Consultation Appendix

Default Tariff Cap: Statutory Consultation

Appendix 10 - Exemptions

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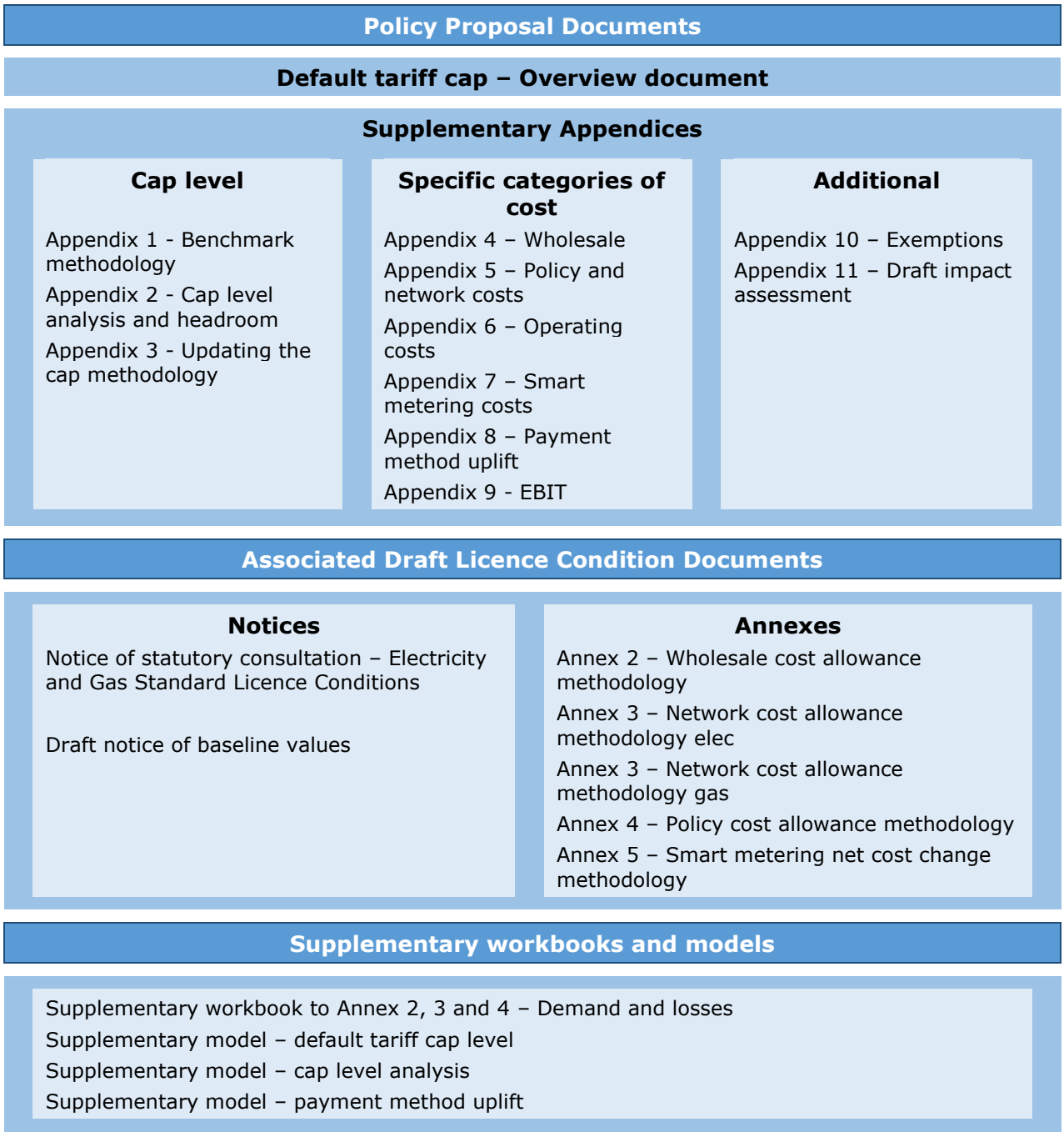
We are consulting on our proposals for setting and updating a default tariff cap in accordance with the Domestic Gas and Electricity (Tariff Cap) Act 2018. This supplementary appendix provides details of the proposals and methodology in relation to potential exemptions from the default tariff cap. This document is aimed at those who want an in-depth understanding of our proposals. Stakeholders wanting a more accessible overview should refer to the Default tariff cap – Overview document.

We welcome views from stakeholders on all of our proposals set out within this document. Please see the Default tariff cap – Overview document for instructions on how to respond to the consultation.

Document map

Figure 1 below provides a map of the default tariff cap documents published as part of this statutory consultation.

Figure 1: Default tariff cap – statutory consultation document map



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1. Introduction

Overview

1.1. The Domestic Gas and Electricity (Tariff Cap) Act (2018) places a duty on Ofgem to introduce a default tariff cap for domestic consumers on Standard Variable Tariffs (SVTs) and default tariffs as soon as reasonably practicable. The price cap will not apply to:

- consumers on the prepayment meter cap (these consumers are exempt from the default tariff cap because they are already receiving price protection) and
- domestic consumers on non-default fixed term tariffs.

1.2. The Act provides some discretion for Ofgem to exempt certain groups from the default tariff cap.[1] This includes:

- SVTs that have been chosen by the consumer and that appear to the Authority to support the production of renewable gas or electricity, and/or
- vulnerable consumers benefiting from a safeguard tariff.

1.3. This document provides our proposed decisions on each of these potential exemptions, first addressing exemptions for renewable SVTs (Chapters 2 and 3) and then for vulnerable consumers on the existing safeguard tariff (Chapter 4).

Whether to exempt renewable SVTs

1.4. The Act requires Ofgem to consult on whether a renewable tariff exemption is appropriate, and if so, how to exempt the respective tariffs.[2] If we consider an exemption is appropriate, we are required[3] to introduce the exemption at the same time that we introduce the default tariff cap, unless it is not practicable to do so, in which case we must introduce the exemption as soon as practicable after that date.

1.5. In Chapter 2 we describe our proposed decisions on whether (and how) we should provide an exemption for renewable electricity and gas tariffs, and our rationale for our proposed decisions. We also summarise the stakeholder responses to our May consultation and explain our views on those responses. In Chapter 3 we set out our proposed approach to receiving and processing derogation requests, including the criteria against which we expect to assess any requests.

Our proposed decisions

1.6. Our proposed decision is that by default the tariff cap should apply to all SVTs, but we propose to provide a route for suppliers to apply for derogations for renewable

[1] At section 3(2).
[2] At section 3(3).
[3] At section 3(5).

electricity and/or gas SVTs that have been chosen by the suppliers' customers. For electricity, this is the position we proposed in our May consultation. For gas, we have changed our position compared to our May consultation where we proposed not to provide a route for exemptions or derogations.

1.7. The reason why we consider that by default the tariff cap should apply to all SVTs is that we are not convinced that any of the options that we proposed in our May consultation for creating an exemption are robust to gaming. We also have no strong evidence that gas or electricity renewable SVTs:

- support renewables materially beyond support provided through subsidies, obligations or other mandatory mechanisms, and/or
- involve materially higher costs due to the renewable element of those tariffs.

1.8. Our rationale for providing a route for suppliers to apply for a derogation is that suppliers may, on a case-by-case basis, be able to demonstrate that a particular SVT does support renewables and involve materially higher costs. It would also be easy to monitor who has a derogation and, because we would assess derogation requests on a case-by-case basis, it would be more difficult for suppliers to game compared to an exemption. In our May consultation, we expressed some concerns about monitoring the provenance of a suppliers' gas, but in light of stakeholder responses (see paragraph 2.53), we now consider there may be other satisfactory approaches to monitoring the provenance.

1.9. Of the feedback received from respondents to our May consultation, the majority supported our minded-to position of not providing exemptions for renewable electricity SVTs. However, some suppliers were in favour of an exemption over a derogation. Many stakeholders supported, in principle, providing suppliers with a route to apply for derogations for renewable SVTs. However, stakeholders raised a number of concerns with how the derogations process would work in practice, particularly calling on Ofgem to provide transparency and certainty on the derogations process and the criteria against which we would consider derogation requests.

1.10. A number of respondents supported our minded-to position of not providing exemptions for renewable gas SVTs. However, some suppliers stated that they were in favour of an exemption, one saying that they believed they had a renewable gas tariff that would meet Ofgem's proposed criteria for electricity derogations. Some stakeholders provided evidence to attempt to address our concerns with providing a route for derogations for renewable gas SVTs. These stakeholder comments have helped to persuade us to propose to treat renewable gas SVTs in the same way as renewable electricity SVTs.

1.11. One supplier highlighted the risk of renewable tariffs having to comply with the default tariff cap whilst suppliers await our decisions on derogation requests. To mitigate this risk, we propose that as a transitional measure only, we will have a mechanism to fast-track derogation requests and aim to provide suppliers with a provisional decision at least 30 days ahead of the licence condition taking effect on their derogation requests.

Renewable tariffs

1.12. Our initial analysis suggests that suppliers who claim to offer renewable tariffs range from suppliers who offer tariffs backed by a certain percent of renewable electricity to

others who also offer tariffs backed by renewable gas and carbon offset for any gas that is from fossil fuels.

1.13. Suppliers offering renewable electricity tariffs have different approaches to purchasing renewable electricity, which tends to be reflected in their pricing structures. We can categorise them in three ways, although suppliers might not sit solely in a single category and there may be other ways to categorise suppliers:

- suppliers that purchase renewable electricity via power purchase agreements (PPAs)[4] and match the totality of the electricity bought with Renewable Energy Guarantees of Origin (REGO) certificates equal to the total electricity demand of their customer base

- suppliers that are vertically integrated: suppliers plan, build and maintain wind and/or solar farms and,

- suppliers that buy REGOs on a parallel market to match it with purchased electricity that does not come from renewable sources at the wholesale level.

1.14. Our data suggests that there is a range of renewable electricity tariffs available on the market. These range from suppliers who claim to offer a single 100% renewable electricity SVT to others who offer both a 'standard' SVT and then a renewable energy "add-on" to that SVT for a premium.[5]

1.15. The number of energy deals where suppliers claim to provide 100% renewable electricity has increased over the last year. In June 2017, our analysis suggests there were around 25 dual fuel tariffs backed by a claim of 100% renewable electricity available on the market, offered by 16 different suppliers. On the market the following year there were in the region of 56 distinct dual fuel tariffs that suppliers claimed to be backed by 100% renewable electricity available, offered by 26 different suppliers. This represents around 30% of the total tariffs offered in the market in the last year.

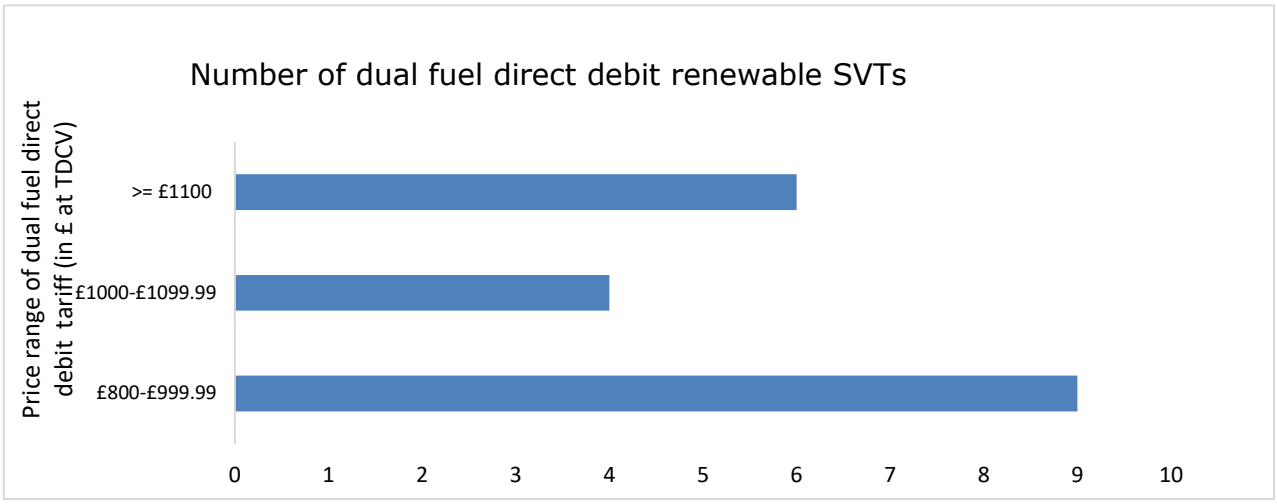
1.16. Our analysis suggests that in June 2018, there:

- were around 18 distinct SVTs backed by 100% renewable electricity available on the market offered by 16 different suppliers. Most of these 16 suppliers were small suppliers (ie less than 250k customers), and

- was one dual fuel renewable SVT on the market backed by less than 100% electricity.

[4] In this context, a PPA is a legal contract between an electricity generator and an energy supplier regarding the sale and purchase of energy.
[5] Eg, a consumer would select that they want the SVT, then they have an option of having that SVT backed by renewable energy, but at a higher price.

Figure A10.1: price range of dual fuel direct debit renewable SVTs



Source: The original sources of all data are Energylinx (up to May 2017) and EnergyHelpline (June 2017 onwards) - Last update: 25/06/2018.

1.17. There was a £402 difference in price between the cheapest and most expensive SVT claiming to offer 100% renewable electricity, with the highest tariff being £1,258 and the cheapest being £856.

1.18. Our initial analysis suggests that consumers can on average pay £325 more for their energy per year for a SVT with a supplier who claims to invest in renewable technology innovation and/or support independent generators producing renewable energy, compared to a supplier that buys REGOs on a parallel market to match it with purchased electricity that does not come from renewable sources at the wholesale level.

1.19. Our analysis also suggests that 67% of the renewable tariffs backed by 100% renewable electricity in the market were fixed-term tariffs.

1.20. The average price of a dual fuel renewable tariff was £1,025, while the average annual price of a dual fuel renewable SVT was £1,034.

1.21. The average annual price of a dual fuel renewable SVT backed by at least 100% renewable energy is £1,022.[6] This is £150 less than the average annual price of being on a regular dual fuel paper billing SVT with the six largest energy suppliers (on the basis that the average price was £1,172).[7]

1.22. We noted above that we are aware of 56 distinct dual fuel tariffs that suppliers claimed to be backed by 100% renewable electricity available on the market, offered by 26 different suppliers. Our analysis suggests that only ten of those suppliers couple these

[6] Source: Energyhelpline, 25 June 2018.
[7] Source: Energyhelpline, 25 June 2018, and also published as part of Ofgem's retail market indicators (https://www.ofgem.gov.uk/data-portal/retail-market-indicators)

renewable electricity tariffs with a renewable gas tariff. Among these tariffs, around half of them are offered as an SVT.

1.23. We are also only aware of three suppliers that offer tariffs backed by 100% renewable gas, and two of them only offer fixed tariffs with 100% renewable gas.

1.24. Our analysis also suggests that just over half of suppliers that offer a renewable gas tariff do not offer it as a single fuel tariff - it is only available as part of their renewable dual fuel tariff.

Challenges in designing an exemption

1.25. Since an exemption would allow suppliers to charge more than the default tariff cap, there may be a significant incentive for suppliers to want to claim that their tariffs qualify as exempt. It is important that we define any proposed exemption or derogation in such a way that it would be clear exactly which tariffs qualify, to minimise the risk of gaming.

1.26. We support initiatives to promote energy consumption from sustainable sources. It is worth noting that all electricity consumers contribute to government policies to subsidise renewable energy. The cost of these policies, such as Renewable Obligation and Contracts for Difference, are passed on to consumers through their bills.

1.27. This means that all (electricity) tariffs could be described as supporting renewable energy/electricity. Our challenge in assessing whether an exemption or derogation is appropriate is therefore to ensure that there is a good reason why certain tariffs should cost more than the default tariff cap. Our starting point in our May consultation was that simply having renewables in the portfolio is not enough to demonstrate that a tariff is providing support for renewables. There was broad support from stakeholders on not providing an exemption based on simply having renewables in the tariff, although one respondent did suggest that having a 100% REGO-backed tariff should qualify, but with suppliers justifying why they cannot price the tariff below the cap.

1.28. There is no single, clear definition of renewable gas, so we would need to define it for the purposes of providing an exemption or derogation.

1.29. We also note that the Act refers only to supporting renewable energy, meaning we cannot design the exemption or derogation to cover broader green or community support initiatives (such as planting trees or other offsets).

Suppliers obliged to have a default tariff that complies with the default tariff cap

1.30. We note that even if a supplier were to receive a derogation from the default tariff cap for a renewable SVT, it would still need to have a default tariff that complies with the default tariff cap. This is because a derogation could only ever be given for a SVT that consumers have chosen to be on, but any supplier could acquire customers on a deemed contract, or, for suppliers that have fixed terms deals, customers could roll

onto a default tariff at the end of the fixed term.[8] Those consumers, which by definition will not have chosen a tariff, could not be defaulted onto the derogated SVT.

Informed choice

1.31. Where consumers choose SVTs that provide additional support to renewable energy, over and above that provided through any government schemes, we in principle do not want the default tariff cap to prevent this. However, we need to ensure that suppliers cannot 'game' an exemption or derogation, using it to avoid the default tariff cap without providing any additional support beyond that already provided by government policies. This could occur if a supplier allocated the energy they are already incentivised to purchase from renewable sources to a particular tariff, by reducing their allocation to other tariffs. This practice would not increase the total level of support for renewable energy, and would not be consistent with the purpose of the Act.

1.32. The Act requires that an exemption can only be provided at a tariff level. This means that we cannot derogate at a supplier level. In deciding whether to derogate a renewable SVT, we would only be able to consider a supplier's environmental credentials on other tariffs where the level of renewables on the renewable SVT are affected by the other tariffs. For example, we could consider whether the level of renewables provided through the renewable SVT is to the detriment of renewables provided on other tariffs.

1.33. Supply licence condition (SLC) 21D[9] requires suppliers to be transparent to consumers about the claims of environmental tariffs and, where a claim is made, requires that they can demonstrate the basis of the claim. However, this condition does not have any threshold for environmental benefit and therefore we do not believe we can rely on it to prevent the gaming we described above.

1.34. We are concerned that this gaming risk is still possible within the existing rules and an exemption or derogation for renewable tariffs may increase supplier incentives to not distribute equally the fuel mix across its customers. In parallel, we are considering whether to consult on introducing a new rule to require suppliers to allocate the same fuel mix to all of their tariffs. For example, if the supplier's fuel mix is 20% renewable and 80% fossil fuel, then each tariff must reflect this mix (ie each tariff must contain 20% renewable and 80% fossil fuel). Such a supplier would not be allowed to say that 20% of customers are on a 100% renewable tariff and 80% are on a 100% fossil fuel tariff.

1.35. We are currently only considering taking this further in respect of electricity tariffs. Any solutions we propose would likely focus on the existing licence requirements on fuel mix disclosure, and these only apply to electricity.

[8] Typically a deemed contract will occur where a consumer moves into a new property and has not agreed contractual terms with a supplier who is supplying energy to that property or where a fixed term contract expires and there are no explicit provisions for terms and conditions for the period immediately after expiry.
[9] See Annex 1 of Appendix 13 of our May consultation for further details on this licence condition https://www.ofgem.gov.uk/system/files/docs/2018/05/appendix_13_-_renewable_tariff_exemption.pdf

Whether to exempt vulnerable consumers on the existing safeguard tariff

1.36. On 1 April 2017, the amount of money suppliers can charge a domestic prepayment meter (PPM) customer per unit of energy became subject to a safeguard tariff.

1.37. The prepayment safeguard tariff is one of the remedies introduced following the Competition and Markets Authority's (CMAs) investigation into the energy markets. It is temporary, and is due to expire at the end of 2020. Initially, the safeguard tariff related only to domestic prepayment customers (except those with a fully interoperable smart meter).

1.38. On 7 December 2017, we decided to modify the standard conditions of the electricity and gas supply licences by inserting new standard condition 28AA to regulate charges for domestic customers who receive the Warm Home Discount (WHD). The main effect of this change is to extend the scope of the existing PPM cap to protect around one million consumers who receive WHD, who are also on their supplier's default tariff. These protections began rolling out from 2 February 2018. This will provide some short term relief for vulnerable customers, ahead of implementation of the default tariff cap.

1.39. The existing safeguard tariff will end in December 2019 if it has not already been replaced by other price protection; for instance, either by a wider vulnerable safeguard tariff or the default tariff cap.

1.40. The Act includes provision that allows for an exemption from the default tariff cap for vulnerable consumers.[10] This could be applied to the safeguard tariff cap that is currently operational in the marketplace. However, we have decided not to provide for an exemption for vulnerable consumers on the existing safeguard tariff at this time.

1.41. In response to the May consultation, and at our workshops, a number of stakeholders wanted to understand how the existing safeguard tariff would interact with the default tariff cap. Some consumer organisations raised concerns that vulnerable consumers who are currently protected by the existing safeguard tariff would see an increase in their bills as a result of being transferred on to the default tariff cap. One supplier was concerned about the potential for lack of clarity around which price cap applies to a WHD customer because they would qualify for both caps.

Our proposed decision

1.42. When we introduced the existing safeguard tariff we were clear that this was a temporary measure until either the default tariff cap or a broader vulnerable safeguard tariff came into effect. We propose to maintain this position and transfer existing safeguard tariff consumers and those consumers that are identified as eligible for the WHD up until 31 March 2019 on to the default tariff cap. Ie we are proposing to not exempt customers on the existing safeguard tariff from the default tariff cap. We recognise that we need to provide stakeholders with clarity on how we intend to implement this policy in practice, and we do this in section 4 of this document. To address concerns about vulnerable consumers potentially being disadvantaged as a

[10] At section 3(2).

result of the default tariff cap we propose to transfer consumers on the existing safeguard tariff on to the direct debit (DD) default tariff cap.

1.43. Our research shows that consumers with vulnerable characteristics – low income, social housing renters, aged 65 or over, living with a disability – find it difficult to engage in the market, are more likely to lack confidence, or to be wary of the potential risks of switching tariff or supplier.

1.44. Consumers in vulnerable situations are more likely to be on high-priced standard variable tariffs and spend a higher proportion of their income on energy. This group is more likely to suffer in a number of ways, including struggling to afford bills. The impact of high energy prices is greater on poorer consumers, and the situation has got worse. In 2015, the poorest 10 per cent of households spent an average of 9.7% of their income on energy, compared to 5.8% of their income in 2005.

1.45. Transferring the consumers on the existing safeguard tariff onto the DD default tariff cap will ensure that this vulnerable group of consumers do not experience an unexpected increase in their energy bills upon the end of the existing safeguard tariff. They will receive an appropriate protection which is more tailored and will in the longer term, provide continuity in protection, leading to a better customer experience than the current safeguard tariff. Additionally, this decision will reduce complexity in the sector.

Context and related publications

1.46. Default Tariff Cap: Policy Consultation; Appendix 13 - Renewable tariff exemption
https://www.ofgem.gov.uk/system/files/docs/2018/05/appendix_13_-_renewable_tariff_exemption.pdf

1.47. Warm Home Discount Scheme 2018/19 consultation document:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/696467/WHD_extension_consultation.pdf

1.48. Background to prepayment meter safeguard tariff:
https://www.ofgem.gov.uk/system/files/docs/2017/08/intro_to_the_prepayment_price_cap.pdf

1.49. Decision to extend PPM cap:
https://www.ofgem.gov.uk/system/files/docs/2017/12/decision_letter_whd_safeguard_tariff_-_final.pdf

2. Whether to exempt renewable tariffs

In this chapter, we explain our proposed decisions on whether (and how) we should provide an exemption for renewable electricity and gas SVTs, and our rationale for our proposed decisions. We also summarise the stakeholder responses to our May consultation and explain our views on those responses.

Our proposed decision is that, by default, the tariff cap should apply to all SVTs, but we propose to provide a route for suppliers to apply for derogations for renewable electricity and/or gas SVTs that have been chosen by the suppliers' customers. For electricity, this is the position we proposed in our May consultation. For gas, we have changed our position compared to our May consultation where we proposed to provide no route for exemptions or derogations.

Renewable electricity tariff exemption and options

Is a renewable electricity tariff exemption appropriate?

2.1. Our proposed decision is that, by default, the tariff cap should apply to all SVTs, but we propose to provide a route for suppliers to apply for derogations for renewable SVTs.

2.2. In this section, we summarise our proposals in our May consultation, the stakeholder feedback that we received, and the rationale for our proposed decision.

2.3. Section 3 provides further details on our proposed derogations process, including the criteria against which we expect to assess derogation requests.

What we consulted on

2.4. Our position was that by default, the default tariff cap should apply to all SVTs, but that we would provide suppliers a route to apply for a derogation from the default tariff cap for renewable SVTs. Our rationale for not providing for exemptions was that:

- we were unable to define a tariff (for the purposes of an exemption) that materially supports renewables and is robust to gaming
- we did not have sufficient evidence that renewable SVTs support generation of renewable energy materially beyond what is already in place, noting that renewable generation (both gas and electricity), for the most part, is already supported through subsidies
- we did not have sufficient evidence to suggest that providing a renewable tariff costs a supplier materially more, and that any additional costs can be specifically attributed to a certain tariff.

2.5. Many stakeholders supported our proposal of not providing for exemptions, although two suppliers disagreed and noted that they preferred exemptions over derogations. Some stakeholders provided views on our rationale for not providing for exemptions. We discuss stakeholders' views in more detail below, including sharing our views on stakeholders' comments and how these have affected our proposed decision.

2.6. We consulted on four options for designing an exemption for renewable electricity SVTs

- option A, 100% renewable SVTs
- option B, X% of tariff being from unsubsidised renewable sources
- option C, Y% of the generation associated with a certain tariff being backed by long-term power purchase agreements (PPAs)[11] with renewable generators
- option D, Z% of tariff costs spent on renewable investment or R&D.

2.7. Where X, Y and Z are amounts that we would need to define. We noted that these options are not mutually exclusive.

2.8. We noted that each of these options has challenges, and that it was not clear to us that any of these options would be capable of defining a tariff that materially supports renewables and is robust to gaming (as mentioned in paragraph 2.4).

2.9. We therefore proposed to include all SVTs within the scope of the default tariff cap and consider allowing suppliers to apply for a derogation from the default tariff cap, based on a set of conditions or outcomes. We noted that this approach sets a high bar for an exemption; however, at the same time it provides flexibility to exempt tariffs in the light of new evidence. This would allow us to evaluate on a case-by-case basis how a tariff may fulfil our criteria. It would also be easy to monitor who has a derogation and would be more difficult for suppliers to game compared to an exemption.

2.10. We proposed that a derogation could be granted if a supplier could demonstrate its renewable SVT was chosen by the customer and delivers the following outcomes:

Outcome 1: By consumers choosing to be on the tariff, the supplier provides support for renewables, materially beyond what is provided by subsidies, obligations or other mandatory mechanisms.

Outcome 2: The tariff costs the supplier materially more to provide compared to standard tariffs, due to the provision of renewable electricity under that tariff.

Outcome 3: The supplier is able to provide unambiguous evidence that it has met outcomes 1 and 2 for the purposes of Ofgem monitoring whether the supplier is complying with those outcomes.

Stakeholder feedback

Stakeholder views on not providing exemptions but providing a route for derogations

2.11. Many suppliers and a consumer group supported our minded-to position of not offering exemptions, but providing a route for derogations. A number of suppliers offered some support for derogations, subject to us providing more clarity and transparency on the

[11] In this context, a PPA is a legal contract between an electricity generator and an energy supplier regarding the sale and purchase of energy.

derogation process and criteria against which we would assess derogation requests. Two suppliers preferred exemptions over derogations. They felt exemptions could be made workable, and one of those suppliers expressed concerns about derogations creating a regulatory barrier to offering non-default renewable SVTs. One supplier noted that they understood the rationale for not offering exemptions, but thought it was a backward step in promoting the use of renewables.

2.12. Some stakeholders offered specific thoughts on why they supported our proposed positions:

- some suppliers agreed with our concern that suppliers may attribute purchases of renewable energy at a supplier level to individual tariffs, allowing them to offer renewable tariffs without changing their business model

- one supplier suggested that allowing for exemptions for renewable tariffs would "perpetuate the myth" that renewable energy must be more expensive.

2.13. Below we summarise stakeholders' views (including any evidence they provided) against the four criteria against which we assessed exemption options. A consumer group noted that all the criteria should be challenging and a supplier noted they support the criteria.

Criterion 1: The tariff provides support for renewables, materially beyond support provided through subsidies, obligations or other mandatory mechanisms

2.14. Three suppliers supported this criterion, agreeing that it should be a high bar, and that tariffs should offer true additionality.

2.15. One supplier thought that we had set the bar too high to achieve a derogation for renewable electricity, suggesting that having a tariff that was 100% certified by REGOs should qualify, but with suppliers justifying why they cannot price the tariff below the cap. We note that in the Business, Energy and Industrial Strategy Committee's pre-legislative scrutiny of the draft Bill, they suggested the exemption should only apply to tariffs that provide "substantial environmental benefits". We do not believe that a 100% REGO-backed tariff in itself offers substantial environmental benefits, and suppliers would need to demonstrate additional support for renewables to be considered for a derogation. Also, in our May consultation we considered an option of exempting 100% renewable SVTs, but noted that it would be too open to gaming (by suppliers allocating all their renewable energy to one tariff) and may exempt tariffs that do not provide additional support for renewables because these tariffs would be built using existing supplier subsidies and obligations.

2.16. One supplier suggested that being able to offer an SVT was fundamental to their business model, which relied on striking PPAs with generators across the year, for different amounts and contract lengths. This, they said, matches the industry-wide approach to power purchasing for an SVT, where the volume of power can be layered into position. This contrasts with fixed tariffs, which rely on a large amount of power to be purchased for a fixed price and for a fixed term. Having the SVT allows that supplier to provide a route to market for different sizes of generators. This supplier explained that working with the smallest generators meant purchasing power that was below a tradable clip size, meaning that the supplier has to wait for sufficient volume to come in to be aggregated into a tradable clip size, which leaves the supplier vulnerable to fluctuations in the market. Offering an SVT allows the supplier to enter into PPAs with these generators, as they can alter the SVT to reflect cost of volume in its position. We

note that we are not prohibiting suppliers from offering SVTs, and that we received no strong evidence that renewable tariffs involve materially higher costs. We do however see the benefit in providing a route for suppliers to apply for derogations and to have an opportunity to demonstrate that their SVTs involve materially higher costs and provide support for renewables.

2.17. One supplier suggested that carbon offsetting[12] should not be included in the requirements for an exemption, as it is cheap and has no long-term impact on sustainability. They proposed that projects involving long-lasting environmental gain, such as habitat creation, where land is given back to nature, should be considered. The scope of what we can consider in deciding on whether to provide exemptions/derogations is informed by the Act, which focuses on whether it appears to the Authority that a tariff supports the generation of renewable electricity or production of renewable gas. This excludes us considering carbon offsetting and habitat creation.

Criterion 2: The tariff involves materially higher costs

2.18. Other than the general comments across all criteria (mentioned above), no-one provided specific views on whether they support or oppose this criterion.

2.19. One supplier expressed concern that applying the default tariff cap to renewable SVT's would require suppliers to offer them at a loss, and that this in turn would be detrimental to the promotion of renewable energy in the long term. This suggests they consider that offering renewable SVTs does impose additional costs on suppliers. It is difficult for us to verify these claims, as the supplier did not provide any supporting evidence. We also do not have any strong evidence to support these claims.

2.20. One stakeholder noted that although a derogations process could be a workable solution from a practical point of view, it provides no certainty to renewable generators that they will be able to continue to access such a competitive PPA market. We note that this assertion assumes that not providing derogations/exemptions would affect a supplier's ability to continue to enter into PPAs. We do not have any strong evidence that suppliers need to charge above the default tariff cap in order to be able to enter into PPAs. However, we are open to receiving this evidence at a later date, and our proposed decision is that suppliers will be able to apply for a derogation for renewable SVTs and such issues could be considered at that time.

2.21. In our May consultation, we suggested that the Renewables Obligation obliges suppliers to source energy from renewable sources. One supplier disagreed with this assertion, noting that the Renewables Obligation does not require a supplier to purchase renewable power, only to purchase a sufficient number of Renewable Obligation Certificates (ROC), or face paying the buy-out price. In our May consultation, we went on to suggest that due to the Renewables Obligation, there is a large base-load of renewable electricity (which was built with the support of subsidies paid for by all consumers) that can, theoretically, be purchased by suppliers without facing additional costs. The same supplier argued that the requirement to purchase ROCs does not imply that renewable energy can be purchased without additional cost, and that we are failing to account for increased forecasting, imbalance and contracting costs (amongst others). We note that our overarching argument on this point was that

[12] We understand this to mean a supplier offsetting the carbon generated through supplying non-renewable electricity by, for example, planting trees or investing in other schemes that reduce carbon emissions or remove carbon from the atmosphere.

the Renewables Obligation drove up the amount of renewable generation on the grid and that this generation was subsidised, which offset the additional costs involved in constructing and operating the renewable generators. We believe that this point still stands. In terms of the supplier's suggestion that they face increased forecasting, imbalance and contracting costs; it is difficult for us to verify that suppliers face these additional costs, as stakeholders did not provide any supporting evidence. We also do not have any strong evidence to support these claims. However, we are open to considering this evidence at a later date, and our proposed decision is that suppliers will be able to apply for a derogation for renewable SVTs and such issues could be considered at that time.

2.22. In reference to our proposed criterion/outcome 2, which explained that it would need to cost a supplier materially more to provide a renewable SVT, one supplier suggested that we had not been clear what would be the benchmark for costs and noted that in outcome 2 there was reference to "standard tariffs" with no explanation of what a standard tariff is. They suggested this causes confusion as to what level acts as a benchmark above which a tariff would qualify for a derogation. We have refined the outcomes and given more thought to the more detailed criteria that we would use to assess derogation requests. This has included clarifying outcome 2. We provide further details in section three below.

2.23. Another supplier raised the question of how a new supplier would be able to prove the costs of their renewable SVT to gain a derogation before they had become operational. We acknowledge that an existing supplier with a live renewable SVT may be better placed to demonstrate the proposed criteria against which we would assess derogation requests. We note that new suppliers will be establishing tariffs with the knowledge of the default tariff cap, and as such could offer fixed term tariffs (which could be outside the scope of the default tariff cap), rather than SVTs.

2.24. In our May consultation, we suggested that suppliers may not need to charge more for renewable SVTs in order to provide support to new generators, as new generators may have access to various revenue streams for their generation (via the capacity market and ancillary services), particularly when co-located with storage. One supplier disputed whether new generators have access to the capacity market, suggesting that subsidy-free renewable generators are effectively precluded from the capacity market, unless they make additional investments to co-locate with battery storage. The same supplier suggested that similar issues affect variable renewable generators being able to access ancillary markets, but the supplier did not expand on the specifics. They went on to note that generators face reducing revenue streams from triad benefits[13] and may see further reductions in other benefits, and suggested that this means it is increasingly important that those renewable generators are offered robustly priced PPAs. We assume the supplier is suggesting that to offer robustly priced PPAs, renewable tariffs need to be priced above the default tariff cap. We acknowledge the suppliers point about renewable generators participating in the capacity market. However, even if renewable generators are unable to access the capacity market or find additional revenue from ancillary services, this does not affect our overall position which is that:

- we have no strong evidence that suppliers face materially higher costs from providing renewable electricity SVTs

[13] The avoidance of transmission network use of system charges (TNUoS charges) by an electricity supplier where an embedded generator generates during a triad period.

- we were unable to define a tariff (for the purposes of an exemption) that materially supports renewables and is robust to gaming.

Criterion 3: The exemption can be clearly defined and robustly monitored

2.25. Other than the general comments across all criteria (mentioned above), the only other comment made on this criterion was a supplier agreeing that if derogations are to be available, they must be robustly specified and compliance monitored. We agree, and as such we would intend to build this into the criteria required for receiving a derogation.

Criterion 4: The exemption should be difficult to game

2.26. Other than the general comments across all criteria (mentioned above), the only other comment made on this criterion was a supplier supporting our position of not offering exemptions, pointing to the gaming risk of doing so.

Standard Licence Condition (SLC) 21D

2.27. One supplier suggested that we have the power within SLC 21D to prevent suppliers from misleading customers about renewables in their tariffs and suggested that SLC 21D could be amended to cover exemptions for renewable SVTs from the default tariff cap. Similarly, a supplier suggested that we could rely on SLC 21D to bring transparency to what a tariff actually contributes to the production of renewable energy. We did consider utilising SLC 21D, but as explained in our May consultation, SLC 21D does not have any threshold for environmental benefit and therefore we do not believe we can rely on it for the purposes of an exemption.

2.28. One supplier felt it was contradictory that on the one hand we said we "struggle to see how a tariff could materially support the production of renewable energy over and above what is already in place" and on the other hand SLC 21D says that to make an environmental claim, it must be shown that the benefit is as a result of the tariff, and not just as a result of existing subsidies. To clarify, our proposed criterion is that a tariff must demonstrate support for renewables materially beyond what is provided by existing subsidies. This means a tariff might be able to demonstrate that it complies with SLC 21D, which doesn't set a lower threshold, yet may not be able to meet the criteria we proposed, which sets a higher bar.

Suggestions on designing an exemption and/or the derogations process

2.29. A number of respondents believed that, if there were to be derogations, the whole procedure should be entirely transparent, with qualifying methodologies clearly outlined, timescales provided, and outcomes fully explained. One stakeholder suggested that the derogation process could disadvantage smaller suppliers, as large suppliers tend to be better resourced in applying for derogations. Similarly, one supplier suggested the derogation process could be off-putting to suppliers (whether large or small) and stifle innovative renewable tariffs being offered to consumers. We acknowledge that there is a risk that the derogations process will create a regulatory barrier to offering non-default renewable SVTs, but we judge that the impact of the risk of gaming from an exemption approach would be more detrimental to consumers. We will attempt to mitigate it by providing as much transparency and clarity as possible on the derogations process and the criteria we will use for deciding whether to provide a derogation. Section 3 provides further transparency and clarity on our

proposed derogations process and assessment criteria, and, at Annex A, we have provided a draft derogation request form.

2.30. One supplier raised the issue of data security regarding the information suppliers would be required to provide to us in applying for a derogation. In response to this we note that:

- Any information provided to us which relates to the affairs of an individual or a particular business will be subject to statutory restrictions on disclosure under section 105 of the Utilities Act (2000). In so far as it is practicable to do so, we will normally seek consent before making any disclosure.

- We cannot provide any assurances in relation to the treatment of information which may be the subject of a request made under the Freedom of Information Act (2000) ('FOIA'). However, we can confirm that we will always consider whether the statutory restrictions on disclosure apply to the requested information and therefore whether one or more of the FOIA exemptions apply.

2.31. One supplier suggested that suppliers who have renewable tariffs should be able to maintain the price of their tariff while we are considering their request for a derogation. They suggested that this would protect customers from sudden price changes and, if the derogation is not granted, the supplier could rebate the customer the amount owed. We acknowledge these concerns, but think that to do this would potentially cause detriment to consumers and create a risk of gaming of the mechanism. To help to mitigate this risk, we propose that we will – as a transitional measure only - fast-track priority requests and aim to provide suppliers with a provisional decision at least 30 days ahead of the licence condition taking effect on their derogation requests.

Other

2.32. One supplier noted that we had said we intended to publish a working paper on renewable exemptions, and that we had not done so, and that this meant that the policy consultation was the first opportunity for stakeholders to engage with Ofgem on the matter. We acknowledge that we did not publish a working paper on renewable exemptions. We believe we have taken an appropriate approach to exercising our duty under the Act to consult on whether and if so how we will implement an exemption. Additionally, we have provided stakeholders opportunities to engage with us, including through an industry workshop, a webinar, and meeting suppliers bilaterally.

2.33. One supplier suggested that a supplier offering a fixed renewable tariff priced under the cap would not be able to roll the customer on to a renewable default tariff at the end of the fixed tariff. The suppliers suggested this would mean that the customer would have to positively opt for a renewable tariff after the end of every fixed tariff period, harming the customer experience. As to this, our proposed decision would still allow a supplier to roll customers onto a renewable default tariff at the end of a fixed term, but that default tariff would have to be priced at or below the level of the default tariff cap. Requiring customers to make a choice to pay more for a renewable SVT is in line with the requirements set out in the Act.

2.34. One stakeholder proposed that wherever a customer has contacted the supplier and requested to begin a contract on the basis of an SVT, this should constitute a definition of 'choice'. They argued it would not be appropriate to put any sort of time limit (such as requiring that customers must have joined that SVT in the past five years). We

propose that we will not rule out setting some parameters around what counts as 'choice'. We are proposing to place the burden on suppliers to demonstrate (when requesting a derogation) that their customers made an active choice and that the choice is still valid. We would be interested, for example, in any significant changes to the nature of the tariff or terms of the contract since their customers joined the tariff.

2.35. One stakeholder argued that suppliers should be encouraged to continue to offer renewable SVTs and they felt that the default tariff cap should not be applied where engagement is clearly evident. We note that we are indeed proposing that there would be a route for renewable SVTs to receive a derogation from the default tariff cap (subject to meeting certain criteria).

Rationale for our proposed decision

2.36. The rationale for our proposed decision of requiring that by default the tariff cap should apply to all SVTs is that we are not convinced that any of the proposed options for creating an exemption is robust to gaming. Also, we currently have no strong evidence that renewable electricity SVTs:

- support renewable generators materially beyond support provided through subsidies, obligations or other mandatory mechanisms, and/or
- involve materially higher costs due to the renewable element of those tariffs.

2.37. As such, we have been unable to define a workable exemption that captures tariffs that materially support renewables and is not open to gaming. Given our overall duty under the Act to protect existing and future domestic customers who pay standard variable and default rates, it would be inappropriate to provide an exemption that could be gamed by suppliers to exempt tariffs that do not support renewables or involve materially higher costs due to the renewable element of those tariffs.

2.38. The rationale for providing a route for suppliers to apply for derogations for renewable SVTs is that suppliers may, on a case-by-case basis, be able to demonstrate that a particular SVT does support renewables and involve materially higher costs. A derogations process allows us to consider each derogation request on its merits and to only provide an exemption where we are persuaded that we will be able to monitor that it complies with any derogation given. We expect to set a high bar for approving any derogation.

2.39. In our May consultation, we set out four potential options for defining an exempt tariff and explained why we consider these options fail to define a tariff that materially supports renewables and is robust to gaming. Below we briefly summarise our concerns with each option.

2.40. **Option A, 100% renewable SVTs:** We consider that this option would be too open to gaming (by suppliers allocating all their renewable energy to one tariff) and may exempt tariffs that do not provide additional support for renewables because these tariffs would be built using existing supplier subsidies and obligations.

2.41. **Option B, X% of tariff being from unsubsidised renewable sources:** We consider that this option could exempt tariffs on the basis of them being partly composed of old hydro generating stations (ie not supporting new renewable investment). Suppliers may also be able to game the exemption by notionally allocating unsubsidised

renewable energy, which was purchased for the benefit of all of their tariffs, into a single renewable SVT.

2.42. **Option C, Y% of the generation associated with a certain tariff being backed by long-term power purchase agreements (PPAs)[14] with renewable generators:** We consider that this option may allow suppliers to game the exemption by notionally allocating PPAs, which they put in place for the benefit of all of their tariffs, into a single renewable SVT.

2.43. **Option D, Z% of tariff costs spent on renewable investment or R&D:** We consider that this option would likely be difficult to clearly define and robustly monitor as regards compliance with the exemption. It would also be too open to gaming, as suppliers could notionally allocate their renewable investment, which was invested for the benefit of all of their tariffs, into a single renewable SVT.

Renewable gas tariff exemption

Is a renewable gas tariff exemption appropriate?

2.44. Our proposed decision is that by default, the tariff cap should apply to all SVTs, but that we propose to provide a route for suppliers to apply for derogations for renewable gas tariffs. This represents a change compared to our May consultation, where we had proposed to provide no route for exemptions or derogations for gas tariffs.

2.45. Section 3 includes further details on the expected derogations process, including the criteria against which we expect to assess derogation requests.

What we consulted on

2.46. Our position was that an exemption was not appropriate. Similar to renewable electricity SVTs, we had no strong evidence that renewable gas SVTs support renewables or involve materially higher costs due to the renewable element of those tariffs. We also noted that:

- our analysis suggested renewable gas is not currently widely available and therefore we were not convinced that it would be proportionate to provide an exemption; and
- there was no equivalent of the REGOs scheme that exists in electricity, which we could use to monitor the provenance of a gas supplier's fuel mix. We are aware of at least one industry-led certification scheme that mimics the REGO scheme, but we did not consider this sufficiently comprehensive and transparent.

2.47. We noted that to consider an exemption for gas we would need an independent and comprehensive scheme that validates the supplier's purchase of renewable gas to base the assessment on. Our view was that, given the default tariff cap is temporary, it

[14] In this context, a PPA is a legal contract between an electricity generator and an energy supplier regarding the sale and purchase of energy.

would not be proportionate to design and implement a new scheme for the purposes of the default tariff cap.

Stakeholder feedback

Overall support on not providing exemptions but providing a route for derogations

2.48. We assume that the suppliers that supported (or not) providing for exemptions did so equally for renewable gas and electricity SVTs. Three suppliers and one trade body were opposed to our minded-to position to not provide a route for derogations.

Views on the four criteria that we assessed exemption options against

2.49. For gas, we did not provide exemption options and assess them against the four criteria that we did for electricity. However, we assume that the comments made on those four criteria broadly apply equally to gas. Below we set out some of the specific comments made on gas against the criteria.

2.50. One supplier noted that they had a renewable gas tariff that would meet Ofgem's proposed criteria for electricity derogations. No stakeholders provided evidence that gas tariffs would meet the criteria. However, we appreciate that this evidence might exist and could be provided at a later date, so we have decided to provide a route for derogations.

2.51. A supplier suggested that not providing an exemption route for renewable gas might stifle innovation in an immature marketplace. Some suppliers pointed out that the Committee on Climate Change had stated that the UK was on course to miss its target of 15% of energy to be sourced from renewables by 2020 and that this is particularly affected by lack of progress in the renewable heat sector. It was suggested that not providing a renewable gas exemption would further harm this progress. We did not receive any strong evidence that renewable gas tariffs provide support for renewables or involve materially higher costs. As such, we had no evidence to suggest that not providing a route for derogations would affect progress in the renewable heat sector. However, we appreciate that this evidence might exist and could be provided at a later date, so we have decided to provide a route for derogations.

2.52. One supplier noted that the production of renewable gas is currently low and properly certified renewable gas certificates attract a significant cost premium due to scarcity and other external influences. It is difficult for us to verify these claims, as the stakeholder did not provide any evidence to demonstrate that renewable gas certificates attract a significant premium. However, we appreciate that this evidence might exist and could be provided at a later date, so we have decided to provide a route for derogations.

Other comments

2.53. One supplier agreed with our concerns about there being no REGO-style certification scheme for renewable gas, and questioned whether a remedy to this could be an external auditor verifying renewable gas purchases from Renewable Heat Incentive (RHI)-backed plants. However, another supplier suggested that there were certification-style schemes operating in the market and the onus should be on the supplier to convince Ofgem that their tariff deserves a derogation. They noted that it was harder to source renewable gas and that the supplier should be able to prove the

provenance of their gas and the percentage of which is renewable. We agree that there may be other approaches to monitoring the provenance of suppliers' gas. We are proposing to provide a route for suppliers to apply for derogations, and the onus would be on the supplier to demonstrate that we would be able to monitor the support their tariff is providing to renewable gas producers.

2.54. One supplier noted that our May consultation presented a minded-to position to not provide for exemptions/derogations for renewable gas tariffs. They suggested that, as there is a requirement to consult on a renewable gas exemption set out in the Act, there is a risk of Ofgem's decision being challenged by judicial review. We note that although we presented a minded-to position, in our May consultation we invited evidence to either support or refute our initial position. We were very clear on the criteria against which we were considering whether an exemption is appropriate. We also held a workshop and a webinar on our policy proposals where stakeholders had the chance to provide comments. We do not consider that there has been any error in our approach to our duty to consult.

Rationale for proposed decision

2.55. The rationale for our proposed decision of requiring that by default the tariff cap should apply to all SVTs, is broadly the same as for electricity as captured at paragraphs 2.36 to 2.43.[15]

2.56. Specifically on renewable gas SVTs, in our May consultation we flagged our concerns around the lack of a REGO equivalent making it more difficult to monitor the provenance of the gas provided under a supplier's renewable gas tariff. Having considered it further (following the evidence submitted by a stakeholder), we now believe it might be possible to establish alternative routes to demonstrating the provenance of a supplier's gas. It will be for suppliers to provide evidence to support any derogation application.

[15] In our May consultation we did not provide detailed options for designing a gas exemption. However, broadly the same options as we set out for electricity could apply to gas, and we consider that they present the same concerns as they do for electricity.

3. Derogation process and criteria/outcomes: renewable tariffs

In this chapter, we set out our proposed approach to receiving and processing derogation requests. Our key proposals are that:

- we would consider derogation requests against three key outcomes, covering costs, support for renewables, and customers having chosen the SVT
- as a transitional measure only when the default tariff cap is introduced, we would run a two-stage derogation process, fast-tracking priority derogation requests to provide a decision on a time-limited derogation, followed by an in-depth review of derogation requests to provide a decision on a more enduring derogation
- the prioritisation of derogation requests would be against criteria that aim to minimise any potential consumer detriment, such as prioritising tariffs with a large number of customers.

Our proposed approach to receiving and processing derogation requests

3.1. We have an existing process for receiving and considering derogation requests from supply licence conditions. We propose that we would build upon this process, but would need to tailor it for assessing renewable SVT derogation requests. In particular, we propose that we would:

- provide a bespoke derogation request form with questions specific to renewable SVT derogation requests, with supporting guidance on completing that request form. We have attached a draft derogation request form in Annex A to this appendix
- as a transitional measure only when the default tariff cap is introduced, run a two-stage derogation process, fast-tracking priority derogation requests to provide a decision on a time-limited derogation, followed by an in-depth review of derogation requests to provide a decision on a more enduring derogation.

3.2. Below we explain how we propose to process derogation requests, including both the process we expect to follow and the criteria we expect to assess requests against. We welcome views on these proposals.

Our criteria for assessing derogations

3.3. In our May consultation, we proposed that a derogation may be granted if a supplier could demonstrate its renewable SVT delivered three outcomes. Our current view on the high level outcomes are:

Outcome 1: the tariff is an SVT that consumers have chosen to be on.

Outcome 2: by consumers being on the tariff, support is given to renewables to an extent that is materially greater than that which is brought about as result of subsidies, obligations or other mandatory mechanisms.

Outcome 3: the cost to the licensee of supplying electricity/gas by virtue of the tariff is materially greater than the level of the default tariff cap for reasons that are directly

3.4. Stakeholders called for transparency on the criteria we would use to assess derogations. We intend to develop the detailed criteria over the coming weeks and months. We explain below our current expectations on the more detailed criteria we propose we would assess derogation requests against. Some sub-criteria may be assessed on a pass/fail basis (where a 'fail' would mean the derogation request is rejected), whereas others may be assessed in the round.

Criteria to demonstrate that the tariff is an SVT that consumers have chosen to be on (outcome 1)

3.5. Some suppliers will have a renewable SVT that they have used to both acquire new customers (ie customers that have 'chosen' to be on that tariff) and to default customers onto from their fixed term tariffs. They may also have 'deemed customers'[16] on a renewable SVT. The Act only allows us to exempt/derogate tariffs that consumers have chosen to be on (ie we cannot derogate 'default' tariffs). As such, suppliers will need to be able to demonstrate that the tariff we are derogating does not/will not have defaulted or deemed customers on it.

Criteria to demonstrate 'support for renewables' (outcome 2)

3.6. We would expect to request evidence against two broad areas: financial support and non-financial support for renewables. We expect to assess this by considering the range of support a supplier provides and deciding whether, overall, this equates to support materially beyond what is provided through subsidies etc. No single activity that a supplier does or does not do would lead to us rejecting a derogation request.

3.7. On **financial support**, some examples of the sorts of activities a supplier might carry out that would demonstrate 'support' for renewable generators would be:

- investment into renewable generation, including into research and development
- paying above the market rate for energy to enable a generator to enter the market who may otherwise have been unable to enter the market.

3.8. On **non-financial support**, some examples would be:

[16] Typically a deemed contract will occur where a consumer moves into a new property and has not agreed contractual terms with a supplier who is supplying energy to that property or where a fixed term contract expires and there are no explicit provisions for terms and conditions for the period immediately after expiry.

- providing administrative support to help generators enter and/or remain in the market

- entering into PPAs with generators to enable them to obtain financing.

3.9. On both financial and non-financial support, suppliers would need to demonstrate that the support flows from the tariff for which they are applying for a derogation and is not to the detriment of support provided through other tariffs.

Criteria to demonstrate the supplier incurs materially higher costs (outcome 3)

3.10. We would expect to review supplier derogation applications in two key areas.

3.11. **Renewable costs:** we would require suppliers to explain the costs that they face solely from the 'support' they provide to renewables, and which they would not otherwise face. We may require suppliers to demonstrate that these costs are efficient. We may do this by considering whether other renewable suppliers incur these costs, and where they do, considering whether they incur the same level of costs. If other suppliers can provide similar levels of support to renewables but without incurring such costs, it would raise the question of why the applicant needs to incur them.

3.12. **Overall costs:** We would expect the supplier to demonstrate there is a relationship between the overall cost of the tariff, the renewable specific cost and the need to price materially above the default tariff cap. The rationale is that if the supplier does not need to charge materially above the default tariff cap in order to recover costs, then it would not be appropriate or necessary to provide a derogation. We will consider whether the supplier's overall costs must be 'efficient' compared to the benchmark used for the default tariff cap.

3.13. Suppliers would need to demonstrate that costs are specific to the tariff and that they are not cross subsidising to, eg, drive up the apparent costs of the renewable SVT in order to game the derogations framework.

Other criteria

3.14. When a supplier requests a derogation, we also propose that we would expect them to demonstrate that they will be able to provide information to Ofgem to allow us to monitor whether their tariff will continue to meet the outcomes above. We would then expect to work with the supplier to agree on the monitoring requirements.

The process and timescales

3.15. One supplier identified a risk that a derogation may not take effect in advance of the default tariff cap taking effect, meaning consumers may see their prices fall and then rise. We recognise this risk and note that there are some factors that contribute to it:

- We can only invite derogation requests once we make our final decision on whether to provide a route for derogations (we intend to make our final decision on the default tariff cap in November).

- We can only make a final decision on a derogation request once our proposed licence condition 28AD takes effect (56 days after we publish our final licence decision).

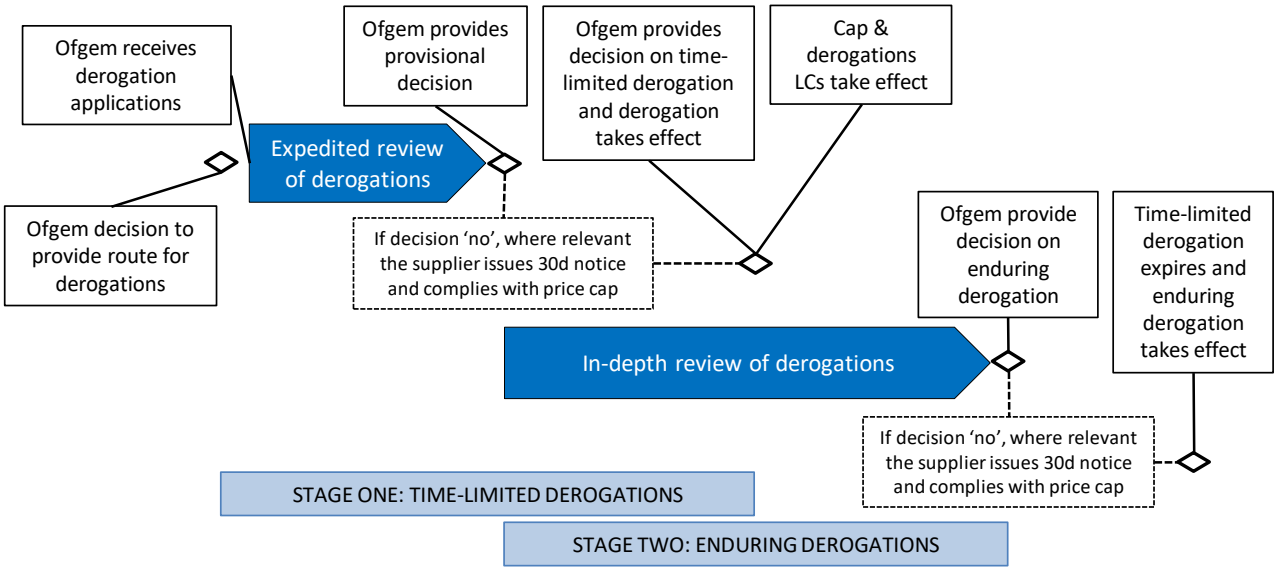
- When a supplier changes the terms and conditions of a consumer's contract in a way that is to the disadvantage of the consumer, they must give 30 days' notice.[17] If a supplier is required to issue this notice ahead of complying with the default tariff cap, then this notice would need to be issued at least 30 days ahead of the default tariff cap taking effect, in order to change the terms and condition of the respective contract with the consumer at the same time.

- Similarly, if the default tariff cap has taken effect and a supplier has brought their renewable SVT prices in line with the cap and then receives a derogation for the SVT, they would need to provide at least 30 days' notice before increasing prices.

3.16. Without any mitigating actions, if we were to wait until the derogation licence conditions come into effect before issuing a decision on whether to derogate a particular SVT, then suppliers may need to reduce prices to comply with the default tariff cap and then issue a 30-day notice to increase prices. This risks a poor customer experience. It may also risk a supplier with a SVT that genuinely supports renewables and that faces materially higher costs having to reduce its prices. Recognising these risks, we are proposing a derogations process with a transitional element that helps to mitigate the risk.

3.17. We propose to invite derogation requests immediately upon making our final decision on whether to provide a route for derogations. We would then carry out up to two stages of assessment, and after each we may provide a derogation.

Figure A10.2: The two-stage process



[17] This requirement is captured in the electricity and gas supply licences at condition 23 (Notification of Domestic Supply Contract terms).

Optional stage one: expedited review of derogation requests, feeding into provisional decision and final decision to provide a time-limited derogation

3.18. The aim of stage one is to "fast track" priority requests (for instance, those tariffs affecting a large number of customers) for a time-limited derogation decision until we can provide a decision on whether to provide a more enduring derogation. The expedited review of derogation requests would necessitate a less in-depth assessment than we would ordinarily carry out. As such, if we issue a derogation based on an expedited review, we would expect it to be a time-limited derogation, which would expire after a number of months.

3.19. We propose that if suppliers submit a derogation request shortly after we invite requests, we would aim to carry out an expedited review of those requests. If we receive many requests, we may have to prioritise our assessment of requests to minimise the risk of consumer detriment (we explore this further from paragraph 3.26).

3.20. If a supplier wants a provisional decision ahead of the default tariff cap taking effect then we would need to receive the derogation request shortly after we invite derogation requests. The sooner we receive these, the more likely we will be able to provide a provisional decision far enough in advance to potentially avoid the supplier having to temporarily comply with the default tariff cap. It is likely that if we do not receive a full and complete application within one week from inviting derogation requests that we will not be able to make a provisional decision that can take effect in time for the start of the default tariff cap.

3.21. We would aim to carry out an expedited review and provide provisional decisions on whether we will provide a derogation as soon as possible, and ideally no later than 30 days ahead of the default tariff cap taking effect. We would aim to issue a final decision on the time-limited derogation (based on our expedited review) once the licence conditions take effect, which would align with when the default tariff cap takes effect. We reserve our right to issue a different decision to our provisional decision. However, the provisional decision would provide some comfort to the supplier in terms of the decision we provisionally expect to give once the licence conditions take effect. In light of having this comfort, suppliers will need to decide on changing their prices or not on the basis of their expectations of receiving a derogation.

Stage two: in-depth review of derogation requests with decision on an enduring derogation

3.22. We propose that once we have completed our expedited review, we would carry out a more in-depth review of derogation requests. We would aim to conclude that review ahead of any time-limited derogations expiring. If we consider that the derogation request meets the criteria, we would issue an enduring derogation to take effect upon expiry of the time-limited derogation. If we were not satisfied, then the time-limited derogation would expire and the supplier would be required to comply with the default tariff cap.

3.23. We do not expect to set a deadline for receiving derogation requests, so suppliers would be able to apply for a derogation at any point during the lifetime of the default tariff cap.

3.24. If a supplier received a time-limited derogation (under stage one) but did not receive an enduring derogation (under stage two), we propose that we would not require them to rebate their customers.

3.25. After the transitional arrangements relating to the introduction of the default tariff cap, we would retain only the in-depth phase as the sole approach to processing derogations.

Prioritisation of derogation requests

3.26. For the purposes of our expedited review of derogation requests, we propose that we may consider prioritising our assessment of derogation requests. The aim of any prioritisation would be to minimise any potential consumer detriment. As such, we are proposing that if we were to prioritise, it would based on:[18]

- how many customers are on the renewable SVT (prioritising suppliers with more customers)
- how many customers are on the renewable SVT, as a percentage of the relevant suppliers' entire customer bases (prioritising suppliers with a higher percentage)
- whether we consider the derogation request may represent an attempt to 'game' the default tariff cap for a tariff that isn't genuinely supporting renewables (we would expect to deprioritise these requests)
- how high the quality of the submission is (those that do not provide from the earliest opportunity a sufficient level of detail for us to make a decision will necessarily take longer to process).

3.27. As noted above, the sooner we receive derogation requests, the more likely we will be able to provide a provisional decision far enough in advance to potentially avoid the supplier having to comply with the default tariff cap.

[18] To be clear, we are explaining how we will prioritise the order that we assess derogation requests in. We are not listing the factors that will influence whether we ultimately provide a derogation.

4. Whether to exempt vulnerable consumers on a safeguard tariff

In this chapter, we set out our proposed approach to the future of the existing safeguard tariff (which applies to customers in receipt of the Warm Homes Discount (WHD)).

Our proposal is to end the existing safeguard tariff, which we introduced as a temporary measure, and move the customers protected by it onto the direct debit (DD) default tariff cap. In doing this, customers will not see an increase in bills. Our rationale for putting all these customers on the direct debit cap, regardless of payment type, is to ensure that these vulnerable customers are not exposed to an unexpected bill increase when we end the existing safeguard tariff. For suppliers, the costs to serve these customers will be better accounted for through the default tariff cap than the existing safeguard tariff and this move will reduce complexity in the sector.

Exemptions for vulnerable consumers on the existing safeguard tariff

Proposed decision

4.1. The Act states that default tariff cap licence conditions may provide for an exemption from the cap for consumers who benefit from an Ofgem vulnerable cap. However, we are not proposing to use this mechanism to exempt Warm Home Discount (WHD) consumers on the existing safeguard tariff.

4.2. Instead, we propose to end the existing safeguard tariff and place WHD consumers currently receiving that protection on the direct debit default tariff cap. This includes those consumers that are identified as eligible for the WHD up until 31 March 2019.

What we consulted on

4.3. We extended the prepayment meter (PPM) cap in February 2018 to WHD consumers. This safeguard tariff provided around a million vulnerable consumers (those in receipt of the WHD) with temporary price protection. The intention was to provide these consumers with short-term protection until a broader cap came into place.

4.4. During the consultation process to extend the PPM cap to include WHD consumers we explained that to ensure the measure is proportionate and in line with EU legislation, the existing safeguard tariff would end in December 2019 if it has not already been replaced by other price protection.

4.5. As a part of the consultation process we suggested that this protection for vulnerable consumers would come from the default tariff cap for consumers on SVTs and default tariffs, or, if that was not in place by winter 2018, a vulnerable safeguard tariff using data matching.

4.6. We issued an open letter on 20 July 2018 confirming that plans were in place for the default tariff cap. This letter confirmed that, as a result, we would no longer be progressing with our vulnerable safeguard cap.

Stakeholder feedback

4.7. Suppliers had different views on the approach to the existing safeguard tariff. In response to our May consultation one supplier was supportive of our position with regards the removing of the safeguard tariff when the default tariff cap comes into effect. However, another supplier explained that it would prefer to see a separate safeguard tariff for vulnerable consumers exist alongside the default tariff cap.

4.8. One respondent noted in response to a previous consultation that the existing safeguard tariff will fall away once the government's wider price cap is in place and said that it was crucial that progress to identify and support 'vulnerable' consumers is maintained and built upon to tackle the high energy costs different groups, including disabled people.

4.9. Whilst considering the options for the end of the existing safeguard tariff, we heard from a number of consumer groups who were concerned about how its removal could disadvantage vulnerable consumers. There was concern about whether these vulnerable consumers would be moved onto the default tariff cap and have to pay higher energy bills as a result.

4.10. A supplier referred to increased confusion amongst consumers moving between two different cap arrangements depending on their transitory qualification for safeguarding (currently Warm Home Discount eligibility). The same stakeholder explained that suppliers should not be placed in a position where it is unclear which cap arrangement is the appropriate choice for a consumer, as this creates additional complexity, risk and administration cost. Another stakeholder was concerned that having different methodologies for the default cap and the existing safeguard tariff would create confusion for consumers and may be perceived as unfair.

4.11. One supplier noted that eligibility for the vulnerable safeguard tariff is linked directly to WHD eligibility, and that consumers with an exempted supplier are excluded from the vulnerable safeguard tariff and do not realise the benefits attributed to that tariff. We recognised this issue when introducing the existing safeguard tariff, which was an interim measure for protecting vulnerable consumers.

4.12. A consumer organisation suggested there was a significant risk that low-income consumers may still see their bills increase if the existing safeguard tariff is withdrawn prematurely once the default tariff cap is introduced.

Rationale for proposed decision

4.13. We propose to maintain our previous decision[19] and end the existing safeguard tariff and transfer consumers on to the default tariff cap. When we introduced the existing safeguard tariff we were clear that this was a temporary measure until either the

[19] (Ofgem 2017) Decision to extend PPM cap: https://www.ofgem.gov.uk/system/files/docs/2017/12/decision_letter_whd_safeguard_tariff_-_final.pdf P. 2.

default tariff cap or a broader vulnerable tariff came into effect to replace it. However, we agree with the stakeholder who raised the concern about WHD consumers' bills increasing once we remove the safeguard tariff.

4.14. As such, we are proposing to transfer all existing safeguard tariff consumers onto the direct debit default tariff cap, whether they pay by direct debit or standard credit. The direct debit level of the proposed default tariff cap is very similar to the level of the existing safeguard tariff. Therefore, consumers will see very little difference in their bills after the switch.

4.15. Our analysis shows that 50% of SVT WHD consumers pay by standard credit (SC) and the remaining by direct debit (DD). At a default tariff cap level of £1,219 for SC, SC WHD consumers would pay in the region of £80 more per year if they were transferred on the proposed default tariff cap in 2019. That would be an unexpected bill increase for these vulnerable consumers.

4.16. We agree with stakeholders that maintaining the existing safeguard tariff would add complexity, which we can remove by transferring the vulnerable group identified by the existing safeguard tariff onto the default tariff cap, whilst continuing their price protection. In addition, through the process of introducing the existing safeguard tariff, stakeholders highlighted the challenges of identifying recipients of this particular benefit by payment type (either DD or SC). Our proposal will reduce these complexities.

4.17. We note that suppliers have some flexibility on by when they must identify which of their customers are eligible for the WHD for a particular scheme year. This means that some consumers that have been/will be identified in scheme year 8 will be identified as eligible ahead of the initial cap period, whereas others will be identified during the initial cap period (ending 31 March 2019). We considered whether consumers identified during the initial cap period should be treated the same as consumers identified before. Those identified after would not be at risk of seeing a step-change in their bills if they are transferred to the SC default tariff cap, which could support the position of not treating them the same. However, if we were not to treat them the same, it could create an incentive on suppliers to delay when they identify which of their customers are eligible for the WHD (and by extension the existing safeguard tariff). It could also create an uneven playing field between suppliers that promptly identify eligible consumers and those that do not. As such, we propose that consumers that are identified as eligible for the WHD by 31 March 2019 will be protected by the DD default tariff cap.

Annex A: Renewable SVT draft derogation request form

To provide transparency to suppliers, we have provided an early draft of the potential questions a supplier would have to answer when applying for a derogation. We intend to refine these over the coming weeks and months ahead of formally inviting derogations. To be clear:

1. We have not yet decided to provide a route for derogations (which is part of an ongoing consultation process)

2. This is draft of the potential questions we may ask, but is subject to change.

The majority of the questions below would apply to derogations in relation to both gas and electricity tariffs. However, some are more tailored to electricity tariffs and we would need to develop tailored questions for gas tariffs. We would also need to decide whether we provide separate derogation request forms for electricity, gas and dual fuel requests, or whether we would provide a single form but with only some questions being relevant, depending on whether the supplier is applying for an electricity, gas or dual fuel derogation.

We would not expect suppliers to provide answers on the greyed out cells.

	Question/section - **Sub-questions**	**Notes**
1.	**Applicant's basic details**	
	1.1 Licence holder's name	
	1.2 Licence holder's address	
	1.3 Licence holder's company number	
	1.4 Contact name	
	1.5 Contact email	
	1.6 Contact phone number	
2.	**Additional applicant and tariff details**	A general theme across these questions is to gather information that will help us to crosscheck the answers provided to later questions around 'supporting generators' and 'costing more'. It will also gather information that helps us to draft any derogation notice that we may decide to grant
	2.1 Number of tariffs you are applying for a derogation for, with explanation of why it is appropriate to group them for the purposes of applying for a derogation.	Suppliers tend to have a generic tariff but with a variant tariff per DNO region, per payment type etc., so we would expect them to apply for a single derogation across all tariffs that are essentially variants of a single tariff. Where there are these variants, the supplier should make it obvious to us that they are essentially the same

		tariffs and that we are able to complete our assessment as a single assessment
	2.2 Names of tariffs (NB the tariffs to which this derogation request relates are called "Relevant Tariffs" from here on).	
	2.3 Demonstrate that the Relevant Tariffs are SVTs.	The Act requires that we can only provide derogations for SVTs.
	2.4 Number of customers in suppliers' portfolio, split by domestic and non-domestic. Provide the most up to date figure you have and state the date that the figures relate to.	Having this information will help us spot potential attempts at 'gaming'.
	2.5 How many customers are on the Relevant Tariffs? Specify the date these figures relate to.	
	2.6 What is your overall fuel mix (ie across all tariffs in your portfolio)? Specify the date these figures relate to. Explain any changes you expect to your overall fuel mix over the period of the derogation.	Assume the 'period of the derogation' to be the start and end date you have requested the derogation applies to.
	2.7 What is the fuel mix of the Relevant Tariffs? Where this differs to your overall fuel-mix, explain the reasons. Explain any changes you expect to the fuel mix of the Relevant Tariffs over the period of the derogation.	Assume the 'period of the derogation' to be the start and end date you have requested the derogation applies to.
	2.8 Break down the 'renewable' element of your fuel mix by the means by which you acquire that energy. (NB this is not in relation to technology type) - Where this differs to your overall fuel mix, explain the differences and the reasons for the differences. - Explain any changes you expect to the breakdown (at overall level and for the Relevant Tariffs) over the period of the derogation.	The categories we have in mind are, eg, energy purchased through PPAs, energy from generators owned by parent company etc. We would expect this to be weighted by the amount of energy the supplier gets from each category (eg is it 80% through PPAs and 20% through directly owned?)
	2.9 Number of renewable generators that a) you have a PPA with, and/or b) you/your parent company own/partly own and which provide energy to your customers. Explain how these generators are 'split' between Relevant Tariffs and the rest of your portfolio.	By "split across Relevant Tariffs and the rest of their portfolio", we are looking to understand whether suppliers are, eg, notionally allocating all the PPAs to Relevant Tariffs, meaning the remaining tariffs get some renewable energy under some other arrangement.
	2.10 Size (max capacity of output in MWh) of renewable generators that you have a PPA with.	
	2.11 Provide the price charged for each Relevant Tariff, split by unit rate, standing	

	charge, and annual charge for a typical consumer (using Typical Domestic Consumption Values).	
	2.12 Please set out: a. the duration for which you are requesting a derogation b. why this is the appropriate length of time required for the derogation.	It would be valid to request that the derogation starts as soon as possible and for it to end when the default tariff cap ends. If we decided to provide a derogation, we may specify dates different to what the supplier requested.
3.	**Provide evidence to demonstrate that the Relevant Tariffs provide support for renewables, materially beyond support provided through subsidies, obligations or other mandatory mechanisms.**	The Act requires that we can only exempt tariffs that appear to the Authority to provide support for renewables. This question is the opportunity for a supplier to demonstrate that.
	3.1 Provide a brief summary of how the Relevant Tariffs provide support.	
	3.2 Provide details and evidence of any financial support you provide to renewable generators. Demonstrate that the support flows from the Relevant Tariffs and is not to the detriment of support provided through other tariffs	
	3.3 Provide details and evidence of any non-financial support you provide to renewables. Demonstrate that the support flows from the Relevant Tariffs and is not to the detriment of support provided through other tariffs	
4.	**Provide evidence to demonstrate that you incur materially higher costs due to the support the Relevant Tariff provides to renewables**	For answers to 4.1-4.3, clearly signpost any relevant data from the figures provided for question 4.4.
	4.1 Explain how much the Relevant Tariffs cost to provide per typical customer. Demonstrate that costs are specific to the tariff and not from any cross-subsidy.	
	4.2 Demonstrate that you incur additional or increased costs as a result of providing the Relevant Tariffs, due to the support that those tariffs provide to renewables. Demonstrate that those additional costs are necessary and efficient. Demonstrate that costs are specific to the tariff and not from any cross-subsidy.	
	4.3 Explain any cost savings you make from providing renewable energy.	
	4.4 Complete a detailed cost spreadsheet.	We would expect to provide an excel template with predefined headings to understand all costs that underpin the Relevant Tariffs.

5.	**Monitoring that the Relevant Tariffs are <u>supporting renewables</u>**	
	5.1 Explain what information you could provide to Ofgem to allow us to monitor that your tariff is supporting renewables.	
	5.2 Describe any independent sources that Ofgem could monitor to verify that the Relevant Tariffs continue to support renewables (including verifying any information you may provide to us under 5.1).	
6.	**Explain what information you could provide to Ofgem to allow us to monitor that you incur materially <u>higher costs</u> due to the support the Relevant Tariff provides to renewables.**	
7.	**Demonstrate that consumers on the Relevant Tariffs made an active choice to be on that tariff and that the choice is still valid.**	
8.	**Provide any other relevant information, analysis or evidence that may be useful in supporting your application.**	