incentive for suppliers to buy ROCs.

As highlighted in the consultation document, the most common reason cited by respondents for difficulties in complying with quarterly settlement was the seasonality of ROC supply. Whilst there was seasonality in electricity demand, it did not match the ROC cycle. There was therefore likely to be a shortage of ROCs in the first two quarters due to the time-lag in them becoming available from generation in the windier Winter/Spring months, and an excess, potentially above permitted banking levels, in Q3 and Q4. The more stringent deadlines for Option 1b would intensify this problem, with potentially only 2 months of ROCs available for the Q1 deadline and 5 months for Q2 (instead of the 3 and 6 months suggested in the consultation document). The subsequent need for cash settlement in the first two quarters would leave a bigger surplus of ROCs in Q3 and Q4. In addition, suppliers buying annual ROCs from microgenerators could have a surplus against Q4 requirements.

It was noted that the flexibility to use a letter of credit under Option 1c would help with the problem of ROC shortages but it could be costly for some suppliers to obtain them. It was also noted that shorter timescales for settlement would increase the importance of the efficient issuance of ROCs by Ofgem.

As highlighted in the Q1 responses, respondents thought that difficulties would arise due to increased admin burdens, and resultant costs, particularly due to the need to renegotiate contracts. There was also a need to allow adequate time for suppliers to make the necessary changes to contracts, and to their financing structure and working capital arrangements. It was also commented that on-going admin burdens would also be exacerbated if RO deadlines overlapped with the levelisation schedule under the Feed-in Tariffs scheme.

Respondents also thought that the removal of long-term access to RO funds used as interest-free working capital could increase the cost of capital for suppliers and cause them cashflow difficulties. That could result in supplier failure and the risk of mutualisation. However, some respondents thought that preventing suppliers from using RO funds for that purpose was a positive outcome. ROC and recycled payments owed were often unsecured liabilities and so took a lower priority in some supplier’s cash management, which could encourage risk taking. Requiring capital to be sourced on commercial terms would ensure that it reflected the underlying risk of a supplier’s business model and would improve internal governance.

One respondent commented that it was not necessarily “Interest-free” working capital. In the years that mutualisation was triggered, there was an implied cost to the market of providing the working capital to suppliers that had failed. That cost could extend beyond the RO to other socialised costs. In the years where the RO shortfall was below the mutualisation threshold, the working capital was effectively funded by generators, who lost out on recycled buy-out payments.

Other respondents thought it would make paying the buy-out price more attractive, due to lower admin costs, price certainty and removal of uncertainly over the supply of ROCs, particularly as only around 5-15% of ROCs were reportedly freely available and traded outside of Power Purchase Agreements (PPAs).

Several suggestions were put forward by respondents to deal with issues identified above. These were:

- Reduce supplier admin costs by using figures from Ofgem for the first three quarters;
- Reduce supplier admin costs by allowing suppliers to nominate a third party to submit data for them. For example, Elexon already had data used in the RO verification process, and already supplied Ofgem with Quarterly Supply volumes for levelisation under the Feed-in Tariffs scheme;
- Reduce supplier admin costs by increasing the 3-month settlement window to avoid having to renegotiated existing contracts;
- Reduce the impact on microgenerators receiving annual ROCs by increasing ROC banking levels to encourage suppliers to buy ROCs from microgenerators, or to not require a substantial price discount to do so;
- Require suppliers to operate client accounts so that money owed to generators could not be used as free working capital to subsidise a loss-making trading activity. Coupling that with monthly settlement would ensure generators received the money as quickly as possible;
- Allow parent company guarantees (PCG), third party guarantees or funds in escrow as well as letters of credit as they would be cheaper options. However, it was noted that a PCG was only as good as the strength of the parent company, and Ofgem would need to critically examine guarantees before accepting them.

Q3. How, and to what extent, might more frequent/earlier settlement impact the operating costs of your business?

Summary of responses

A summary of the responses to question 3 is as follows:

Responses to Q3	Number of responses
Positive impact	4
No difference	9
Adverse impact	11
Unsure/Don't know	2
No comment	14

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q3	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	2	1	Small supplier: 1	-
No difference	2	3	Large supplier: 3	1
Adverse impact	1	2	Small supplier: 5 Medium supplier: 1 Large supplier: 2	-

Main messages from the responses

The issues raised were similar to those raised under Q1 and Q2.

Respondents saw the key positive impact as being for generators through improved cashflow (both from more frequent payment for ROCs and quicker receipt of recycled payments which would not be delayed due to the lengthy mutualisation process), and reduced risk of failed suppliers not paying for contracted ROCs. The reduced risk of mutualisation also would mean generators would not lose the buy-out payments when the mutualisation threshold was not breached. For suppliers, they thought that the risk of mutualisation would be significantly reduced. That would reduce supplier costs (although only marginally for some) because the full cost of mutualisation cannot always be recovered from customers due to fixed term contracts for which rates were set and agreed in advance. Respondents also thought that reduced supplier default would reduce the risk of missing mutualisation payments that occur when a supplier with a mutualisation bill fails. Supplier of last resort payments would also be lower. Some respondents thought Ofgem could benefit from reduced costs for compliance, mutualisation and enforcement. They thought that would allow Ofgem to direct greater attention towards other activities, such as monitoring and early intervention.

Some respondents thought the proposals would make no difference as no changes were needed to their current processes or operating models (e.g., as ROCs were currently traded monthly, even if delivery was only on an annual basis). For some, although there would be a slight increase in costs, this would not be significant, particularly if settlement was quarterly rather than monthly, and there was sufficient flexibility in the design of the proposals.

The comments on adverse impacts focussed on increased admin and operating costs for suppliers, through having to settle more frequently, and through the reduced availability of free RO working capital. It was felt that the loss of working capital could result in more suppliers going into default. Some were concerned that having to pay for credit or guarantees would adversely affect suppliers who currently operated in good faith. This increase in costs would be passed onto consumers. Generators could also be affected by an increased admin burden due to renegotiating contracts and having to make more frequent settlements. Others acknowledged the increase in costs but thought that it would be minimal or outweighed by the benefits.

Some thought ROC prices could become more volatile, affecting both suppliers and generators. Others thought that adverse impacts on ROC market liquidity could be avoided by the flexibility of Option 1c to submit cash or letters of credit in earlier settlement periods and to exchange those payments for ROCs in subsequent periods. The need to allow parental company guarantees was also mentioned.

It was also pointed out that Ofgem would hold recycling funds throughout the year, and that the interest earned on that money should be passed back to suppliers, either directly or via reduced administration charges.

Q4. How, and to what extent, might more frequent/earlier settlement impact competition in the supply sector?

Summary of responses

A summary of the responses to question 4 is as follows:

Responses to Q4	Number of responses
Positive impact	12
No difference	4
Adverse impact	6
Unsure/Don't know	1
No comment	17

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q4	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	3	3	Small supplier: 3 Large supplier: 3	-
No difference	1	2	-	1
Adverse impact	-	-	Small supplier: 3 Large supplier: 2	1

Main messages from the responses

The positive impacts of more frequent settlement for competition centred around the benefits of preventing suppliers from relying on RO funds as interest-free working capital. It was thought that the number of suppliers had been artificially high because reliance on RO funds allowed unsustainable business models that underestimated true costs and allowed deficits to be covered for some time. They thought that distorted the market and penalised prudent suppliers, requiring them, and their customers, to pay the costs of failed under-capitalised suppliers with no resources to pay their annual obligation. Shortening access to RO funds could create a fairer, more sustainable, and competitive supply market. Suppliers who experienced financial difficulty from quarterly settlement were thought likely to already be at greater risk of insolvency due to their unsustainable business models.

The comment was made that encouraging more sustainable business models could reduce the likelihood of consumers being adversely affected by the Supplier of Last Resort process, through being moved to a more expensive tariff under the new supplier. Respondents thought that the reduced risk of mutualisation could also result in cheaper consumer tariffs as responsible suppliers currently priced in the risk of mutualisation costs. With a reduction in that risk, the risk premium could be replaced by the equivalent fixed costs of buy-out payments or credit cost, which would be easier to predict. They thought that was likely to reduce tariffs and support more sustainable competition. Suppliers could also have more funds available to put towards new or improved consumer tariffs etc or to focus on other issues, such as investing in smarter and more flexible systems to complement the smart metering roll-out, and the implementation of market-wide half hourly settlement.

Some thought the changes would make no difference to competition and would cause least disruption to the operation of the RO market, preserving liquidity whilst giving confidence throughout the year that suppliers would meet their obligation.

Respondents who thought there would be adverse impacts thought it would be harder for new suppliers to enter the market as they would have less free working capital available, and consequently higher costs. Not all would be able to obtain letters of credit or keep funds in escrow accounts. Some thought more frequent settlement could favour larger suppliers. The resultant reduction in suppliers would result in less competition, and less consumer choice.

Q5. How, and to what extent, would the abolition of late payments impact your business?

Summary of responses

A summary of the responses to question 5 is as follows:

Responses to Q5	Number of responses
Positive impact	15
No difference	6
Adverse impact	2
Unsure/Don't know	2
No comment	15

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q5	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	3	6	Small supplier: 4 Large supplier: 2	-
No difference	-	-	Small supplier: 4 Large supplier: 2	-
Adverse impact	-	1	Large supplier: 1	-

Main messages from the responses

The respondents thought that the key positive impact from the abolition of late payments was the removal of a delay to recycling the buy-out fund, which would improve cashflows for generators. Both generators and suppliers would benefit from reduced admin costs of dealing with the payments. It was thought that this would also remove uncertainty and bring forward the point when Ofgem and the market was aware of supplier failure. Ofgem had previously indicated that it was unable to commence enforcement proceedings until the late payment period had concluded. So, abolishing it might reduce by two months the obligation accrued by failed suppliers in the subsequent obligation year.

The low rate of interest rate charged on late payments was not seen by respondents as being a penalty. Some suppliers were thought to routinely use it simply to extend the payment period, or as a short-term loan at a low interest rate. If late payments were retained, some suggested the rate should be increase to at least 10%.

One respondent supported the abolition of the late payment period provided all other aspects of the RO scheme remain unchanged.

Those who said its abolition would make no difference to them had always complied with their obligation by the 1 September settlement deadline.

Five respondents, including some who thought there would be a positive impact from abolishing late payments, nevertheless thought there could be situations where late payment would be justified, to cater for genuine and unforeseen administrative challenges, including system outages, correcting mistakes etc. It was suggested this window should be between 1 to 2 weeks.

Q6. This consultation only considers quarterly settlement – should consideration be given to monthly settlement to further reduce sums at risk?

Summary of responses

A summary of the responses to question 6 is as follows:

Responses to Q6	Number of responses
Yes	7
No	16
Unsure/Don't know	2
No comment	15

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q6	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes	4	-	Small supplier: 1 Large supplier: 1	1
No	2	6	Small supplier: 5: Large supplier: 3	-

Main messages from the responses

Respondents who supported monthly settlement thought that it would create more stability in the market, and would reduce the risk of large-scale supplier default and mutualisation to the lowest possible level. It would prevent suppliers from using RO funds as interest free credit and it would enable Ofgem to identify and intervene earlier with suppliers at higher financial risk. They acknowledged that monthly settlement would increase operational and commercial costs for suppliers. But some thought this would be a small increase. It was pointed out that suppliers collected their funds from customers on a monthly basis, so settlement with generators should be on the same basis to reduce the risk to generators of non-payment. Suppliers already met monthly standards elsewhere in the supply sector and aligning the RO should be achievable for suppliers. However, there was some concern that Ofgem was not equipped to deal with monthly settlement.

Those who preferred quarterly settlement thought it was a proportionate response to the problem. Whilst it was likely to benefit generators, it was not thought that monthly settlement would significantly reduce the risk of default compared to quarterly settlement. But it would significantly increase administrative costs for Ofgem and suppliers, particularly small suppliers, and would introduce additional complexity, e.g., in estimating supply volumes. They thought it could also cause problems in the trading of ROCs and would exacerbate the problem of seasonality in ROC availability, the impact of which was lessened in longer settlement periods. Delays in the issue of ROCs would have a more marked effect and if supply was constrained in one month, it could cause price volatility. These problems would make it challenging to operate a coherent ROC purchasing strategy. It was suggested that monthly settlement would only be realistic if Fixed Price Certificates were introduced

It was suggested that although quarterly settlement was the preferred option at present, it should be kept under review and legislative provisions made to allow the period to be varied in future

Q7. Are there any alternative settlement models that should be considered as a way of addressing supplier payment default? Please provide details.

Summary of responses
A summary of the responses to question 7 is as follows:

Responses to Q7	Number of responses
Yes, there are alternative models	11
No, there are not	5
Unsure/Don’t know	1
No comment	23

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q7	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes, there are alternative models	3	3	Small supplier: 3 Large supplier: 1	1
No, there are not	1	2	Large supplier: 2	-

Main messages from the responses

Some of the alternative models suggested were already covered by the options in the consultation document. But some variations on those options were put forward as follows:

- A variation of Option 1c to allow parent company guarantees as an alternative form of collateral to a letter of credit;
- A combination of Option 1c and Option 2 to minimise the risk of costs arising from supplier failures. Option 1c would not provide protection until 6 months after the start of the obligation. Adding Option 2 would provide for a supplier's accrued obligation to be settled in full in the event of market exit, or failure to put protections in place when next required to do so;
- A variation of Option 2 requiring 100% credit cover, comprised of ROCs, cash or credit, based on the supplier's market share for the obligation year. At the end of the year, the supplier would fulfil their obligation through ROCs or paying the buy-out price;
- A variation of Option 2 requiring RO money collected by suppliers to be held in client accounts, and not used for trading activities.

The following alternatives to the options in the consultation document were suggested by respondents:

- Use the existing supplier settlement mechanisms provided by the Low Carbon Contracts Company (LCCC). The LCCC would be the central agency for ROC settlement and suppliers would submit buy-out payments or ROCs to them on a quarterly basis. Ofgem would deal with enforcement action, intervening in the event of compliance issues, licence breaches or wider concerns. Ofgem would also oversee the annual buy-out fund calculations, but the LCCC would distribute those payments. The advantages would be a potentially quicker implementation of changes, as settlement processes were already in place at the LCCC and could be expanded to include the RO. This would also facilitate an earlier move to fixed price certificates or allow for dual running of both commercial ROC contracts and fixed price supplier payments in the interim to 2027;

- Maintain the current system but suppliers issued with a warning by Ofgem for any late or non-payment of their obligation would be moved to quarterly or monthly settlement;
- Revoke a supplier's licence if default was not resolved within seven days;
- Give Ofgem the necessary framework in legislation to take speedy action to minimise risk across the market. Legislation should set out a defined timeline for action following payment default, up to and included revocation of the supplier's licence to stop the default payments accruing for a substantial period of time;
- Fund support for renewable electricity generation via general taxation for the remaining duration of the RO scheme;
- Require direct debit payments;
- Target measures to where the problem existed, to ensure compliance and credit lines were put in place in the business to customer sector only; and
- More effective regulation to verify a supplier's capital.

Q8. Under the Option 1c proposal, suppliers would be given the option of settling their Q1 – Q3 quarterly obligations with a standby letter of credit (LoC), conditional on them substituting it with ROCs or buy-out payments ahead of the Q4 settlement deadline.

(a) Is a LoC the most appropriate alternative to exchangeable buy-out payments, or should other measures be considered?

Summary of responses

A summary of the responses to question 8(a) is as follows:

Responses to Q8(a)	Number of responses
Yes, it is appropriate	3
Allow other measures as well as a letter of credit	10
No, it is not appropriate	6
Unsure/ don't know	4
No comment	17

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q8(a)	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes, it is appropriate	1	1	Small supplier: 1	-
Allow other measures as well as a letter of credit	1	3	Small supplier: 1 Large supplier: 4	1
No, it is not appropriate	2	-	Small supplier: 3 Medium supplier: 1	-

Main messages from the responses

Respondents who thought that letters of credit were the most appropriate alternative to exchangeable buy-out payments, and those who thought they were not, had similar concerns. It was suggested that determining the obligation to be covered by the letter of credit could be difficult. In addition, not all suppliers would be able to obtain letters of credit as cheaply as others, and some would not be able to use parent company guarantees. That could be a barrier to entry, particularly for small companies. Some highlighted the possible cashflow difficulties for suppliers due to the requirement for cash collateralisation. There were likely to be increased costs that would be passed onto customers, plus increased admin costs for Ofgem, which would reduce the buy-out fund recycled to suppliers. There was also concern that letters of credit were only as useful as the institution guaranteeing them: only those issued by high grade credit institutions should be permitted. It was suggested that the wording of the letter of credit should be as standard as possible, with no unreasonable 'demand payment terms' used. Ofgem could include (within their protection proposals) rule ISP98, which was an international set of rules governing the rights and obligations of parties under standby letters of credit produced by the International Chamber of Commerce, as that would make it palatable to most banks. Suppliers should also be allowed to spread the letter of credit across multiple facilities and/or provide more than one letter of credit. However, it was pointed out that suppliers could meet their quarterly obligation by ROCs or the buy-out price if that was a cheaper approach.

Other issues were noted that would need to be resolved. That included the detail of the substitution arrangements, the criteria for letters of credit and other guarantees, and the legal position regarding letters of credit in insolvency procedures in event of supplier failure. There was also the question of how Ofgem would validate and monitor the protections that each supplier used.

Some of the respondents put forward suggestions for alternative or additional options. Those that did so represented a range of views, including those that thought letters of credit were not appropriate, those who thought they were, and those who were unsure. Most of the suggestions focussed around giving extra flexibility by also allowing the options listed under Option 2 in the consultation document, as well as letters of credit. The supported measures were allowing parent company guarantees (PCG), other guarantees from a third party, and escrow accounts. It was noted that guarantees would need to come from institutions with an investment grade credit rating.

It was suggested that the wording of PCG should be robust, binding, and enforceable in the instance of supplier failure and, as with letters of credit, it should be as standard as possible with no unreasonable terms. A PCG might be a lower cost option for some parties (reflecting their creditworthiness). Making sure the terms were reasonable, and allowing more suppliers to use them, would reduce the costs that are ultimately passed through to customers. Any guarantors should be suitably creditworthy, e.g., a minimum investment grade credit rating, otherwise it would diminish the level of protection provided by PCGs. Whilst not all suppliers would be able to access a PCG from an investment grade parent company, this was an established method of providing robust credit support across many industries. If a rating from any of the three main credit rating agencies (Standard & Poor's, Moody's and Fitch) was allowed, as with most existing industry arrangements, it would ensure the widest possible scope.

Two other options were suggested: requiring RO funds to be held in client accounts; and allowing cash to be provided instead. One respondent was concerned about over-complicating the RO scheme and thought it might be better to switch to fixed price certificates.

(b) Does a LoC offer any benefits over exchangeable buy-out payments?

Summary of responses

A summary of the responses to question 8(b) is as follows:

Responses to Q8(b)	Number of responses
Yes, it does	3
Yes, it does, but allow other measures as well	5
No, it does not	2
Unsure/Don't know	4
No comment	26

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q8(b)	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes, it does	1	1	Small supplier: 1	-
Yes, it does, but allow other measures as well	-	2	Large supplier: 3	-
No, it does not	1	-	Small supplier: 1	-

Main messages from the responses

Respondents who supported letters of credit thought they would free-up working capital, and offer flexibility and cost efficiency over exchangeable buy-out payments.

Some suggested alternative measures as well as letters of credit. These were similar to those raised under question 8(a), and called for flexibility in the options available, including allowing parent company and third-party guarantees.

Similar concerns as for question 8a were expressed, that is, the inability of some suppliers to access such options at all, or to access them as cheaply as larger suppliers, the need for robustness in the institutions issuing letters of credit or guarantees, and the legal status of letters of credit in the event of supplier failure. It was also suggested that letters of credit should cover a rolling period, so they did not need to be re-arranged each quarter, unless called upon.

Of those who saw no benefits in letters of credit or were unsure, some preferred any type of guarantee that was robust and transparent, or the use of client accounts.

Q9. Do you agree with our assessment that a contract for the supply of ROCs does not offer sufficient assurance that a supplier's accrued obligation will be met in the event it exits the market?

Summary of responses

A summary of the responses to question 9 is as follows:

Responses to Q9	Number of responses
Agree	20
Disagree	0
Unsure/Don't know	2
No comment	18

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q9	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Agree	4	6	Small supplier: 4 Large suppliers: 4	2
Disagree	-	-	-	-

Main messages from the responses

Respondents who agreed that a contract for the supply of ROCs did not offer sufficient assurance saw several pitfalls. In some situations, the supplier might not have purchased all the contracted ROCs at the time of failure and might not be able to purchase the remaining ones. Once it entered administration, the ROC supply contract could be terminated. Any remaining ROCs would be sold into the market. A contract could also be terminated or re-negotiated for other reasons, and a supplier in difficulties could renege on a contract. The credit cover or guarantees some generators required to enter into these contracts protected the generator from supplier default to some extent but did not offer security to the wider industry if the supplier could not fulfil the contract. There was also no guarantee that the ROCs covered by the contracts would not be resold rather than submitted to Ofgem. Nor did a contract show that sufficient capital was in place to meet the supplier's obligation. The only assurance that was provided by ROCs was when they had been submitted to Ofgem during the settlement process.

One respondent who was unsure agreed there were circumstances where a ROC supply contract could be terminated, so it was not a reliable indicator in every case. But they thought that where a supplier could prove its commitment to the market through a combination of historic performance and by warranty of its directors, that would display sufficient assurance. Another respondent thought that if a ROC contract fell under a Grid Trade Master Agreement (GTMA) or European Federation of Energy Traders (EFET) standard contract, it is likely that collateral would have been posted allowing for the delivery of ROCs to still take place, especially if there was a netting agreement. If the ROC contract fell outside of a GTMA/EFET or there was no netting agreement, then a generator should not be expected to deliver ROCs for which they were unlikely to receive payment.

Q10. Do you agree with our assessment that the introduction of sub-100% compliance at the quarterly deadlines to accommodate shortages in the availability of ROCs would be an inappropriate course of action?

Summary of responses

A summary of the responses to question 10 is as follows:

Responses to Q10	Number of responses
Agree - inappropriate to pursue	19
Disagree - should pursue	3
Unsure/Don't know	1
No comment	17

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q10	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Agree - inappropriate to pursue	3	5	Small supplier: 5 Large supplier: 4	2
Disagree - should pursue	-	-	Small supplier: 2 Large supplier: 1	-

Main messages from the responses

Respondents who agreed that sub-100% compliance at the quarterly deadlines would be an inappropriate course of action thought it would put a larger amount than necessary at risk of mutualisation, would introduce further complexities (and so costs) and was not necessary in view of the flexibility offered under Option 1c.

Other comments in support of not pursuing it suggested that a supplier who was struggling to meet their quarterly obligation would be unlikely to meet their annual obligation, meaning the chance to address the developing shortfall would be missed earlier in the year. It was noted that many suppliers collect equal monthly payments from domestic customers and target maintenance of a credit balance. So it could be argued suppliers were receiving working capital. This money should be ringfenced, as suggested in Option 2, so there was no risk of default.

One respondent who supported sub-100% compliance at the quarterly deadlines thought it should be permitted within a certain relative threshold or tolerance limit per quarter. That would allow for seasonal variation in availability of ROCs over the quarter, but still prevent suppliers accruing their obligation over 12 months and increasing the risk of mutualisation. Another supported it, provided suppliers demonstrated their ROC supply pipeline e.g., with a Renewable PPA.

The respondent who was unsure did not provide comments.

Q11. If one of the Option 1 proposals were to be introduced, how much notice should be given to participants ahead of its introduction?

Summary of responses

A summary of the responses to question 11 is as follows:

Responses to Q11	Number of responses
No notice	1
As soon as possible	3
56 days	1
3 months	2
At least 6 months	3
6 - 12 months	2
12 months	1
18 months	2
Sufficient/appropriate/reasonable notice	3
No point in doing it	1
No comments	12
Said only when it should be introduced, rather than the period of notice	10

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q11	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
No notice	1	-	-	-
As soon as possible	-	-	Small supplier: 1	2
56 days	-	-	Large supplier: 1	-
3 months	-	-	Small supplier: 1 Large supplier: 1	-
At least 6 months	1	1	Small supplier: 1	-
6 - 12 months	-	1	Small supplier: 1	-
12 months	-	-	Small supplier: 1	-

18 months	-	-	Small supplier: 1 Large supplier: 1	-
Sufficient/appropriate/ reasonable notice	-	1	Small supplier: 1 Medium supplier: 1	-
No point in doing it	-	1	-	-

Main messages from the responses

The question in the consultation document did not suggest any timeframes, so a variety of responses were received, as summarised above. The table adds up to 41 as one respondent gave two answers, proposing the statutory implementation period of 56 days for Option 1c, and up to three months for Options 1a and 1b.

Most respondents wanted the changes to be brought in as soon as possible, but some recognised that it would take time to make the necessary legislative amendments. Some recognised that suppliers needed time to re-do their forecasts, change contracts, arrange banking facilities, and raise sufficient funds from customers before the first settlement window. It was pointed out that changes needed to be planned to ensure they fed through to the price cap. But thoughts varied on how long the lead-in period needed to be. Some said it should be sufficient, appropriate or should give reasonable notice without specifying how long that should be.

Most thought it was best to avoid changes mid-obligation year as that would create complexity, and suggested having the changes in place before the start of an obligation year.

One respondent commented that there was no point in introducing any changes as there was only 4-5 years to go, but did not elaborate on their comment.

Ten respondents gave only the obligation year that they would like the changes to be in force by, and four suggested both the period of notice and the year. In total, 5 suggested 2022/23, and 9 suggested 2023/24.

Questions on option 2

Q12. Should supplier payment default under the RO be addressed via the legislation, the electricity supply licence, or neither? Please explain your answer.

Summary of responses

The following table summarises the responses to question 12. It lists all the various options put forward by respondents and the number who supported each. Some gave an alternative option in addition to their preferred choice: these are shown in the second column.

Responses to Q12	Preferred option	Second choice option
Option 1 unspecified but monthly settlement	1	0
Option 1 unspecified but quarterly settlement	0	1
Option 1a - quarterly settlement	0	1
Option 1b - unspecified settlement period	1	0
Option 1c - unspecified settlement period	4	0
Option 1c - monthly settlement	1	0
Option 1c - quarterly settlement	8	0
Option 2	3	3
Option 1 unspecified with monthly settlement period & Option 2	1	0
Option 1c unspecified settlement period & Option 2	0	1
Option 1c monthly settlement & Option 2	3	0
Option 1c quarterly settlement & Option 2	4	1
Option 3 - do nothing	9	0
Early implementation of Fixed price certificates	1	0
Fund RO via taxation	1	0
Unsure/Don’t know/No comments	3	0

The following table shows the number of responses for each type of respondent for their preferred option against each category of response:

Responses to Q12	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Option 1 unspecified but monthly settlement	-	-	-	1
Option 1b - unspecified settlement period	-	-	Small supplier: 1	-
Option 1c - unspecified settlement period	1	1	Small supplier: 1 Medium supplier: 1	-
Option 1c - monthly settlement	-	-	Small supplier: 1	-
Option 1c - quarterly settlement	1	2	Small supplier: 1 Large supplier: 4	-

Option 2	2	1	-	-
Option 1 unspecified with monthly settlement period & Option 2	1	-	-	-
Option 1c monthly settlement & Option 2	2	--	Large supplier: 1	-
Option 1c quarterly settlement & Option 2	-	2	Small supplier: 1	1
Option 3 - do nothing	1	2	Small supplier: 3 Medium supplier: 2	1
Early implementation of Fixed price certificates	1	-	-	-
Fund RO via taxation	-	-	Small supplier: 1	-

Main messages from the responses

Not all respondents gave a full answer to question 12, so the above table takes account of relevant comments in the responses to all the consultation questions. In particular, the preferences for monthly or quarterly settlement take account of the responses to question 6. The following summary gives an overview of the reasons for supporting each option: the full details are given under the other questions relevant to each option.

Whilst there was an overall preference for a legislative approach, some did not indicate which of option a, b or c they preferred and/or did not indicate a settlement period. The respondent who supported Option 1a with quarterly settlement saw it as a future option if the recent changes to the mutualisation threshold and supplier licence did not have the required effect.

Those supporting Option 1c welcomed the settlement flexibility whilst keeping default to a minimum. Seven respondents wanted parent company guarantees to be allowed. Others were concern that letters of credit might distort the market. Some supported retaining a short late payment period (between 1 - 2 weeks) to allow for any unforeseen administrative challenges.

Those supporting Option 2 thought it was a simpler way to protect against default and should make it difficult for suppliers to exit the market and leave costs behind for others to pick up.

Those who supported combining Options 1c and 2 together thought it was the best way to achieve maximum protection from supplier default. It was noted that under Option 1 there would be a period at the start of the year without protection. Adding a forward-looking collateral requirement from Option 2 would provide for a supplier’s obligation to be settled in full when needed.

A variety of reasons were given for making no Changes to the RO. Some thought the recent changes to the mutualisation threshold and the supply licence conditions should be allowed time to take effect. Others said that supplier default was not caused by the RO but by rising wholesale gas and electricity costs and poor governance by suppliers. Given the extent of recent market exit, those left were more financially resilient, with a lower risk of default. Some wanted to avoid adding complexity and cost to the RO, causing disruption to suppliers' business models, and creating barriers to entry to the market. Others thought Ofgem now had sufficient powers and information at its disposal to better regulate poor supplier financial management. Some thought effort would be better spent preparing for fixed price certificates in 2027.

It was noted that quarterly settlement would ease the transition to fixed price certificates in the future. Eight respondents expressed support for fixed price certificates but the timescale for their introduction varied from straightaway, to bringing them forward to an unspecified time, or leaving them for 2027.

Five respondents supported Ofgem either making stronger use of its existing powers, including the new Financial Responsibility Principle; or being given sufficient additional powers to act decisively in the event of supplier default.

Other suggestions for action included: abolishing late payments but keeping all other as aspects of the scheme unchanged; or introducing the measures in the 2021 call for evidence to only mutualise the sum above the threshold.

Q13. How, and to what extent, might a new requirement for suppliers to protect sums at risk of mutualisation impact competition in the supply sector?

Summary of responses

A summary of the responses to question 13 is as follows:

Responses to Q13	Number of responses
Positive impact	11
No difference	3
Adverse impact	7
Unsure/Don't know	1
No comment	18

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q13	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	4	3	Small supplier: 2 Large supplier: 2	-
No difference	-	2	Large supplier: 1	-
Adverse impact	-	1	Small supplier: 4 Medium supplier: 1 Large supplier: 1	-

Main messages from the responses

The respondents thought that the positive impacts of requiring suppliers to protect sums at risk of mutualisation were similar to those expressed under Q4, and focused on the benefits of preventing suppliers from relying on RO funds as interest-free working capital. It was recognised that there would be a cost impact for those that relied on that capital, but that was offset by the wider benefits to other suppliers, generators, and consumers. It was thought it would promote more responsible and resilient business models, and support sustainable tariffs that reflected true costs and so enhanced fair competition. The reduction in the risk of mutualisation would allow financial risks to be more easily forecast and managed. Consumers with prudent suppliers would be protected from having to pay the unmet obligation of other, less robust suppliers. However, the point was made that Option 2 might not be as robust a solution as Option 1c, as the amounts would only be ring-fenced (or otherwise secured) and might be at risk under insolvency procedures in the event of supplier failure.

Respondents who thought the proposals would make no difference to competition pointed out that similar collateral requirements were already in place for the Contracts for Difference scheme, the Capacity Market, network charges etc, and that did not affect competition. In addition, although smaller suppliers might not have the same access to cheap credit as larger, established companies, they were likely to have smaller amounts requiring protection.

The adverse impacts of requiring suppliers to protect sums at risk of mutualisation focused on the barriers to market entry for small suppliers and the resultant loss of competition. It was thought the menu of options would give an advantage to large suppliers (and particularly vertically integrated companies) as they were often well-capitalised and more able to protect cash, secure letters of credit, or obtain a parent company or third-party guarantee. Smaller, challenger suppliers might not have the credit rating or capitalisation to protect their RO payments. In addition, leaving an option for ‘other’ measures, with suppliers entering bespoke arrangements, was not considered a fair or justifiable option. However, some thought the adverse impact would be short lived as new suppliers that did enter the market were more likely to be more financially robust and therefore less likely to default. In the long term, that would have a positive impact on competition. It was also thought that many suppliers who had relied on free credit had already exited the market, so the supply sector might now be more robust anyway. The suitability of parent company guarantees was also questioned as it was thought they did not offer the same level of assurance as letters of credit.

The respondent who was unsure of the impact on competition acknowledged that the measures would affect smaller suppliers, and that needed to be addressed. However, they pointed out that the business practices of those suppliers, who did not recover sufficient revenues from their customers, were the reason new measures were being considered.

Q14. Do you have a preference for a forward-looking or backward-looking approach to protecting sums at risk of mutualisation? Please explain your answer.

Summary of responses

A summary of the responses to question 14 is as follows:

Responses to Q14	Number of responses
Forward-looking approach	14
Backward-looking approach	4
Unsure/Don't know	1
No comment	21

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q14	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Forward-looking approach	4	4	Small supplier: 4 Large supplier: 2	-
Backward-looking approach	-	-	Small supplier: 2 Large supplier: 2	-

Main messages from the responses

Respondents supporting a forward-looking approach thought that it would be the best way of ensuring a suppliers' obligation could be met in full in the event of default, and therefore gave the best protection against the risk of mutualisation. A backward approach was thought to raise the risk of a proportion of a supplier's obligation being unmet. In addition, if a supplier became uncreditworthy during a protection period, they would not be able to obtain the required protection at the end of the period, and so would not be covered at the very time the company was at risk of failing. If a backward approach was used, additional measures would be needed to reduce the risk to the unprotected part of the obligation, for example by requiring higher levels of protection.

It was acknowledged that a forward-looking approach would require a forecast of supplier volumes. That would require a clear RO methodology to ensure all suppliers forecasted their quarterly requirements robustly and in the same way. It was pointed out that there was a risk that small suppliers might underestimate their forecasts to secure cheaper financing of their cover. However, it was expected that this would be apparent to Ofgem and might constitute an enforceable breach of the existing Financial Responsibility Principle.

One respondent advocated monthly upfront credit cover. That would give the greatest protection against mutualisation and would align with other processes in the supply sector, such as wholesale power and Balancing Services Use of System settlement timescales. Another respondent suggested that as soon suppliers collected RO money from customers, it should be protected. It was also suggested that a supplier's contracted ROC position and past settlement performance should be taken into consideration. It was pointed out that regardless of the approach, any form of third-party guarantee would require a full year forecast of the amount at risk, on the basis that the cover was a credit facility which was drawn upon over the obligation period rather than being re-evaluated over time.

Respondents supporting a backward-looking approach thought it would give more accurate figures and result in a lower working capital requirement, and so lower costs to consumers. Whilst it was acknowledged that it would increase the risk of mutualisation, it was thought this would be minimised if the schedules for compliance were robustly enforced. Forward-looking forecasts were seen as being difficult to do accurately as supply would be dependent on factors such as weather and customer churn. Verifying and monitoring the forecasts would also be difficult. Concern was also raised over suppliers under-forecasting to reduce the cost of their cover. One respondent acknowledged that there were some benefits in a forward-looking approach but wanted more information on how accurate the forecasts would be before considering that option in the future.

The respondent who was unsure thought that each option should be assessed in terms of the ease of implementation and the lead time required to introduce changes to the existing legislation or supplier licence.

Q15. How, and to what extent, might a new requirement for suppliers to protect sums at risk of mutualisation impact the way in which your company complies with the RO?

Summary of responses

A summary of the responses to question 15 is as follows:

Responses to Q15	Number of responses
Positive impact	3
No difference	10
Adverse impact	5
Unsure/Don't know	1
No comment	21

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q15	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	1	-	Small supplier: 1	1
No difference	2	4	Small supplier: 1 Large supplier: 3	-
Adverse impact	-	1	Small supplier: 3 Large supplier: 1	-

Main messages from the responses

The respondents who thought the requirement would have a positive impact saw it as providing increased supplier security.

The respondents who thought the requirement would not have an impact on them did not foresee any need for material change to their current practices, particularly if the arrangements allowed flexibility and gave suppliers sufficient time to purchase ROCs. Although there would be an administrative impact, the cost and resource implications were considered minimal, and far smaller than the benefits. However, one said that additional costs would need to be passed onto customers. Others were likely to make more use of continuous assessment to ensure the most beneficial or least costly method of providing cover was chosen for each protection period.

Those that said there would be adverse impact thought it would introduce new costs and would reduce suppliers' working capital. That would make compliance more difficult and would affect investment in innovation and the development of products such as smart electric vehicle tariffs. The additional costs would be passed onto consumers. However, it was recognised that reducing the mutualisation risk would enable suppliers to reduce risk premiums and would leave customers less exposed to unpredictable market costs via tariff pricing. One respondent thought the impact would be low provided a supplier's contracted ROC position was considered: if not, significant collateral would be required.

The respondent who was unsure pointed out the potential for overlap between credit lodged for the Balancing and Settlement Code and that lodged for the RO.

Q16. Are there any other methods of demonstrating compliance with a requirement to protect sums at risk of mutualisation that should be included within the 'menu' of protections?

Summary of responses

A summary of the responses to question 16 is as follows:

Responses to Q16	Number of responses
Yes, there are other methods	4
No, there are no other methods	11
Unsure/Don't know	2
No comment	23

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q16	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes, there are other methods	2	1	Small supplier: 1	-
No, there are no other methods	3	3	Small supplier: 2 Large supplier: 3	-

Main messages from the responses

Some of the alternative models suggested were already covered by the options in the consultation document. Other methods suggested were as follows:

- Letters of credit should be included in the menu of option as well as under Option 1c;
- Allow ROCs to be placed in an escrow-style holding account. Excess ROCs could be released after the full settlement of that quarter's obligation;
- Suppliers should be required to hold RO money in client accounts, and not use it for trading activities;
- Suppliers should be required to demonstrate that the money held on account to pay generators was 100% intact and not being used in trading activities that had risk; and
- Suppliers should be required to demonstrate that they continued to be fit to trade by submitting to quarterly audits of their trading activities.

The respondents who thought there were no other methods of demonstrating compliance considered that the most appropriate measures had been identified and that they covered a broad range of options. The menu was seen as important in allowing individual suppliers to select the option most suitable to them. One respondent thought collateral and guarantees were the most suitable methods, whilst another preferred parent company guarantees or letter of credit. However, one thought only a third-party guarantee (from a bank or lending company) or an escrow account provided sufficient assurances. They thought there were risks around parent company guarantees relating to a cascade of default if the parent company could not meet subsidiary debts. In addition, a ROC supply contract did not offer evidence that sufficient capital was in place to meet obligations (for the reasons set out in summary for Q9). Another respondent thought that the 'other' option was of concern as was so broad in its scope.

The respondent who was unsure did not provide comments.

Q17. How, and to what extent, might a new requirement to protect sums at risk of mutualisation impact your company's operating costs? For this question, assume that the requirement would be for an amount equivalent to 100% of a supplier's obligation to be protected, on a quarterly basis, one month after the quarter in question and remain in place until the RO settlement deadline has elapsed.

Summary of responses

A summary of the responses to question 17 is as follows:

Responses to Q17	Number of responses
Positive impact	6
No difference	7
Adverse impact	8
Unsure/Don't know	2
No comment	17

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q17	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	2	3	Small supplier: 1	-
No difference	1	2	Small supplier: 1 Large supplier: 2	1
Adverse impact	1	1	Small supplier: 4 Medium supplier: 1 Large supplier: 1	-

Main messages from the responses

Positive benefits were seen both from those who thought it would reduce their costs (e.g., due to the reduced risk of mutualisation or by reduced cost of capital) and those whose thought their costs would rise, but nevertheless saw an overall positive benefit from a more sustainable market. Others saw benefits to generators.

In terms of the ease of accessing the various options, it was thought that suppliers with a sufficient credit rating would be able to use a parent company guarantee at no additional cost. Such suppliers would also be able to obtain a letter of credit relatively quickly and easily as this was used as collateral for a range of other industry obligations. The terms for the provision of a letter of credit (with a rate typically around 0.5% per annum) would normally be made based on a total revolving facility that would be agreed at the start of the obligation period and required to cover the maximum forecast amount, with draw downs in excess of agreed amounts prohibited. It was acknowledged the cost of such a facility might vary according to the credit worthiness of the supplier. But it was thought that the use of escrow accounts was almost unheard of in the current market, and that suppliers would be unlikely to find an institution willing to undertake such an arrangement.

Those who expected no impact on their operating costs either thought their costs would not change at all or would not change significantly. This was because they either: already had measures in place to commits funds throughout the year to cover their obligation; or they would be able to put the protection in place at minimal cost; or they would not be directly involved in the arrangements.

Those who expected negative impacts thought there would be a significant increase in their admin and/or operating costs. Third-party guarantees or funds in escrow were seen as particularly expensive and would be most costly to those suppliers at risk of default. One thought it could potentially close their business. Another commented that they thought Ofgem already had sufficient oversight of suppliers' cash management (through the financial responsibility principle and the weekly data provided in supplier financial requests for information) to regulate effectively without needing the new proposals. They thought that limiting a well-run supplier's access to working capital would also reduce the scope for innovation.

Of those that were unsure, one thought the impact would depend upon whether ROCs could be settled or posted as collateral within the quarter to reduce the amount that would need to be protected via a parent company guarantee, third party guarantee or an escrow account. Another thought the amount at risk of mutualisation should reflect a supplier's contracted ROC position and hence apply only to the expected share of the buy-out fund at risk.

Q18. Can you foresee any additional issues or challenges with the Option 2 proposal, in particular the menu of options, that need to be considered?

Summary of responses

A summary of the responses to question 18 is as follows:

Responses to Q18	Number of responses
Yes, foresee additional issues	13
No, do not foresee additional issues	7
Unsure/Don't know	1
No comment	19

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q18	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Yes, foresee additional issues	3	3	Small supplier: 3 Medium supplier: 1 Large supplier: 3	-
No, do not foresee additional issues	1	3	Small supplier: 2 Large supplier: 1	-

Main messages from the responses

Those who did not foresee additional issues thought the issues and challenges had been identified and that the option 2 proposals allowed sufficient flexibility. However, the question was raised as to why parent company guarantees (PCG) were proposed under Option 2 but not under Option 1c, as they were thought to be the most cost-efficient protection method.

Those that thought there were additional issues that needed to be addressed made the following suggestions:

- The level of obligation to be protected should be 100% as anything less would allow supplier shortfalls which would be large and frequent in view of the current market;
- The level of credit rating considered acceptable to allow a supplier to use a PCG should be defined and should be investment grade;
- The financial health of the parent company should be carefully examined before a PCG was accepted. A PCG was only as strong as the parent company. For smaller suppliers, it was possible for the entire group to run into financial difficulties at or around the same time period. In that situation a PCG might be of little or no use;
- Third party guarantees (TPG) should only be accepted where the guarantor was vetted for creditworthiness and satisfied any qualifying criteria Ofgem believed necessary. As with PCG, TPG were only as robust as the third-party guarantor. A supplier might secure a ‘paper’ TPG from a guarantor that was not properly capitalised to cover the costs in the event of the supplier failure;
- Option 2 should be combined with Option 1c to ensure maximum impact. A solely licensing approach was not considered robust enough. Suppliers had left the market without paying their obligation or transferring it to a new supplier. Others had paid after the late payment deadlines. There was risk that such practices would continue under the Option 2 proposals, even with the increased frequency of requirements. Greater protection would be achieved by legislative change via Option 1, backed by simple and effective licence changes to post monthly RO credit cover. That would align with the

longer-term trajectory of fixed price certificates in post-2027, as well as place better incentives on suppliers to purchase and trade ROCs where possible to meet obligations, rather than look for more novel ways to pay the RO;

- ROCs should be permitted to be used to net off any quarterly obligation within that compliance period. Collateral (letters, cash, ROCs etc.) would be posted before the quarter began and settlement would be in line with other standard arrangements currently in place in other schemes (to account for retrospective changing flows). ROCs should be released to allow suppliers to net off any other quarters or to sell to other counterparts and avoid stranded costs being applied to customers; and
- The consequence of a breach of the requirements should be defined, with very short timescales to remedy or face loss of the supply licence.

Other points made were as follows, and some respondents wanted clarity on some of the issues before they could properly assess the proposals:

- Suppliers who had access to fewer of the options on the menu should be treated equitably;
- The measure would cause huge cash flow issues, especially for small suppliers;
- The measures would only work for suppliers that were well capitalised, had a high credit score and/or had assets to guarantee against;
- The measures were unsuitable for those most at risk of default. To date, most default had been from the smaller suppliers. But they were unlikely to be able to obtain the proposed protection measures;
- There were challenges in obtaining credit. There were competing demands for finite credit facilities due to increasing calls for collateral across the sector. Credit limits were frequently being breached. The resulting squeeze on credit not only impacted small suppliers but also much more highly capitalised suppliers;
- The measures did not address the fundamental risk of mutualisation. Instead, it balanced the risk against the creditworthiness of suppliers' guarantees, whilst the real cost exposure remained largely the same;
- It was inefficient to post cash unless there was a meaningful rate of return;
- The current scheme administrator might not be adequately resourced to make these changes and needed to be more costumer focussed and accessible to enable effective administration; and
- It was not clear how funds in escrow would work in terms of protecting against supplier default and how effective they would be. Typically, a transaction using escrow occurred with two (or more) transacting counterparties with a

third party acting as the escrow agent. The escrow agent would receive, hold, and then distribute the money amongst the transacting parties once the parties had discharged their respective obligations under the terms of the transaction (and, where applicable, consented to such a release of monies). The consultation document did not indicate who the counterparty to the supplier would be to perform obligations and/or consent to the release of the funds from the escrow (as is typical in many escrow arrangements). The proposal could potentially work if the supplier and, for example, Ofgem were the two counterparties, with a solicitor (for example) acting as the escrow-agent who could only release funds to the supplier following Ofgem's approval. Where the supplier deposits funds with the escrow agent, the latter would act in accordance with the instructions of the supplier, i.e. their client, and so would release the funds from the escrow account upon client instructions to do so. If it was being suggested that the escrow agent would only release funds upon compliance with specific terms, there needed to be clarity over who would set those terms, who would assess them for adequacy and how the mechanics would operate. Otherwise, it would appear that the supplier could withdraw the funds at will, and the risk of that happening would increase as the supplier moved towards failure.

The respondent who was unsure did not provide comments.

Q19. If one of the Option 2 proposals were to be introduced, how much notice should be given to participants ahead of introduction?

Summary of responses

A summary of the responses to question 19 is as follows:

Responses to Q19	Number of responses
No notice	1
As soon as possible	3
56 days	1
3 months	1
At least 6 months	3
12 months	2
2 years	1
3 - 5 years	1
Sufficient/appropriate/reasonable notice	4
No point in doing it	1
No comments	17

Said only when it should be introduced, rather than the period of notice	5

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q19	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
No notice	1	-	-	-
As soon as possible	1	1	-	1
56 days	-	-	Large supplier: 1	-
3 months	-	-	Small supplier: 1	-
At least 6 months	1	1	Small supplier: 1	-
12 months	-	1	Small supplier: 1	-
2 years	-		Small supplier: 1	-
3 - 5 years	-		Small supplier: 1	-
Sufficient/appropriate/ reasonable notice	1	2	Large supplier: 1	-
No point in doing it	-	1	-	-

Main messages from the responses

The question in the consultation document did not suggest any timeframes, so a variety of responses were received, as summarised above.

Most thought the changes should be in place before the start of an obligation year. Most also recognised that suppliers needed time to put the arrangements in place. But thoughts varied on how long that period needed to be. It was thought that letters of credit and parent company guarantees could be arranged relatively quickly. But placing funds into escrow quickly could create cashflow problems for some suppliers. Ofgem would also need time to amend its administrative processes.

Some said there should be sufficient notice without specifying how long that should be. One respondent commented that there was no point in introducing any changes as there was only 4-5 years to go, but did not elaborate on their comment.

Five respondents gave only the obligation year that they would like the changes to be in force by, and seven suggested both the period of notice and the year. In total, 1 suggested 2021/22, 4 suggested 2022/23, 6 suggested 2023/24, and 1 suggested 2024/25.

Questions on option 3

Q20. Do you agree or disagree that supplier payment default under the RO is a matter that warrants action beyond the recent steps that have been taken to increase the mutualisation threshold, and Ofgem's supply licence reforms? Please explain your reasoning.

Summary of responses

A summary of the responses to question 20 is as follows:

Responses to Q20	Number of responses
Agree (need further action)	28
Disagree (no action needed)	7
Unsure/Don't know	2
No comment	3

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q20	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Agree (need further action)	7	6	Small supplier: 7 Medium supplier: 1 Large supplier: 5	2
Disagree (no action needed)	1	2	Small supplier: 1 Medium supplier: 2	1

Main messages from the responses

The respondents who wanted further action were concerned that widespread supplier failure had occurred in 2021 despite the recent changes by BEIS and Ofgem. The risk of future mutualisation meant that further reform was needed to reduce the likelihood and impact of supplier default. That would make the energy market more resilient and work better for compliant suppliers, generators, and consumers.

It was thought that the current arrangements allowed suppliers to operate risky business practices which increased the likelihood of failure. Annual compliance compounded the problem by preventing early identification of suppliers unable to meet their liabilities. Suppliers were able to enter the market at relatively low cost, relying on their own customers' credit balances and RO payments to fund day-to-day operations. Such suppliers were thought to have insufficient creditworthiness, financial standing or risk management experience and oversight. When wholesale prices rose, an unhedged supplier was unable to cover their increased costs. Their unpaid obligation was then mutualised. It was thought that responsible suppliers not only had to pay that mutualisation cost, but they also lost customers to rivals who were pricing below cost because they were defaulting on their obligations. It was thought likely that mutualisation would be triggered for the fifth consecutive year for the 2021/22 period, due to the number of suppliers who had already failed during 2021.

It was noted that the RO scheme was the largest policy cost to suppliers and had the largest mutualisation risk, but it currently required no protection and was not held to the same standard as other schemes. The intention to move to Fixed Price Certificates in 2027 was also noted but it was thought that changes could not be left until then. Allowing the current arrangements to continue could be seen as giving tacit approval to suppliers to use RO money collected from consumers to meet their operational costs, despite Ofgem highlighting that this was not acceptable. It would also encourage suppliers to continue engaging in behaviours that Ofgem acknowledged had a distortive impact on competition.

It was thought that the current Ofgem supply licence reforms were designed to prevent irresponsible suppliers entering the market, and did not prevent the mutualisation of costs should an existing supplier fail. Although the Financial Responsibility Principle gave Ofgem more powers to intervene where a supplier showed risk of failure or poor financial practice, it was noted that Ofgem had acknowledged that the principle might not, by itself, provide sufficient certainty that suppliers had in place appropriate protections to prevent mutualisation in the event of their failure.

Some thought that the current process created revenue risks and cashflow uncertainty for generators and ultimately added a risk premium to their activity under the scheme. When supplier default was below the mutualisation threshold, they lost income; when it was above the threshold, they received it up to 20 months in arrears. Supplier exits resulted in increased costs for consumers, who effectively paid twice when mutualisation was triggered.

One of the respondents who was unsure whether further action was warranted had thought at the time the consultation was launched that there was a need for action. But in view of the large number of supplier failure since then, they now thought it might be beneficial to re-consider whether further action was still warranted. The other did not give an explanation for their view.

Those who supported no further changes being made at the present time generally thought that the recent changes to the mutualisation threshold and Ofgem's supply licence changes should be given time to take effect and then be evaluated before further action was considered. It was pointed out that the market was different now compared to when the consultation was launched and that those left in the market were the more financially resilient suppliers who were a lower mutualisation risk. The recent high levels of supplier default had been caused by rising wholesale gas and electricity costs and poor governance by suppliers. Those problems would not be solved by quarterly settlement and could make the situation worse, for example: through creating barriers to entry to the market due to the high up-front costs; adding additional costs to suppliers already under pressure; disrupting supplier business models; and causing problems due to the seasonality of ROC availability. Generators who currently received monthly payment for their ROCs were content with the current arrangements.

Q21. What would be the costs and benefits associated with further action aimed at addressing supplier payment default under the RO?

Main messages from the responses
26 respondents provided comments on this question.

It was widely acknowledged that Options 1 and 2 would result in an increase in administrative and compliance costs for suppliers, Ofgem and Elexon, and to a lesser extent generators and traders if suppliers required ROCs more frequently than under the current arrangements. Suppliers would lose access to the free working capital provided by customers' RO payments and could have cash tied up in an escrow account or have increased credit costs (it was suggested that could be between 1 – 9%, depending on the supplier's creditworthiness). Such increases could result in more suppliers defaulting. Respondents thought the increased costs would be passed onto consumers. One respondent suggested that Ofgem's additional admin costs (on a per ROC basis) should be included in the annual Obligation setting calculation. That would result in the additional costs being recovered from suppliers, who were best placed to bear them, rather than recovering them from the buy-out fund, which reduced the amount received by generators.

However, although noting that costs would increase under the measures, some respondents thought this would be limited for financially responsible suppliers and would be reduced further for some if parent company guarantees were permitted. Over a third of those who responded thought the increased costs would be outweighed by the reduced risk of supplier payment default and the avoided costs of mutualisation. Other benefits included the development of a more robust, stable, and sustainable supply market as the requirements would raise standards in supplier business models, and ensure only prudent, well capitalised suppliers could continue to operate. That would benefit suppliers and customers and would allow more money to be invested in delivering the best products and services for consumers. Consumers would also benefit from not having to pay for the cost of mutualisation, and so would not be paying twice for the RO. It was also thought there could be wider behavioural and cultural benefits in reducing supplier default as it could help build consumers' trust in suppliers and promote more widespread responsible behaviour in the market.

Some thought generators would benefit from early settlement and more stable cashflows, with less risk of non-payment from suppliers.

Some thought Ofgem would benefit from savings on compliance, enforcement, and the administration of the Supplier of Last Resort process.

Questions on impacts

Q22. How, and to what extent, might the Option 1 and 2 proposals, if implemented, increase RO compliance administration costs for your business?

Summary of responses

A summary of the responses to question 22 is as follows:

Responses to Q22	Number of responses
Positive impact	1
No difference	9
Adverse impact	11
Unsure/Don't know	0
No comment	19

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q22	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	-	1	-	-
No difference	4	1	Large supplier: 3	1
Adverse impact	1	3	Small supplier: 6 Large supplier: 1	-

Main messages from the responses

The respondent who saw a positive impact thought their costs would be less compared to the burden of mutualisation costs borne in recent years. There would be less need to monitor the risk of mutualisation, consider price adjustments to customers and administer additional payments. There would also be a reduced burden for suppliers required to engage with the Supplier of Last Resort process.

Of those who thought there would be no impact, some were generators. Suppliers did not expect any material impact to their administration costs because they either saw no need to change their current commercial arrangements to remain fully compliant, or the cost of any changes would be minimal. The point was made that any administration costs would be minimal for well capitalised and responsible suppliers.

Of the respondents who considered there would be an adverse impact, three said their cost would increase significantly, two saw only minimal impact, four did not specify the severity of the impact, and two considered that the additional costs were worth it for the increased stability in the scheme. Generally, the costs for suppliers would be for increased admin costs in setting up cover and more frequent settlement, as well as on-going credit costs. The impact would be worse if RO quarterly payments overlapped with quarterly levelisation under the Feed-in Tariffs scheme. Ofgem would also have increased costs. Generators and traders could be affected if suppliers presented ROCs earlier than they currently did.

Q23. How might quarterly settlement impact the income of generators who receive ROCs on an annual basis? Please explain your reasoning and explain when and how annual ROCs are traded.

Summary of responses

A summary of the responses to question 23 is as follows:

Responses to Q23	Number of responses
Positive impact	2
No difference	5
Adverse impact	2
Unsure/Don't know	7
No comment	24

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q23	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	-	1	Large supplier: 1	-
No difference	1	2	Small supplier: 2	-
Adverse impact	-	-	Small supplier: 2	-

Main messages from the responses

Many of the comments focussed on the impacts on generators generally, rather than the specific problems that may be faced by microgenerators who receive all their ROCs for the year from Ofgem in one transaction in the following June, at the earliest. The following summary therefore merges relevant comments from across the positive impact/no difference/adverse impact/unsure categories.

It was thought that the flexibility under Option 1c to make interim buy-out payments or submit letters of credit and subsequently exchange them for ROCs, would still allow annual ROCs to be used. However, quarterly settlement was likely to result in a significant increase in trading throughout the year for ROCs not under a PPA, rather than the current concentration of trading in July and August. It was likely that those with annual ROCs would be relying on a smaller pool of suppliers seeking to fulfil their obligations at that stage. It was possible that if there was a general surplus of ROCs due to increased generation, demand for ROCs could be low at the time the annual ROCs became available, resulting in a lower price. But if there was a shortage of ROCs, those with annually issued ROCs would benefit from increased demand and higher prices. There could also be problems if annual ROCs were withheld or issued late. However, it was noted that those receiving annual ROCs had the option to move to monthly issue, although there might be a small additional administrative overhead in doing that.

Q24. The territorial extent of this consultation is England and Wales (i.e. it relates to matters contained within the RO only). What impacts do you foresee on participants in the interlinked Scotland and Northern Ireland schemes (i.e. the ROS and NIRO) if any of the Option 1 or Option 2 proposals were to be implemented through the RO only?

Summary of responses

A summary of the responses to question 24(a) on the Scotland scheme is as follows:

Responses to Q24(a) - impact on Scotland scheme	Number of responses
Positive impact	0
No difference	2
Adverse impact	17
Unsure/Don’t know	6
No comment	15

The following table shows the number of responses for each type of respondent against each category of response on the Scotland scheme:

Responses to Q24(a)	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	-	-	-	-
No difference	1	1	-	-
Adverse impact	4	4	Small supplier: 3 Large supplier: 5	1

A summary of the responses to question 24(b) on the Northern Ireland scheme is as follows:

Responses to Q24(b) - impact on Northern Ireland	Number of responses
Positive impact	0
No difference	2
Adverse impact	11
Unsure/Don’t know	6
Position unclear	1
No comment	20

The following table shows the number of responses for each type of respondent against each category of response on the Northern Ireland scheme:

Responses to Q24(b)	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	-	-	-	-
No difference	1	1	-	-
Adverse impact	3	3	Small supplier: 2 Large supplier: 1	2

Main messages from the responses

Most respondents did not give separate comments on the respective impacts on the ROS and NIRO.

Those who thought there would be no difference in the impacts on either scheme did so on the basis that they expected suitable amendments would be made to ensure consistency across the UK. It was recognised that until that was done there could be different impacts due to ROC surpluses or shortages in one of the schemes. There would also be administrative complexity where suppliers had obligations under more than one scheme. However, one of the respondents considered that would not have a material impact and would be outweighed by the benefits from more frequent settlement.

Those who thought there would be an adverse impact called for consistency across the UK to ensure a level playing field for all suppliers, generators, and consumers. If the schemes diverged, it would add complexity to suppliers' and Ofgem's administrative processes, increase costs, and could introduce barriers to entry to new suppliers. An additional concern was the impact on ROC prices and the risk of a 2-tiered ROC market developing if the schemes followed different rules.

However, one respondent thought the impact of disparity across the schemes was not significant enough to prevent going ahead with the implementation of quarterly settlement and the abolition of late payments under the England and Wales RO scheme.

Those who were unsure of the impact nevertheless thought it best that there was consistency across the UK to avoid confusion, increased admin costs, reduced confidence and market distortions. Disparity could also be a barrier for smaller suppliers.

Questions on fixed price certificates

Q25. What are your initial views on the introduction of the fixed price certificate based scheme that was envisaged in 2011 in terms of addressing supplier payment default?

Summary of responses

A summary of the responses to question 25 is as follows:

Responses to Q25	Number of responses
Positive impact	14
No difference	3
Adverse impact	3
Unsure/Don't know	5
No comment	15

The following table shows the number of responses for each type of respondent against each category of response:

Responses to Q25	Interests in generation only	Interests in supply and generation	Interests in supply only	Other interests
Positive impact	6	2	Small supplier: 3 Large supplier: 2	1
No difference	1	1	Small supplier: 1	-
Adverse impact	-	2	-	1

Main messages from the responses

The comments from respondents covered both their views on whether a fixed price certificate (FPC) scheme would help in addressing supplier payment default, and the wider benefits.

Of the 14 respondents who saw a positive impact from FPCs, eight said they might be helpful in addressing supplier payment default. The reasons for this included: making suppliers more certain of upcoming obligations; greater price certainty by removing the current buy-out and recycle approach; and reducing the amount at risk in the event of supplier default. Other benefits put forward included: removing uncertainty in the market for all parties; improving cashflow for generators; and helping to stabilise the ROC market after 2027. It was also suggested that moving to a central purchaser as envisaged under the FPC scheme created an opportunity to review funding for the RO, and whether it should be funded through general taxation. Introducing a central purchaser under the current RO scheme could also facilitate an earlier move to FPCs or allow for dual running of both commercial ROC contracts and FPC supplier payments in the interim to 2027. However, concern was also expressed over the delay in setting out the details of the scheme. It was pointed out that industry would start to trade in post-2027 ROCs over the next 6-12 months, but it would take time to establish the purchasing body and the other changes required.

Some of those who supported FPCs commented on when they should be introduced: one wanted to move straight to FPCs now; three supported bringing forward the introduction from 2027 but didn't specify a date; and seven preferred leaving it until 2027. Three respondents saw the introduction of any of the variations of Option 1 as helping with a smoother transition to FPC in the future.

Respondents who thought FPCs would make no difference commented that: default was part of a capitalist system and could not be stopped; the problems were due to systemic failures which FPCs would do little to address; and the price volatility predicted from 2027 would not materialise until the very end of the RO, so FPCs would not be needed until the early to mid-2030s.

The comments from those who thought there would be adverse impacts from introducing FPCs mentioned the point above about price volatility not being an issue until later. However, the point was also made that FPCs would shift the balance of risk away from generators on to suppliers, and would make their costs more volatile, and harder to forecast and manage. A further comment was that FPCs might remove the current benefit of the RO of stabilising revenues through offsetting wholesale market revenues (ROC values tended to be higher when there was a supply constraint, which would also lead to lower revenues from the sale of electricity, and vice versa).

Some of the respondents who were unsure of the impacts of FPCs thought there could be benefits, but preferred to pursue quarterly settlement under Option 1 instead. Others wanted more information on how it would operate before commenting.

There was some misunderstanding over how FPCs would work, which led to mistaken concerns that they would reduce suppliers' interest in engaging in the ROC market and so cause reduced prices [BEIS note: under the scheme envisaged in 2011, a central purchasing body would buy all ROCs from generators at a fixed price and then reclaim the cost from suppliers].

Other issues raised in the responses

The following comments were made on wider issues beyond the scope of the consultation:

- **Ensure gravity of non-compliance** - if monthly settlement was considered, a decision would need to be taken on the point when a supplier's licence would be revoked, to ensure the gravity of non-compliance was maintained;
- **Payment of a handling fee to suppliers** - There was concern that suppliers were being used as agents by Ofgem to pass through RO payments. That resulted in generators taking on risk that they had no control over. Instead of being able to use RO funds as working capital, it was suggested that suppliers

should be paid a set handling fee for organising the pass-through transaction between Ofgem and generators;

- **Communication on redistributed buy-out payments** - In the vast majority of cases, Ofgem's redistributed buy-out fund payments to suppliers were passed onto renewable generators. There was concern that delays in publishing these values resulted in an unnecessary credit exposure in the ROC market. That was because a seller could not invoice until they knew what the amounts were, and they were reliant on Ofgem's publication in order to calculate and verify the payments. It was suggested that this credit risk could be avoided if Ofgem published the data on, or before, the day that the redistribution of payments took place;
- **BEIS Call for Evidence on changes to the RO mutualisation arrangements** - It was noted that BEIS was still considering how it should proceed following its call for evidence in December 2020 on the possibility of requiring only the amount in excess of the threshold to be mutualised. Urgent clarity was requested on BEIS's thinking on this issue;
- **Default tariff price cap -** It was suggested that a change in Ofgem's price cap might be needed to take account of additional working capital commitments if more frequent settlement was introduced. There was also concern that suppliers' ability to raise trade finance facilities had been severely damaged by the lack of margin, stripping of any profit and the uncertainty imposed via the cap. It was thought that suppliers could not predict the path of the cap with confidence, given Ofgem's adjustments and approach to clawback;
- **Review of retail sector** - It was suggested that BEIS and Ofgem should continue with their work to develop a vision for a sustainable and innovative retail sector after the price cap, and should consider a ban on exclusive tariffs, as the financial regulator had done for insurance policies; and
- **Non-commodity charges -** It was suggested that a review was needed of all the various non-commodity charges. The various charges and methodologies used for the transmission costs, distribution costs and government taxes and levies were complex and made up over 50% of energy bills. The drivers behind those charges were not transparent or translatable to the majority of customers. There was an opportunity to simplify across the board.

Annex A – List of respondents

Action Renewables	Major Energy Users Council
Brook Green Supply	Orsted
Bruxiehill Wind Energy Ltd & Ednie Wind Energy Ltd	Ovo
Bulb	Power NI
Centrica plc	RenewableUK
Citizens Advice	RWE Renewables
Corona Energy	Scottish Renewables
Drax	ScottishPower
E.ON	Sembcorp Energy UK
Eakin	Shell
EDF Energy	Smartest Energy Ltd
Ednie Farms, GWEL, BWEL, EWEL, SE	So Energy
Elexon	Squeaky Clean Energy
Energy UK	SSE
ENGIE	Statkraft
F&S Energy	TLS Energy
GFG	TotalEnergies Gas & Power Ltd
GLID Wind Farms TopCo Ltd	Utilita
Good Energy	Valda Energy
Infinis Energy	Vattenfall

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