

By email: RetailFinancialResilience@ofgem.gov.uk

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RO mutualisation and supplier financial resilience - Ørsted response to Ofgem consultation

Ørsted welcomes the opportunity to respond to this policy consultation and Ofgem's efforts to mitigate the risk of mutualisation costs for schemes such as the Renewables Obligation (RO). Our response **specifically relates to Ofgem's proposals on protecting the RO** (Questions 5 - 9) and can be found below.

Ørsted has a significant interest in measures that will bolster the integrity of the RO Scheme. Ørsted is an owner and operator of assets that are in receipt of ROCs, both under the RO and NIRO. Unlike some other generators which are vertically integrated, Ørsted is less able to manage RO exposures internally. Revenue from the RO provides a vital and stable source of income for Ørsted's eligible offshore wind assets, which are helping to meet the Government's ambition of 50GW installed offshore capacity by 2030.

We agree with the view that suppliers should be prevented from using RO revenues as 'risk-free working capital'. We are encouraged by the regulator's efforts to raise standards of financial responsibility in the retail market such as in the Supplier Licencing Review, 2021 Action Plan on Retail Financial Resilience, increased market monitoring and early intervention with at-risk suppliers.

Ultimately, the aim of any change to the RO Scheme in its current form should be to reduce both the likelihood of mutualisation and the financial impact on RO recipients and consumers. For generators this means reducing the proportion of revenue at risk of being mutualised and the time taken to deliver that revenue in the event mutualisation is triggered. We broadly agree with Ofgem's minded-to position to pursue the protect RO or discharge via ROCs approach. However, we feel in today's market Ofgem should act proportionately and in a way that balances mitigating the risk of mutualisation with requirements that continue to facilitate a healthy and competitive retail sector and as such the integrity of the RO Scheme.

Please get in touch if you would like to discuss our response.

Yours sincerely,
Ørsted

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Response to questions

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5. Do you agree that option 3 ('protect RO payments 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?

Ørsted agrees that Option 3, 'protect RO payments or discharge through ROCs' is the most effective approach out of the stated proposals to address the likelihood and financial impact of supplier payment default.

Ørsted understands the need case for the use of trusts to protect the proceeds of ROC sales as a further check on suppliers preventing the use of RO revenues as free working capital. We welcome Ofgem's plans outlined elsewhere to prevent suppliers or their parent companies from liquidating assets such as ROCs prior to an insolvency event, helping to reduce the value of the mutualised sum.

As a generator we do not have a position on the individual efficacy of the various protection mechanisms Ofgem has outlined. As a package, Ofgem's menu of options are similar to those outlined in consultations elsewhere, and we feel the mechanisms will provide the level of assurance needed for generators in terms of revenue protection.

However, any change to the RO Scheme must ensure that where there is a mutualisation event, close to 100% RO revenues are delivered to generators within a timeframe that is shorter than the current mutualisation process.

We would therefore like to see more detail about how Ofgem intends to ensure the funds protected by trusts and the other protection mechanisms will be delivered to generators in a timely manner in the event of supplier payment default. Ofgem should set out expected timeframes to unlock those sums and deliver the revenue to generators, as well as a plan to ensure such timelines are adhered to by suppliers and/or administrators. This must apply to all Ofgem's proposed protection mechanisms, regardless of which one a supplier has chosen to utilise.

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?

AND

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

It is imperative that Ofgem's chosen approach achieves a balance between protecting the integrity of a competitive ROC market and placing a robust requirement on suppliers to comply with their RO payment obligations. Ofgem should avoid any intervention that may have unintended adverse consequences for the ROC market or one that discourages suppliers from interacting with the Scheme through purchasing and/or trading ROCs. There is a plausible risk that suppliers may opt to meet their RO liability through ringfencing and using the Buy Out mechanism instead of purchasing ROCs due to the trust requirement and economies of scale costs to ringfence overall liability.

To guarantee this, Ofgem should produce analysis about the potential impacts of Option 3 on the ROC market, and more detail about mitigations Ofgem would put in place to avoid making the ROC market redundant. Ofgem's assessment should also include how the new requirements may impact suppliers' strategies for meeting their RO obligation, for instance:

- Impact of seasonality on the availability of ROCs and their cost relative to the Buy Out price
- Impact of changing ROC supply and demand due to external factors

It should also be noted that some suppliers will have agreed medium to long term contracts with RO providers which stipulate ROC delivery timeframes. Ofgem should consider how the requirement to evidence ROCs on a quarterly basis might impact such commercial agreements.

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?

Ørsted supports a Go Live date of 1 April 2023 to coincide with the next RO Compliance Period.

In an ideal world, the protections would be in place before Winter 22/23 as the likelihood and cost impact of supplier non-payment is significant on top of the £117m predicted shortfall for the current RO Compliance Period (21/22). On balance, however, we acknowledge that too short an implementation period may cause more issues for suppliers and their ability to fulfil requirements and ensure the availability of capital to meet their RO liability than would be mitigated from Ofgem's proposals.

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

Ørsted supports a quarterly reporting requirement and efforts to reduce the administrative burden on suppliers as far as possible by aligning the process with FIT levelisation reporting.

We note that the proposed backward-looking approach will not remove the risk of mutualisation entirely as a quarter's worth of RO is still at risk of supplier non-payment. By contrast, a forward-looking approach would not only mean that close to 100% of suppliers' RO liability is protected but would also allow Ofgem early sight of suppliers at risk of non-payment and/or insolvency. While we appreciate that a requirement for suppliers to ringfence their RO obligation for the quarter ahead may have working capital implications and may unnecessarily increase costs to consumers, we encourage Ofgem to instead implement a forward-looking reporting requirement. This would encourage suppliers to behave more prudently with regard to their upcoming RO liability by demonstrating to Ofgem how they intend to protect this sum and highlight potential financial issues to Ofgem. We feel this would be more a proportionate mechanism.

ENDS.