Energy UK

The voice of the energy industry

EUK Response to Addressing Electricity Supplier Payment Default under the RO Scheme

9 November 2021

Introduction

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. We would be happy to discuss any of the points made in further detail with BEIS, Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes BEIS' examination of options to address supplier payment default, the underlying cause of significant RO mutualisation costs and risks across the market. We note that BEIS took action earlier in 2021 to align the mutualisation threshold with the overall scheme costs, but this did not address the underlying risks and just shifted them from suppliers to generators. We believe that robust action is required to tackle the underlying cause of significant mutualisation costs. The case for action is clear - of the supplier failures that have occurred (before the recent significant number of supplier failures in the second half of 2021) Ofgem estimates that c£189.2m of RO costs were mutualised, and Ofgem has recently announced a £276m shortfall in the buy-out funds for the 2020-21 scheme year.[1] Given the supplier failures of recent months, it is extremely likely that the mutualisation threshold will also be breached in the scheme year 2021-22.

Therefore, we believe that robust action is needed to reduce the risk of supplier payment default to the lowest level possible, and as such have put forward a preference for a BEIS-led solution implemented through legislative change. As part of this legislative change, we believe that it is essential that BEIS includes a robust enforcement framework and timeline to ensure that Ofgem can take swift action against defaulting suppliers, minimising the risk of additional costs being passed on to generators or other suppliers.

Continuation of Existing Policy (Option 3)

Energy UK does not believe that the status quo is sustainable for suppliers or generators, nor in the best interest of consumers.

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[1] Renewables Obligation: ROCs presented and Redistribution of Buy-Out Fund 2020-21, Ofgem, 3 November 2021

While Energy UK welcomed BEIS' attention to the issue of substantial RO mutualisation costs over recent years, as we noted in response to its consultation in January 2021, the linkage of the RO mutualisation threshold to the cost of the scheme would not be sufficient as it does not solve the underlying issue of supplier RO payment defaults, instead it just shares the risk between suppliers onto generators rather than actually minimising it.

Ofgem has always been clear that the Financial Responsibility Principle will not by itself be enough to fix the issue of supplier failure, and it does not reduce the number of months of obligation at risk when a supplier exits the market. Mutualisation has been triggered for the past three years, and a £276m shortfall has already been announced for the 2020-21 scheme year. The market has seen 48 suppliers failing to meet their obligation in this period (excluding 2021) with a mutualisation cost to customers of £189.2m. This will continue (and potentially get worse) if BEIS does not take robust action.

Continuation of the existing policy would retain a significant risk burden within the market and would continue to damage investment – significant amounts are being spent on picking up the avoidable costs of supplier failure instead of investing back into the sector to deliver benefits for consumers (which is particularly important in the context of investment for Net Zero).As such, Energy UK welcomes this consultation and would urge BEIS to decide upon a way forward that tackles that ensures that the root causes of significant RO mutualisation costs (supplier payment defaults) are finally addressed.

BEIS-led Solutions Implemented through Legislative Change (Option 1)

Energy UK's general preference is for a BEIS-led solution that is implemented through legislative change. The RO scheme is unique compared to other low carbon policy scheme – it is the largest such scheme yet has the least protections in place. We believe that it should be brought in line with other similar schemes.

As noted above, it is essential that BEIS addresses the underlying causes of significant mutualisation costs, that being supplier payment defaults, and to reduce the level of risk in the scheme to the lowest level possible. To achieve this aim, we would support an adaption of option 1c, with increased settlement frequency and settlement arrangements compressed. This would provide the most robust mechanism for ensuring supplier payments are maintained, and that any default and the resulting mutualisation is kept to an absolute minimum. While there may need to be changes to current processes, we do not believe that it would significantly disrupt current trading practices and arrangements between supplier and generators by maintaining the financial incentive to buy and trade ROCs.

However, some concern has been raised option 1 would involve significant administrative burdens on generators, from an initial need for front offices to revisit all existing RO contracts and potential renegotiations with counterparties, to multiplied back-office processes to meet increased settlement frequency. We would encourage BEIS to ensure that in developing any legislative changes it undertakes a full Impact Assessment so that the costs and benefits of its proposed decision can be effectively scrutinised, and the benefits of mitigating the existing risk highlighted.

We believe that if BEIS is to proceed with the legislative option, flexibility should be added to the proposal in order to minimise impacts upon suppliers and the ROC market. For example, BEIS should allow flexibility in the credit support that suppliers could offer against their obligation, such as suppliers meeting the more frequent obligations with cash payments or parental company guarantees, which could then be swapped out with ROCs for refund at a later date. This is in addition to allowing suppliers to settle their quarterly obligations with a standby letter of credit ahead of final settlement with ROCs or cash.

We also believe that it would be prudent to allow a minimal late payment deadline (for example of one week) to allow for any unforeseen administrative challenges, rather than removing the late payment deadline altogether. However, we would stress that this should be minimal and for legitimate purposes only.

Concern has been raised that this legislative option may not address the likelihood of supplier payment default, and just tackle the impact as it limits any default to one quarter, so further action from Ofgem should not be ruled out. As part of any legislative changes that BEIS makes, it is essential that it includes a robust framework for enforcement against suppliers that default on their payments to ensure that Ofgem can take the appropriate action in a speedy manner to minimise risk across the market. This will aid in addressing both the likelihood and impact of supplier payment defaults. Currently, the process that Ofgem has to follow to enforce against defaulting suppliers is insufficient to minimise the cost of mutualisation. 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.

In addition, in order to ensure that the likelihood of supplier payment default is fully addressed, it is essential that Ofgem responds to the recent supplier failures that extends to revisiting licence conditions and market entry thresholds. We therefore welcome Ofgem's commitment to an enhanced approach to monitoring, compliance and enforcement to ensure suppliers pursue a sustainable business model. The potential reduction in administrative costs to Ofgem via option 1c could also allow it to direct greater attention towards ongoing monitoring of supplier financial/operational health and would leave more resource to ensure early intervention where signs of distress are identified. In doing so, it should ensure that any additional monitoring and compliance requirements are integrated, where possible, with existing reporting schedules to minimise any unnecessary additional administrative burdens upon suppliers. We would welcome Ofgem integrating and streamlining its requests for information and providing, and committing to, a quarterly timetable to improve suppliers' ability to plan their resources and manage operational costs efficiently.

We note that any changes would only relate to England and Wales. It will be important for similar changes to be made in Scotland to ensure consistency across the schemes. We would welcome clarity from BEIS as to its engagement with the Scottish Government on this issue and its willingness to legislate for similar changes.

BEIS Call for Evidence on Changes to the RO Mutualisation Arrangements

We note that BEIS is still considering how it should proceed following its call for evidence in January 2021, examining the possibility of requiring only the amount in excess of the threshold to be mutualised. As Energy UK outlined in its response, our members across supply and generation held different views which they fed into BEIS individually. However, we did highlight two high-level views for BEIS to consider, including the risk of undermining the principle of regulatory stability. We would welcome urgent clarity from BEIS as to the progression of its thinking on this issue.

For further information or to discuss our response in more detail please contact Steve Kirkwood on 0207 747 2931 or Steve.Kirkwood@Energy-UK.org.uk.