

Chapter 1: Introduction

Question 1: Do you think that the measures we are proposing sufficiently and proportionately address our objectives? Are there other measures that you think we should consider to better meet our objectives?

Multiple changes and responses to recent market conditions have been proposed or are in process of being implemented, and we are concerned that further changes are being added before the impact of earlier changes can be observed. There is a risk of duplication of coverage and of adding ineffective cost into the industry. For example, if the capital adequacy proposals are implemented will the RO protection mechanisms still be required as well? And the control of material assets changes should address at least some of the issues around hedging strategies, whilst the proposals below also look at that area.

On proportionality, we are concerned that the costs of the RO proposal will be high relative to the reduced risk of mutualisation costs and therefore do not deliver value for customers. We believe that further detailed analysis is required to ensure the impacts are fully understood and the proposals fully costed.

We query whether licence-based reform is the most appropriate method to tackle these issues and whether it will be less effective than legislative reform. There already exist legislative powers to address some director actions through company law. Additionally, insolvency law is a complex area and the interactions between it and some of the licence conditions proposed would need to be considered which could be better handled through direct alteration of the insolvency law itself.

A further concern that we have is whether there are sufficient drawbacks to breaching licence conditions. The sanction of removing a licence from a supplier who does not comply with protecting their credit balances or RO funds forces that supplier to fail earlier than they may have done otherwise and reduces the cost of that failure – but further SoLR is still the ultimate outcome and there are no further ramifications for the directors of that company than there are today to discourage the risk-taking behaviour observed.

Chapter 2: Customer Credit Balances

Question 2: (For suppliers) What impact would ringfencing customer credit balances have on your business and to what extent could this be mitigated through transitional arrangements? Please explain your response and provide supporting evidence where possible.

As a B2B supplier Bryt does not hold customer credit balances from fixed DD or Standing Order payment arrangements, therefore this proposal would have no impact on our business.

Question 3: Do you agree that we should apply the Gross Credit Balance net of Unbilled Consumption definition for the purpose of ringfencing CCBs? Please explain your response and provide supporting evidence where possible.

N/A

Question 4: Do you agree with our view that the Protection Amount Calculation should be updated quarterly and based on backward-facing data, forward-facing projections, or a combination of the two? Please explain your response and provide supporting evidence where possible.

N/A

Chapter 3: Renewables Obligation

Question 5: Do you agree that option 3 ('protect or discharge through ROCs' obligation) is the best approach for addressing supplier payment default under the RO - and if not, what is your preference and why?

We are unclear whether this proposal is intended to apply to the whole market or just to domestic suppliers. If the main focus is on preventing domestic suppliers from building up excessive value at risk then we are not clear on what the benefits are of applying this change to B2B suppliers.

As a secure, well-capitalised business Bryt are in favour of changes which reduce the risk of additional mutualised costs, potentially even where this results in a decreased positive (rather than negative) cashflow over the reporting period. However, the impact must be proportional and represent value for money for customers. We are concerned over the cost of this proposal to the industry, and ultimately to customers as the increased costs of working capital will be passed on in pricing.

This proposal will increase working capital costs for all suppliers, regardless of whether they are at any risk of RO default or not. Even if suppliers, like ourselves, can fund the required additional capital (whether internally or via external sources), there will be a cost associated. The possibility of RO mutualisation costs is being replaced by a certain cost of capital, that will also arise considerably earlier than mutualisation costs would. For example, we estimate that the 1st year cost of additional working capital for Bryt would be over 60% of the expected mutualisation cost from last year's supplier failures. We are a growing supplier and therefore that proportion is greater than it would be for a stable portfolio, but it is also understated as it ignores the time value of money. Last year was, hopefully, an exceptional period for supplier failures and therefore looking forward the cost of capital may well outweigh the reduction in mutualisation costs.

Therefore, we suggest that, as per the BEIS decision, more considered analysis is required before potentially launching a solution that costs more than the problem and before allowing time for the range of recent licence changes & proposals to take effect.

Question 6: How, and to what extent, would a requirement to protect your RO impact your business and the way you currently interact with the scheme? If we were to ask suppliers to create a trust in favour of Ofgem over the proceeds of sale of ROCs, do you foresee any challenges with this and would it disincentivise you from buying ROCs?

Payment terms common in the B2B market mean that the impact on working capital would not just be the removal of an existing benefit but the creation of a disbenefit. The proposal suggests aligning the timeline of protecting RO funds with the existing FiT levelisation dates – this would mean that funds would need to be posted around 6 weeks after the end of a quarterly reporting period. For B2B customers payment will not take place until after invoicing, which is typically conducted in the month after delivery, and then the customer will have variable credit terms under which to pay, potentially up to 90 days or longer.

The existing cashflow benefit counteracts other disbenefits in the B2B market. For example, for the forthcoming winter triads will still be in place for HH customers and as the majority of B2B contracts renew on an annual October basis it is usual for the winter cost to be smeared over the six months of Summer to flatten prices for end customers. The positive RO cashflow helps with facilitating this while suppliers are required to settle the TNUoS costs with National Grid by the end of March. Likewise, this arrangement supports the levelisation of commodity costs over the contract rather than requiring more complex price arrangements.

The current arrangement also supports a benefit whereby suppliers purchasing ROCs earlier in the compliance period can get a more favourable price from generators by effectively passing that cashflow benefit to the generator. If there was greater incentive for suppliers to purchase ROCs earlier because the cashflow advantage would be lost either way then this could result in ROC prices rising and suppliers having to seek to recover this lost margin from customers rather than the ROC market.

We do not sell ROCs once they have been acquired, the position is only incremental, so a trust to hold proceeds from sale of ROCs would have no impact on us (and would never have any funds placed in it). Suppliers though must be free to sell ROC positions where their portfolios shrink, for example due to insolvency of a major customer or through the change of tenancy process. We would also absolutely need the ability to remove funds from any trust protecting buy-out funds in order to swap them for ROC purchases.

Question 7: How, and to what extent, do you think a requirement to protect your RO would impact the ROC market?

As stated above we believe incentivising suppliers to purchase ROCs earlier in a compliance period, by removing the cashflow benefit of not doing so via requiring the funds to be protected, would result in a reduction in the availability of discounted ROCs and thereby a need for suppliers to recover this lost margin directly from customers. This reduction in options for different ROC trading strategies would ultimately remove a source of competitiveness / differentiation between suppliers.

The timescales of ROC issuing with certificates typically being available around two and a half months after generation means that at the point of scheme reporting the majority of ROCs produced in the quarter being reported on would not yet be available to the market. This would limit suppliers' ability to discharge their obligations using ROCs during the compliance year.

From a supply perspective this could increase interest in rolling over certificates issued during the previous compliance period which would be available around the time of the first quarterly reporting of the next compliance year. However, this may not be attractive to generators as it creates a new risk of managing recycle benefits over different payment years.

Question 8: Do you agree the proposal should be effective from April 23? Do you see any issues or concerns with the transitional phases we have laid out?

As mentioned above this timing would mean that the reduced RO cashflow would coincide with the smearing of the Winter-22 triad costs which they are supporting for B2B customers. Although this smearing will take place every winter it will be greatly decreased from Winter-23 due to the effects of TCR.

The effect on the ROC market of decreasing availability of discounted ROCs will take place for the appropriate compliance period as soon as clarity is gained on exactly when the proposal will take effect from. Early clarity would be welcomed as the current market norm is for ROC delivery in July ahead of RO compliance, contracts will continue to be signed on this basis in the interim potentially tying certificates up that then will not be available for earlier delivery.

We suggest that the initial implementation, if it goes ahead, applies a longer reporting window after each quarter, say for the first year. Since the impacts on working capital will be significant and impact all suppliers, whether they were at any risk of eventual RO default or not, then providing more time initially will ease the process of increasing working capital facilities.

Question 9: What, in your view, would be the appropriate frequency of the reporting requirement: once an obligation period or quarterly?

Quarterly. This not only removes the risk of needing to choose whether to set a single reporting point early or late in the year to balance how much risk is exposed at the point of reporting, but also allows it to be aligned to the existing FiT volume reporting which will reduce the administrative burden.

We consider that the current arrangement is actually an extreme annual variant of this proposal with the reporting point for the year set at the 17-month mark.

Chapter 4: Protection Mechanisms

Question 10: Do you agree with suppliers being able to select from a menu of protection mechanisms and do you agree with the mechanisms we are considering?

Offering a menu of protections is reasonable and we do not see any issues with the ones under consideration which would be unresolvable.

In addition to the options currently considered we would suggest having the ability to make early Buy-Out payments to Ofgem on account as a further option for suppliers. This would avoid any administrative costs to a supplier of setting up one of the proposed options and would be even more secure than those options as the funds would directly be available to Ofgem.

We would also suggest that the option of legislative change to introduce or strengthen the creditor protections available to a SoLR or Ofgem under insolvency law should be considered. This would allow the funds from even a non-compliant supplier to be protected to some degree in the event of failure.

Question 11: Do you agree with the minimum requirements set out for each protection mechanism and do you have any further comments on the protection mechanisms or the guidance that should be provided on them?

In reference to the suggestion (in 3.11) that protection requirements should apply only to smaller market participants, on the assumption that their higher probability of default makes them the greater risk, we would note that risk is a function of both the likelihood and the impact. While the probability of a larger supplier failing is less, the impact on the market where one did would be many times larger than the impacts seen to date. Large energy businesses (most recently Bulb) have failed historically and the current well-publicised concerns around Uniper on the continent show this is a class of event which must not be overlooked.

Question 12: Do you consider that suppliers would be in a position to obtain suitable insurance to protect CCB or RO funds, and, if so, do you think that this would be competitively priced?

We do not believe this option could be any more competitively priced than obtaining a letter of credit as they would both have to be created with similar constraints on the level of cashflow protected.

Chapter 5: Hedging

Question 13: What do you consider would be the impact on your business and the wholesale market of implementing the two options we set out and how might these be mitigated?

We have concerns that the proposed solution would not work as Ofgem envisages in practice. Prior to insolvency it is normal business practice to adjust hedges regularly in line with the latest volume forecasts, as well as to shape positions as more detailed wholesale products become liquid. Tracking

whether these position adjustments could be considered 'in-the-money' would be an onerous and unclear prospect as the net position will be the result of multiple hedge trades over time.

There is already proposed to be a requirement in the licence for suppliers to possess and maintain control over the material assets required for their business and a suitable set of hedges falls under this requirement. If a supplier liquidated their entire hedge position, for being in-the-money, this would already fail these new conditions and avoids the additional burden of tracking the impact of individual hedge adjustments for compliant suppliers.

An insolvent supplier will likely never possess in-the-money hedge positions as the GTMA any such hedge trades were conducted under will fall away upon an instance of insolvency. This is a standard condition in most GTMAs signed in the current market and attempting to create agreements without this ability for the solvent counterparty would result in making it considerably harder for new entrants to access commodity markets, and where they could do so the counterparty concerned would undoubtedly impose above market prices to counter-act the loss of protection in the event of insolvency.

We also believe that, even in the absence of this issue, creating an asymmetric exposure for the insolvent company's creditors by the market taking the benefit where hedges are in the money but not the risk where they are out of the money would be open to challenge.

Finally, it should be noted that the concept of being able to receive the liquidated benefit of a hedge as a payment at a single point in time is flawed – a liquidated hedge for a solvent company will unwind over the length of the period hedged as settlement of wholesale trades is done in arrears after the delivery period.

Question 14: Are there other options to more effectively reduce the wholesale costs to consumers of supplier insolvencies?

A SoLR could be given status as a preferred creditor perhaps under insolvency law, however as mentioned above it is unlikely that an insolvent supplier would retain a beneficial hedge that the IP could use as an asset, and where this was the case the unwinding of the hedge would occur over a much longer time scale than the SoLR's need to purchase new hedges for the acquired customers. Thus there would remain some need for the SoLR to still be able to access funds from the current support route at least in the short term.

However, for B2B supplier insolvencies there is an additional point that should be considered – the transitioning customers will be moving from a fixed term contract (potentially up to 3 years past the SoLR date) on to a deemed product that they can exit at short notice. The corresponding hedge will also be over the original fixed term and thus there is a strong possibility the SoLR can gain advantage were they to acquire a below market hedge and the customer subsequently leave prior to the period they were originally hedged for. This is not necessarily a negative consequence if it could be used to increase options for the SoLR and make such customers more attractive when determining who the SoLR will be.

For B2B customers on Flexible contracts there is a question around whether the trades which they have made could be considered to be attached to them as a customer and move with them.

More generally if these provisions are part of the supply licence and the licence is revoked prior to insolvency, would any requirement of the licence survive, or could the hedges then be liquidated prior to insolvency as the directors saw fit?

Chapter 6: Capital Adequacy

Question 15: What are your views on our proposed high-level approach to a capital adequacy framework? Do you agree that capital adequacy requirements would be required in addition to our ringfencing proposals?

Question 16: Do you agree with our suggestion that a capital adequacy framework should take a segmented approach – with measures implemented in a proportional way for different segments of the market, largely based on the level of risk that a company could pose to the market?

Question 17: What risks do you think are most appropriate to target with a capital adequacy regime? What risks do you currently target in your internal risk assessments and risk capital determinations?

Question 18: Do you have any views on the level of financial resilience that a capital adequacy regime should seek to target? What are your views on an appropriate time horizon for calculating capital requirements? What time horizons do you use in internal risk management?

Question 19: What type of capital should be included under capital adequacy requirements and what criteria could be used to determine this? How do you currently define what can be considered as sufficiently loss-absorbing capital for unexpected shocks in internal risk management?

Chapter 7: Impact Assessment

Question 20: Do you have any views on our analysis of the impact of our proposals?

As the analysis is mostly domestic focused we do not have any specific views, other than to highlight the absence of analysis on the cost of replacement working capital and its impact on suppliers and ultimately customer prices.