

# Decision Appendix

## Default Tariff Cap: Decision

### Appendix 10 – Exemptions

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In accordance with the Domestic Gas and Electricity (Tariff Cap) Act 2018, we are implementing the default tariff cap to come into effect from 1 January 2019. This supplementary appendix sets out our decision and the detailed methodology in relation to exemptions from the cap.

Please see the default tariff cap – decision overview document for an accessible summary of the complete methodology.

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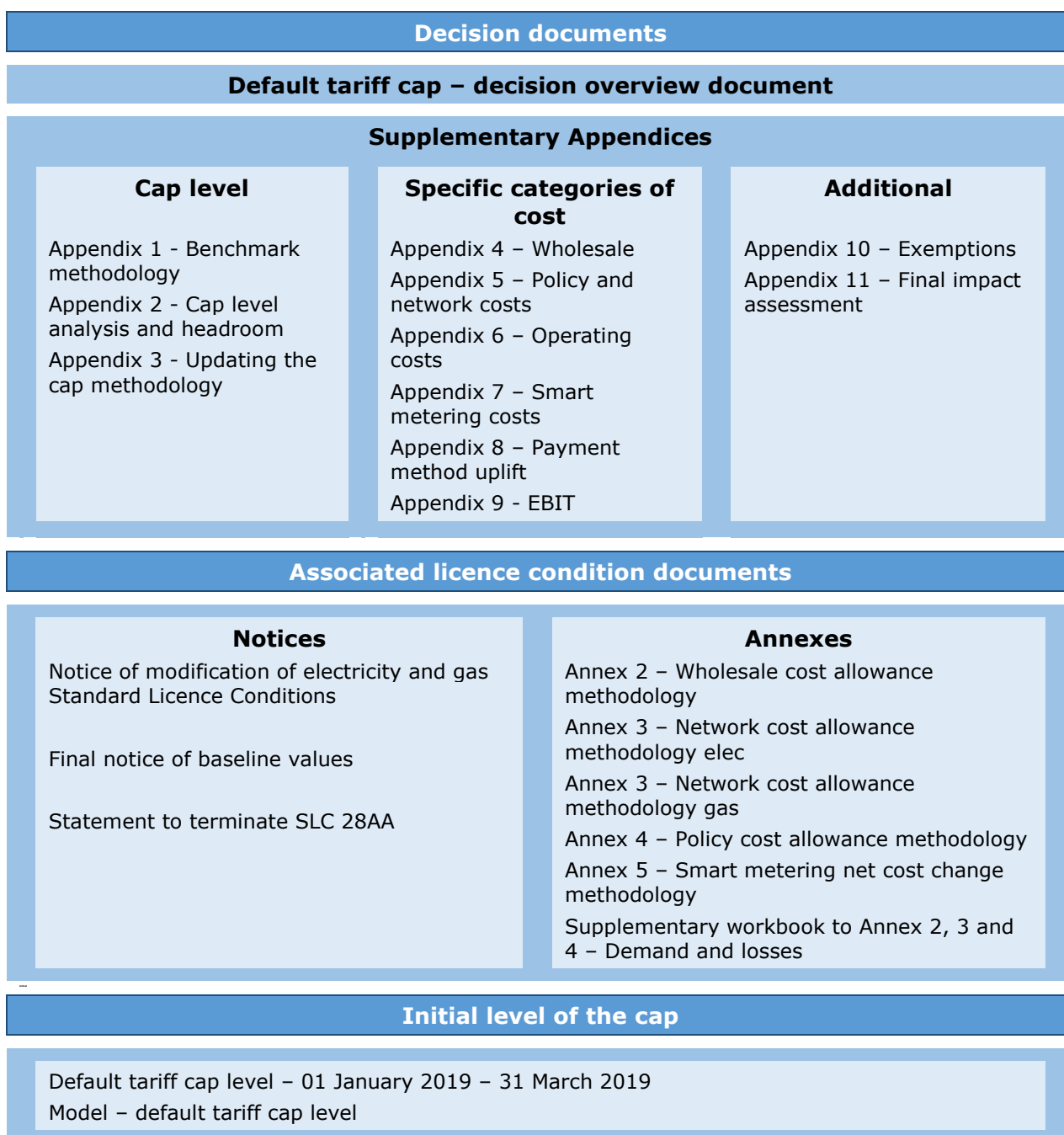
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## Document map

Figure 1 below provides a map of the documents published as part of the decision on the implementation of the default tariff cap.

**Figure 1: Default tariff cap – decision document map**



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## 1. Introduction

### Overview

- 1.1. The Domestic Gas and Electricity (Tariff Cap) Act (2018) (the Act) 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 after the Act is passed. 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.<sup>1</sup> 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
  - vulnerable consumers that may also be benefiting from a safeguard tariff.
- 1.3. This appendix explains our decision on each of these potential exemptions. In line with our proposed approach in the statutory consultation, we have decided, subject to relevant eligibility criteria, that we may grant a derogation for renewable SVT tariffs following application by the relevant supplier. We have decided not to include an exemption for customers receiving the Warm Home Discount (WHD). We outline our methodology in (Chapter 2), and responses to our statutory consultation in (Chapters 3 and 4).

### Methodology

#### Renewable tariffs

- 1.4. In Chapter 2 we explain that:
  - by default the tariff cap will apply to all SVTs, but suppliers will be able to apply for derogations for renewable electricity and renewable gas SVTs that **suppliers' customers have chosen to be on**

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<sup>1</sup> Section 3(2) notes that tariff cap conditions may provide for the conditions not to apply in relation to—  
(a) domestic customers who benefit from a cap imposed by the Authority on rates or amounts charged for, or in relation to, the supply of gas or electricity to customers who appear to the Authority to be vulnerable by reason of their financial or other circumstances;  
(b) standard variable rates which apply only if chosen by domestic customers if, or to the extent that, the rates in question appear to the Authority to support the production of gas, or the generation of electricity, from renewable sources.

- all suppliers will be required to have a default tariff that is compliant with the cap, irrespective of whether they have received a derogation for a tariff that a consumer has chosen
  - we may grant a derogation if a supplier demonstrates its renewable SVT delivers three outcomes: materially higher costs due to supporting renewables, support for renewables beyond existing subsidies, and only applies to customers who have chosen the SVT
  - as a transitional measure only, we will 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
  - 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
  - where necessary, we will prioritise derogation requests against criteria that aim to minimise any potential consumer detriment, such as prioritising tariffs with a large number of customers.
- 1.5. The derogations process is now live, and we invite suppliers to apply for a derogation where they believe they have an eligible SVT for which they would like a derogation. We have published questionnaire templates that suppliers will need to complete to apply for a derogation.<sup>2</sup> We have also published a guidance document (also in Chapter 5) that explains:
- how to apply for a derogation
  - the evidence we expect suppliers to provide when requesting a derogation
  - how we will assess applications for derogations.
- 1.6. We expect to keep the guidance document under review, updating it in light of any new evidence we gather through reviewing derogations or if we are concerned about attempts by suppliers to game the derogations framework.
- 1.7. The default tariff cap provides important protections for consumers, so we will carefully assess whether the tariff in question meets the requirements before granting derogations and will consider as part of any request how the protections the cap provides disengaged consumers are not being eroded. We will not award a derogation where the gaming risks are too high.

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<sup>2</sup> Ofgem (2018), Guidance: Derogation requests for renewable tariffs from the default tariff cap: <https://www.ofgem.gov.uk/publications-and-updates/guidance-derogation-requests-renewable-tariffs-default-tariff-cap>

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### **Existing WHD safeguard tariff (for consumers in receipt of the Warm Home Discount)**

- 1.8. We have decided to end the existing safeguard tariff for customers in receipt of the WHD and transfer these consumers onto the direct debit level of the default tariff cap, whether they pay by direct debit or standard credit. This decision is effective from 1 January 2019, the date the default tariff cap becomes effective. Alongside this decision document we have also published a statement to terminate the existing safeguard tariff for WHD customers as of 23:59 31 December 2018.

### **Key issues raised in response to our consultation**

- 1.9. In Chapter 3, we summarise the key issues raised in response to the proposed approach to renewable tariffs and vulnerable consumers on the WHD safeguard tariff, as set out in our statutory consultation.
- 1.10. First, we discuss submissions related to our proposed derogations approach and then our proposals to move current WHD safeguard tariff customers on to the direct debit rate of the default tariff cap. Below we provide a summary of stakeholders' feedback on each of these topics.

### **Renewable Tariff Exemptions**

- 1.11. Many stakeholders supported our proposals for a derogation process and provided further evidence on why it is necessary. A small number of respondents raised concerns that a derogation process would be challenging to implement and would risk causing market distortions. One stakeholder requested more detail on the criteria for a derogation and how the derogation process would work.
- 1.12. We also received views on the outcomes we proposed that suppliers would need to evidence for a derogation.
- 1.13. On **outcome 1** (the tariff must be an SVT chosen by the customer):
- a supplier argued that the "assessment of ongoing consumer engagement should be based on if a supplier's offering has materially changed since it was chosen", and they shared views on what sorts of change to the offering should affect whether the choice is still valid
  - a supplier was concerned about the "lack of a definition of the 'choice' made by a customer to be on a tariff that is derogated from the cap"
  - a supplier suggested "the derogation should allow for customers who have initially chosen a Green Tariff to be rolled onto a default fixed term green tariff at the end of their initial term so long as the subsequent tariff itself has been granted a derogation".
- 1.14. On **outcome 2** (support for renewables is materially greater than existing subsidies):
- various stakeholders proposed different activities that should or shouldn't be considered as support for renewables.

- 1.15. On **outcome 3** (the costs are materially higher than the default tariff cap due to the support for renewables):
- a supplier suggested that where a derogation is provided, it should only allow the supplier to charge a certain amount above the default tariff cap
  - we received arguments for and against allowing suppliers with inefficient costs to receive a derogation.

### **Existing WHD safeguard tariff**

- 1.16. Stakeholders broadly agreed with our rationale for not including an exemption for vulnerable consumers covered by the existing safeguard tariff, and that the safeguard tariff was always envisaged to be a temporary measure.
- 1.17. Some suppliers expressed concerns that our proposal to allow all existing WHD recipients to be covered under the direct debit level of the cap (regardless of their payment method) would result in costs that they would not be able to recover under the proposed level of the cap.
- 1.18. Some stakeholders noted that our proposal does not include a mechanism to switch standard credit consumers who have ceased to be eligible for the vulnerable safeguard tariff to the standard credit cap level of the cap. In their view, this means they will continue to receive a benefit they are no longer eligible for.
- 1.19. One supplier stated that our proposals were not appropriately consulted on, and the costs of our proposal were not fully captured by our draft impact assessment.
- 1.20. Other issues raised included concerns that our proposals may have operational consequences, and that there may be unintended consequences for vulnerable consumers who receive a WHD payment, such as reduced market choice and confusion.

### **Context and related publications**

- 1.21. Default Tariff Cap: statutory consultation; Appendix 10 – Exemptions  
[https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix\\_10\\_-\\_exemptions\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix_10_-_exemptions_0.pdf)
- 1.22. 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](https://www.ofgem.gov.uk/system/files/docs/2018/05/appendix_13_-_renewable_tariff_exemption.pdf)
- 1.23. 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](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/696467/WHD_extension_consultation.pdf)
- 1.24. Background to prepayment meter safeguard tariff:  
[https://www.ofgem.gov.uk/system/files/docs/2017/08/intro\\_to\\_the\\_prepayment\\_price\\_cap.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/08/intro_to_the_prepayment_price_cap.pdf)



- 1.25. Decision to extend PPM cap:  
[https://www.ofgem.gov.uk/system/files/docs/2017/12/decision\\_letter\\_whd\\_safeguard\\_tariff\\_-\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/12/decision_letter_whd_safeguard_tariff_-_final.pdf)

## 2. Our methodology

In this chapter, we outline our decisions on how to treat renewable tariffs and those consumers on the existing Warm Home Discount safeguard tariff.

### Renewable Tariff Exemptions

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

- 2.1. All suppliers will be required to have a default tariff in their portfolio that is compliant with the cap, irrespective of whether they have received a derogation for a SVT that a consumer has chosen. 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. Those consumers, which by definition will not have chosen a tariff, could not be defaulted onto a derogated tariff, as we do not consider such consumers would have made an active choice, in line with the requirements of the Act.
- 2.2. It is important that the default tariff cap continues to protect SVT customers, particularly those in vulnerable circumstances. Our assessment of derogation requests is intended to ensure that only genuine cases receive a derogation. We are mindful of gaming risks that would undermine the protections the cap.

#### Outcomes that a supplier must demonstrate an SVT meets to be eligible for a derogation

- 2.3. We have decided that we may grant a derogation if a supplier demonstrates that its renewable SVT delivers on three high-level outcomes:
  - **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 a 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 attributable to the support that the tariff provides to renewables.
- 2.4. Chapter 5 sets out the guidance we have produced to support the derogation application process.

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

- 2.5. The supplier will need to demonstrate that consumers made an active choice to be on the SVT. We do not propose to be prescriptive in setting out how suppliers must demonstrate this. However, we can clarify the following:

- we consider that a consumer has not made an active choice if they have defaulted onto the SVT from a fixed-rate tariff or are on the tariff as a deemed customer<sup>3</sup>
- we expect a supplier to demonstrate that at the point the consumer chose to join the SVT, it was clearly advertised as a tariff that supports renewables.

2.6. The onus will be on suppliers to demonstrate that consumers made an active choice to join the SVT. One way that suppliers could demonstrate this could be through requiring consumers to specifically opt-in to the tariff that is derogated, with those consumers that do not opt-in consequently being moved to a default tariff that complies with the cap.

### **Outcome 2: Demonstrating that the SVT supports renewables**

- 2.7. We will assess each application based on the evidence submitted to demonstrate that the tariff supports renewables to a materially greater extent than that required under existing government schemes, licence obligations, or other mandatory mechanisms, with the objective of increasing renewable generation or production capacity.
- 2.8. Whether a tariff and associated activity supports renewables beyond existing schemes and obligations may depend on the specific circumstances. It is for each supplier to set out how a tariff meets outcome 2 and provide appropriate evidence.
- 2.9. This list is not exhaustive, but below we set out factors and information we will take into consideration in our assessment:
- The Act specifically refers to tariffs which support the production of gas, or the generation of electricity, from renewable sources. We will not consider other activities such as electricity storage or carbon offset activities that do not directly support renewables.
  - We will not consider activities and costs associated with subsidies, obligations or other mandatory mechanisms, for example, costs for purchasing Renewable Energy Guarantees of Origin (REGOs; the costs of which we note are immaterial); participating in the Feed-in Tariff (FIT) scheme (even where voluntary); funding the Contracts for Difference (CfD) scheme; or purchasing Renewable Obligation Certificates (ROCs) – even where purchasing more than obligated to (noting that now the Renewables Obligation is closed to new generators, over-purchasing ROCs wouldn't encourage new generators to enter the market).
  - For any activities or costs associated with purchasing renewable gas certificates we will consider whether the generation has received support from existing subsidies, eg the Renewable Heat Incentive. Where generation has received support from a subsidy we do not expect to consider the purchasing of renewable gas certificates as additional support.

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<sup>3</sup> 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.

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- We will consider whether the support for renewables arises due to the SVT; if a supplier would carry out an activity regardless, then we would not consider it as support for the purposes of the derogation request. For example, this includes PR and general communication activities.
- We will consider whether we think suppliers are attempting to game the derogations framework, such as by assessing whether suppliers are potentially allocating activities or costs from their wider portfolio. For example, if activities across a supplier remain the same but there has been a recent reorganisation of renewable generation to certain tariffs.
- We will consider the extent to which there is long-term commitment to the renewables sector and activities that are supporting renewables.
- We will consider the types of renewable generators the activities support and details of the support. For example, suppliers should provide a description of the generators (eg, small generators below 1MW) and length of PPA support.

### **Outcome 3: Demonstrating that the supplier incurs materially higher costs**

2.10. On this outcome, we will review supplier derogation applications in two key areas.

2.11. Renewable costs: suppliers will have to explain the costs they face solely from the support they provide to renewables, and which they would not otherwise face. In our statutory consultation, we noted that we may require suppliers to demonstrate that these costs are efficient. We maintain this position that we may, on a case by case basis, require suppliers to provide information on the efficiency of their spending on supporting renewable generation. Regardless of any assessment we may carry out on the efficiency of costs, where a supplier asserts that they are incurring materially higher cost, they will have to clearly evidence where these costs are incurred and that they are materially higher costs when compared to non-renewable equivalents. We expect the supplier to verify that renewable costs are valid and evidenced, including that they:

- are related to activities that are in scope in terms of supporting renewables (for example, costs for purchasing ROCs would not be valid, as we do not consider that purchasing ROCs provides additional support for renewables in the context of our definition of outcome 2)<sup>4</sup>, and
- haven't been incurred in an attempt to game the derogations framework (for example, by unnecessarily spending on renewables in the run up to requesting a derogation in an attempt to reach a level of costs that is considered material).

2.12. **Overall costs:** suppliers will have 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.

2.13. In our statutory consultation, we noted that we will consider whether the supplier's overall costs must be efficient compared to the benchmark used for the default tariff

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<sup>4</sup> 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.

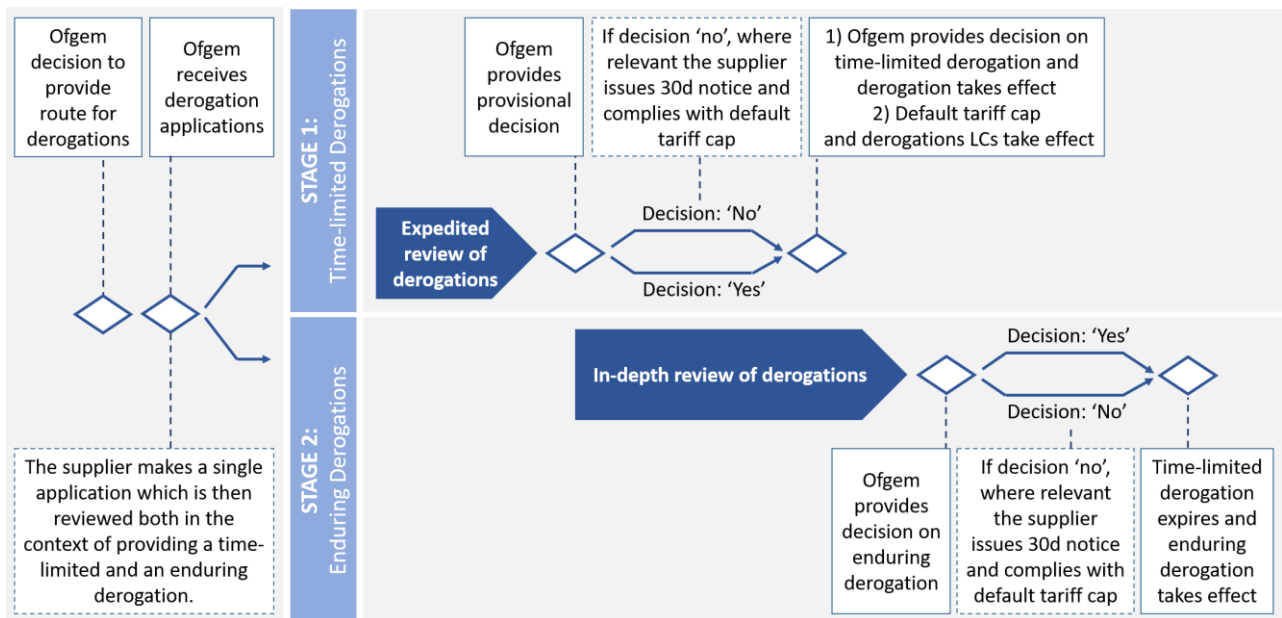
cap. These costs will have to be clearly separated and justified. Given our case by case approach to efficiency we recognise there is a “buyer beware” risk. However, we reserve the right to consider efficiency, particularly where we consider costs have been inefficiently incurred in an attempt to demonstrate material costs, thereby gaming the derogations framework.

- 2.14. Our assessment of materiality and the reasoning for why a supplier is requesting to price above the cap will be on a case by case basis, with the onus being on the supplier to clearly separate and justify why costs are renewable specific additional costs. We expect a supplier to separately demonstrate that there is a relationship between these materially higher renewable costs and the need to price the tariff above the cap.
- 2.15. Our derogation questionnaire provides a non-exhaustive list of costs that may be associated with providing a renewable tariff, and those which we feel are unlikely to be considered as being material or are not specifically supportive of renewables. However, even where costs are specified in the template suppliers still need to provide evidence and justifications that these costs are valid in their particular case. Our guidance document also sets out how suppliers may wish to present their costs.

**Process and timescales**

- 2.16. We invite derogation requests with immediate effect. We intend to carry out up to two stages of assessment, and after each we may provide a derogation. The two stage process will be transitional only, as shown in Figure A10.1.

Figure A10.1: The two-stage process



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

- 2.17. If suppliers submit a derogation request within a week of this decision document being published, we will aim to carry out an expedited review of those requests. 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 grant an enduring derogation. The expedited review of

derogation requests will be a less in-depth assessment than we would ordinarily carry out. As such, if we issue a derogation based on an expedited review, we expect it to be a time-limited derogation, and it will expire after a number of months. Because of the risks of gaming, we will carefully assess whether the tariff in question meets the requirements before granting a derogation, whether temporary or enduring.

- 2.18. The sooner we receive derogation requests, the more likely we will be able to provide a decision on a temporary derogation far enough in advance to 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. 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 2.24).
- 2.19. We will 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 will aim to issue a final decision on the time-limited derogation (based on our expedited review that fed into our provisional decision) once the licence conditions take effect, which will align with when the decision on the default tariff cap takes effect. We reserve our right to issue a different derogation decision to our provisional decision.

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

- 2.20. Once we have completed our expedited review, we will carry out a more in-depth review of derogation requests. We will 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 are not satisfied, then the time-limited derogation will expire and the supplier will be required to comply with the default tariff cap.
- 2.21. We have not 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.
- 2.22. If a supplier receives a time-limited derogation (under stage one) but does not receive an enduring derogation (under stage two), they will not have to rebate their customers.
- 2.23. After the transitional arrangements relating to the introduction of the default tariff cap (ie the short period during which we will carry out the optional stage one expedited review), we will retain only the in-depth phase as the sole approach to processing derogations.

*Prioritisation of derogation requests*

- 2.24. For the purposes of our expedited review of derogation requests, we may prioritise our assessment of derogation requests. Our prioritisation would be based on:
  - 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 base (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 (deprioritising these suppliers)
- the quality of the submission (those that do not provide at the earliest opportunity a sufficient level of detail for us to make a decision will necessarily take longer to process).

2.25. 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.

### **Existing safeguard tariff (for consumers in receipt of the Warm Home Discount)**

2.26. We have decided to end the existing safeguard tariff and transfer affected consumers onto the direct debit (DD) default tariff cap, whether they pay by direct debit or standard credit.

2.27. We note that suppliers have some flexibility on when they must identify customers who are eligible for the WHD for each scheme year. This means that some consumers that have been/will be identified in scheme year eight 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 have decided that customers that are identified as eligible for the WHD by 31 March 2019 will be protected by the direct debit default tariff cap.

### 3. Renewable Tariff Exemptions: key issues raised in response to our statutory consultation

In this chapter, we summarise and consider the main points stakeholders raised in response to our statutory consultation. Where relevant, we also refer to points raised in response to our May consultation. These responses informed our decision on the methodology, as set out in Chapter 2.

#### Renewable Tariff Exemptions

- 3.1. Many stakeholders supported our proposed decision to provide a route for renewable SVTs to receive a derogation from the default tariff cap. However, some stakeholders felt it was unnecessary to provide a route for derogations, and some stakeholders wanted more clarity on how suppliers would demonstrate that they meet the outcomes to receive a derogation. We received comments from a range of stakeholders on various aspects of our proposed decision.
- 3.2. In response to our statutory consultation stakeholders made a number of observations (which we go through in turn) about the:
  - concept of a derogation approach
  - proposed process for the derogation
  - three outcomes we proposed suppliers would need to demonstrate.

#### The derogation approach

- 3.3. Some stakeholders provided evidence and arguments to support our approach of providing a route for renewable SVTs to be exempt from the price cap.
- 3.4. Some stakeholders disagreed with our proposal to provide a route for derogations or felt it was unnecessary. One stakeholder argued that there is not a clear and consistent way to implement an exemption, and suggested that even a derogation process “leaves room for interpretation, gaming and potential mis-information”.
- 3.5. For example, some suppliers felt they demonstrated that suppliers can provide support to renewables without needing to charge above the default tariff cap. One supplier suggested that providing derogations will “distort the market to encourage inefficient domestic suppliers to buy renewable power at above market rates which they will then be able to sell on to residential customers at a premium. This will encourage further inefficiencies to the UK market as a whole and cause the overall prices for customers to rise.” Another stakeholder noted that “we do not anticipate that this derogation would meaningfully help to accelerate deployment of new utility-scale PV in the near term”.
- 3.6. Having engaged further with stakeholders, we remain of the view that some supplier models provide support to renewables and incur some additional costs through providing that support. Therefore, we will provide a route for suppliers to apply for a derogation for renewable gas and electricity SVTs that consumers have chosen to be



on. The key question is whether the support and associated costs are material. Providing a route for suppliers to apply for derogations ensures that suppliers have the opportunity to demonstrate, on a case by case basis, whether they provide material support and incur material costs associated with providing that support. It also allows us to ensure that suppliers cannot game the framework in a way that might be possible if we were to provide an exemption.

### **Derogation process and timelines**

- 3.7. We proposed that 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.
- 3.8. We also outlined three outcomes a supplier would need to demonstrate a tariff would meet to be eligible for a derogation. Alongside this we provided a draft derogation application questionnaire and further details on how we proposed to assess whether a tariff is delivering our proposed outcomes.
- 3.9. Some stakeholders welcomed the additional clarity we provided on the derogations process and how suppliers would be required to demonstrate that they are eligible for a derogation. A supplier was concerned about “the lack of transparency in the proposed derogation process and feel this could unintentionally leave the process open to gaming”.
- 3.10. Some stakeholders requested more visibility on the “specific derogation criteria”. For instance, one stakeholder stated that without this, it “prevents them from giving an informed perspective on the proposal at stake.”
- 3.11. In our view we provided sufficient guidance in our statutory consultation on the outcomes suppliers would need to demonstrate for the derogations process. Alongside this document, we have published guidance on the derogations process (also in Chapter 5). This guidance provides further details on how suppliers must demonstrate the outcomes required to be eligible for a derogation. We aim to be as transparent as possible. However, noting that there are a number of different renewable tariff offerings that may be able to demonstrate support for renewables in different ways, one of the benefits of providing a route for derogations is that it provides us with the flexibility to consider these on a case by case basis. This also means it is difficult to be overly prescriptive in terms of specifying precisely what evidence is needed to receive a derogation. We would encourage suppliers to include any evidence in their derogation request that helps them to demonstrate that the tariff in question supports renewables. We will be vigilant against any attempts by suppliers to game the system.
- 3.12. A supplier also suggested that the derogations process “should be expedient and much quicker to gain approval than the existing licence derogation timeline, otherwise offers to consumers could be delayed.” We are committed to reviewing derogation requests as quickly as practical and have introduced a two-stage process as a transitional arrangement. However, we do not intend to introduce a separate KPI for reviewing derogation requests for new tariffs.

### **Derogation application: outcome 1 (must be an SVT chosen by the customer)**

- 3.13. We proposed that to be eligible for a derogation, the supplier must demonstrate that the tariff is an SVT that has been chosen by the customer. We explained that in considering whether a customer's choice was still valid (eg where they had been on the tariff for some time), we would be interested, for example, in any significant changes to the nature of the tariff or terms of the contract since the customer joined the tariff.
- 3.14. A supplier argued that our assessment of whether a customer's choice is still valid "should be based on if the level of support for renewable generation offered by a tariff has changed since sign up, and if the costs of delivering this green tariff have changed." They suggested that the focus should be on whether the tariff is providing less support to renewables than since the customer signed up. On costs, they went on to note that "where the [renewable-related] costs behind a tariff have materially changed (except where costs have altered as a product of delivering additional environmental benefit), this too could justify a challenge around the validity of a consumers' choice".
- 3.15. A supplier was concerned about the "lack of a definition of the 'choice' made by a customer to be on a tariff that is derogated from the cap". They believe this will "allow suppliers to transfer customers from 'deemed' tariffs to a derogated and more expensive SVT when they are not properly informed about the impact this will have on their energy bills." They "believe that Ofgem must protect consumers by setting out specific criteria that a supplier must meet in order to move a customer from a deemed tariff. This could include express written acknowledgment from the customer that they understand they are being transferred to a more expensive SVT not protected by the cap."
- 3.16. A supplier suggested "the derogation should allow for customers who have initially chosen a Green Tariff to be rolled onto a default fixed term green tariff at the end of their initial term so long as the subsequent tariff itself has been granted a derogation." This is because, in their view, the green tariff is a similar product to the original one and in line with the customer's preference.
- 3.17. The Act requires that SVTs can only be exempt where the consumer has chosen to be on the tariff. We do not consider the customer to have made a choice where they have been rolled onto a tariff at the end of a fixed term or without their explicit choice. We are concerned that even where the renewable offering under a tariff hasn't materially changed over time, the consumers may have become disengaged and their initial choice may no longer be considered valid. **This means that all suppliers will be required to have a default tariff that is compliant with the default tariff cap.**
- 3.18. The onus will be on suppliers to demonstrate that consumers made an active choice to join the SVT. One way in which suppliers could demonstrate this could be through requiring consumers to specifically opt-in to the tariff that is derogated, and those consumers that do not opt-in are consequently moved to a default tariff that complies with the cap, which suppliers are required to introduce.
- 3.19. We will consider the impact of the proposed derogation on the protections for disengaged customers provided by the default tariff cap, and how the supplier will ensure that only customers who have made an active choice to pay more for their energy from renewable sources are covered by the scope of any derogation. For further details, refer to our published guidance (also contained in Chapter 5).

### **Derogation application: outcome 2 (support for renewables)**

- 3.20. We proposed that to be eligible for a derogation, the supplier must demonstrate that by consumers being on the SVT, support is given to renewables to an extent that is materially greater than that which is brought about as a result of subsidies, obligations or other mandatory mechanisms. We proposed that support could be either financial or non-financial in nature.
- 3.21. Various stakeholders proposed different activities that should or shouldn't be considered as support for renewables.
- 3.22. A supplier said "The scoring criteria for the derogation process should be clear and robust and disallow simple renewable electricity products, which are supported by existing policy frameworks Contracts for Difference (CfD), Feed-in Tariffs etc. and only allow products to be derogated which offer true additionality such as investment in environmental schemes outside of those areas financed by existing policy."
- 3.23. A stakeholder said "If there is to be a derogation from the Default Tariff Cap for 100% renewable tariffs, we would urge that it apply only to new-build development of unsubsidised generation assets."
- 3.24. We do not plan to set a prescriptive definition of what can be considered as support, including in terms of investing in new-build unsubsidised generation. Instead we will set out some principles to guide suppliers in considering their derogation requests. Through our stakeholder engagement activities we believe there are various types of support that can be provided even where the renewable generator is receiving subsidies. The key question is whether a supplier can demonstrate that the various support they provide is, in total, material.
- 3.25. Examples of activities that stakeholders argued should be considered as 'support' included:
- investment in storage - a supplier said that the Act "is clearly not limited to the creation of new sources of renewable energy in itself, and investment in storage (or other technology that may emerge) should be allowable from derogated tariffs"
  - PR work and general communications about the value of boosting renewable energy sources
  - the purchase of green gas certificates - one supplier noted that "the production of green gas is low currently and properly certified green gas certificates (such as the Renewable Gas Guarantee of Origin) attract a significant cost premium due to scarcity and other external influences."
- 3.26. It will be the responsibility of the supplier requesting a derogation to provide evidence that the support being provided to renewables is additional to that required under existing government schemes/licence obligations or other mandatory mechanisms. We will not consider the purchasing of REGOs as support, and nor do we expect to consider the purchasing of green gas certificates as support where the certificates relate to energy that has received a subsidy such as the Renewable Heat Incentive.

- 3.27. Also, the Act specifically refers to tariffs which support the production of gas, or the generation of electricity, from renewables. Therefore, in our view, other activities such as storage or low carbon activities that do not directly support renewable generation cannot be considered.
- 3.28. A supplier said that they “do not believe that purchasing power through PPAs or owning renewable generation assets will mean that suppliers will be unable to comply with the cap. Neither of these achieves outcomes 2 or 3 detailed by Ofgem as criteria for assessing derogations. Namely, they do not provide support to renewables that is ‘materially greater than that which is brought about as result of subsidies, obligations or other mandatory mechanisms’, nor do they result in costs that are materially higher.”
- 3.29. We acknowledge this supplier’s view, although we note that through our stakeholder engagement activity, stakeholders have identified many activities relating to providing a renewable tariff that provide some support to renewables and drive additional costs. The key question is whether the support and associated costs are material.
- 3.30. The same supplier also suggested that some suppliers that enter into PPAs or own generation will sell that generation on the wholesale markets, but retain the REGOs. They will then buy energy on the spot markets and match that with the REGOs from the energy they have sold. They argued that this is a standalone profit-making function within their supply business, and should not count as support for renewables and the costs associated with these activities should not contribute to the supplier demonstrating materially higher costs.
- 3.31. In the associated guidance (also contained in Chapter 5) we explain that we will consider whether the support for renewables arises due to the SVT; if a supplier would carry out an activity regardless, then we would not consider it as support for the purposes of the derogation request. We will also consider whether we think suppliers are attempting to game the derogations framework, such as by assessing whether suppliers are potentially allocating activities or costs from the wider portfolio. For example, where activities across a supplier remain the same but there has been a recent reorganisation of renewable generation to certain tariffs.
- 3.32. To be eligible for a derogation, the supplier must demonstrate that by consumers being on the SVT, 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.

### **Derogation application: outcome 3 (materially higher costs)**

- 3.33. We proposed that to be eligible for a derogation, the supplier must demonstrate that 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 attributable to the support that the tariff provides to renewables.
- 3.34. We proposed that we would consider suppliers’ renewable specific costs and their overall costs, and we noted that we were considering whether we would require that suppliers must demonstrate that either or both of these sets of costs must be efficient to be eligible for a derogation.
- 3.35. We received a range of views from stakeholders on this issue. One supplier said that “any derogation should specify an amount above the price cap that a supplier is able to

charge. For example, if a supplier can demonstrate that their renewable tariff involves materially higher costs of £30, then that supplier should be able to charge £30 more than the tariff cap. Whilst this may be more complex than a blanket exemption from the cap, it is fairer for customers. It will also prevent other suppliers from gaming the derogation process by charging customers significantly more than the higher costs they face as a result of supporting the production of renewable electricity or gas.”

- 3.36. While another supplier said that “Ofgem should ensure that any such tariff accurately reflect additional costs and do not reward inefficiencies in the management of renewable supply”. However, another supplier said that “Some costs lie outside the criteria for derogation, but rather than being a sign of inefficiency, these are central to [our] offering”
- 3.37. To be eligible for a derogation, the supplier must demonstrate that 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 attributable to the support that the tariff provides to renewables. We may, on a case by case basis, require suppliers to provide information on the efficiency of their spending on supporting renewable generation. On overall costs, we reserve the right to consider efficiency, particularly where we consider costs have been inefficiently incurred in an attempt to demonstrate material costs, thereby gaming the derogations framework. For further details on how a supplier must demonstrate this outcome, refer to our published guidance (also contained in Chapter 5).

#### **Other issues**

- 3.38. We noted that 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. Some suppliers expressed support for this suggestion.
- 3.39. We are still considering whether to follow this approach.

## 4. Existing safeguard tariff (for consumers in receipt of the WHD): key issues raised in response to our statutory consultation

In this chapter, we set out our decision to terminate the existing Warm Home Discount (WHD) safeguard tariff and protect these vulnerable consumers (those who receive a WHD payment) by placing them under the default tariff cap. We also set out stakeholder responses to our statutory consultation.

### Overview

- 4.1. Our research shows that consumers in vulnerable situations – 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. In designing and implementing the default price cap, we want to ensure there are appropriate protections in place to meet the needs of vulnerable consumers.
- 4.2. 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 WHD. The main effect of this change was to extend the scope of our existing PPM cap to protect around one million consumers who receive the WHD payment, who are also on their supplier's default tariff. These protections began rolling out from 2 February 2018 and expire in December 2019.
- 4.3. 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. The Act does include a provision that allows for an exemption from the default tariff cap for vulnerable consumers.<sup>5</sup> However, we have decided not to provide an exemption for vulnerable consumers on the existing safeguard tariff at this time, as we think these consumers will be better protected under the default tariff cap.

### Decision

- 4.4. We have decided not to provide for an exemption from the default tariff cap for vulnerable consumers. We have carefully considered responses to our statutory consultation and maintain our position that transferring all existing WHD safeguard tariff consumers onto the direct debit default tariff cap will provide the most appropriate protections for vulnerable consumers.
- 4.5. Consumers that are identified as eligible for the WHD up until 31 March 2019 will be placed under the direct debit level of the cap, whether or not they pay by standard credit or direct debit.
- 4.6. We are not including a specific cost allowance under the default tariff cap to account for supplier costs associated with including WHD customers who pay by standard credit

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<sup>5</sup> Act section 3(2).

under the direct debit level. We have considered this cost when setting the headroom allowance, as discussed in Appendix 2.

- 4.7. Suppliers already have strict obligations to identify and support customers who may be in vulnerable situations. This includes specific provisions set out in the Standards of Conduct (Standard Licence Condition 0 of both the gas and electricity supply licences) which require suppliers to identify each vulnerable customer in an appropriate way.<sup>6</sup> Under the default tariff cap, suppliers must continue to ensure they meet their obligations in relation to identifying and protecting vulnerable consumers. We will take any risk of detriment to vulnerable consumers very seriously.

### **Responses to our consultation**

- 4.8. Stakeholders who responded on this area generally recognised the merits of ensuring that there are appropriate protections in place for vulnerable consumers. However, there were a mix of views regarding our proposals to end the existing safeguard tariff and place existing WHD customers under the direct debit level of the default tariff cap.
- 4.9. A number of responses to our statutory consultation reiterated arguments that have been raised previously in our May consultation. We have considered all points raised in this consultation in reaching our decision, but do not seek to comprehensively respond here to those arguments that have already been addressed. More detail on stakeholder views on our May consultation can be found in Appendix 10 of our statutory consultation document.<sup>7</sup>

### *Termination of the safeguard tariff*

- 4.10. One stakeholder raised concerns that by ending the WHD safeguard tariff and moving these customers onto the direct debit level of the default tariff cap, the differing methodologies would lead vulnerable people to paying an estimated additional £9m a year on smart meter rollout costs. The stakeholder went on to suggest that vulnerable consumers have not seen the benefits that were anticipated through the smart meter rollout.
- 4.11. We maintain our view that the government's smart meter rollout will enable all consumers to better manage their energy use, save money, reduce emissions and make it easier to engage in the energy market, often in new, flexible ways. When we introduced the WHD safeguard tariff we were clear that this was a temporary measure which did not reflect the costs to serve these consumers. The default tariff more appropriately aligns with the costs for this group of consumers but at the same time provides them with additional protection through the lower direct debit level. These consumers also receive the WHD which provides them with an additional £140 off their energy bill per year.
- 4.12. One supplier argued that we had not consulted on our proposals previously, or appropriately factored them into our impact assessment. They noted that our "counterfactual to the default tariff cap appears to be a continuation of safeguard tariff, past the date on which it is due to lapse" and suggested that this was "contrary to

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<sup>6</sup> Ofgem (2017), Licence guide: Standards of Conduct  
[https://www.ofgem.gov.uk/system/files/docs/2017/10/standards\\_of\\_conduct.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/standards_of_conduct.pdf)

<sup>7</sup> Ofgem (2018), Default Tariff Cap: Statutory Consultation, Appendix 10 – Exemptions  
[https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix\\_10\\_-\\_exemptions\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix_10_-_exemptions_0.pdf)



good practice.” We were clear when we introduced the WHD safeguard tariff that these consumers would move onto the default tariff cap if it came into effect. In reaching our decision, we have consulted on these proposals through statutory consultation and have taken all views into consideration. As expressed in our impact assessment, the counterfactual is that these vulnerable consumers will be subject to the vulnerable customer safeguard tariff until December 2019 and that beyond this, in the absence of the default tariff cap, they would be subject to longer term price protection, assumed to be at the equivalent level as the default tariff cap.

- 4.13. Some stakeholders suggested that our proposals to align the cap level of WHD safeguard tariff customers to the direct debit level of the default tariff (irrespective of the customer’s payment type) would have operational consequences, and that adequate time should be allowed for operational issues to be addressed. The price cap is an important protection for consumers which we expect suppliers to bring into effect by 1st January 2019.
- 4.14. One stakeholder suggested that, instead of our proposed approach, we should preserve the existing safeguard tariff and instead act on the new data matching powers from the Digital Economy Act to extend protection to all those eligible for the WHD. We have considered this approach. However, utilising the data sharing powers afforded to us by the amended Digital Economy Act (2017) was a back stop measure to ensure that vulnerable consumers would have price protection this winter if the default tariff cap was not implemented. We consider that this is not currently necessary as these vulnerable consumers will be in scope of the default tariff cap and we consider it provides the appropriate level of protection. The passing of the Domestic Gas and Electricity (Tariff Cap) Act (2018) has allowed us to extend the protection for those on the WHD safeguard tariff which was due to end in 2019. As the default tariff cap is a temporary measure, we may re-evaluate using data matching powers allowed in the Digital Economy Act, as part of our work to design a future, post-cap, retail market.
- 4.15. In considering stakeholder responses, we have decided to end the WHD safeguard tariff as planned and move all the customers onto the direct debit level of the default tariff cap whether they pay by direct debit or standard credit. The direct debit level of the default tariff cap is very similar to the level of the existing safeguard tariff which will limit, rather than create confusion. Furthermore, we consider that our proposals will limit the potential for significant step changes in prices for vulnerable consumers who pay by standard credit. These vulnerable consumers will see very little difference in their bills after our proposals come into effect. Future WHD customers will be moved onto the level of the cap related to their payment method, receiving price protection from the default tariff cap, as well as the benefit from the WHD rebate.

#### *Financial impact*

- 4.16. Two suppliers raised concerns that they would not be able to recover the efficiently incurred costs associated with supplying WHD customers who pay by Standard Credit. One supplier calculated (using its own amended version of our payment method differential) that there could be an additional cost. They also suggest that is not provided for within the calculation of the cost allowance on which the cap is based.
- 4.17. We recognise that there will be some additional costs incurred by suppliers from moving standard credit customers from the WHD safeguard tariff onto the direct debit level of the default tariff cap. We have taken this cost into consideration in the round and alongside all other uncertainties when setting out headroom allowance, which we consider to be appropriate.



*Interactions with prepayment meter (PPM) cap*

- 4.18. One stakeholder noted that should the default tariff cap and the PPM cap diverge, vulnerable consumers might be afforded different levels of protection depending on their meter type. This will be confusing for customers and could also damage industry efforts to meet smart roll out targets. The stakeholder proposed Ofgem cooperates with the Competitions and Market Authority (CMA) on their review of the PPM cap in early 2019 to create a simple enduring industry wide cap which uses the cost reflective methodology of the default tariff cap and applies uplifts for varying costs associated with payment type (as opposed to meter type).
- 4.19. Another stakeholder noted the risk of gaming between the PPM and the default tariff caps. The differing methodologies may provide incentives for inappropriate switching between payment methods. The stakeholder commented that, if caps are to be applied, they must be consistently constructed and accurate for all types of customers affected. We have addressed this where it is within our control, by incorporating the WHD safeguard tariff within the default tariff cap.
- 4.20. We acknowledge that there are differences in the methodologies of the PPM cap (which the existing safeguard tariff uses) and that of the default tariff cap. We also recognise that these differences will lead to costs being calculated in different ways. However, we made it clear when introducing the WHD safeguard tariff and aligning it with the PPM cap that it was a temporary measure which would end by 2019, and we are now moving these vulnerable consumers onto the default tariff cap, giving these vulnerable consumers extended price protection. We plan to work with the CMA when they conduct the mid-term review of the prepayment meter cap in 2019 to ensure our approach and thinking is aligned.

*Complexity and potential to create confusion*

- 4.21. One supplier suggested that it would be disproportionate to bring forward a change affecting vulnerable customers that created three complex pricing events for this group within six months, and increased operational costs for suppliers. The stakeholder thought that the licence conditions should be adjusted to require this change to be made by April 2019, when the current safeguard cap level expires. The stakeholder believed that this would minimise the potential for customer confusion and enable suppliers to implement the change in a timely, responsible, and low-risk fashion. As we have noted above, this is an important protection for consumers and suppliers should discuss any compliance issues with us on a case by case basis.

*Potential adverse outcomes for vulnerable consumers, including decreased market choice for WHD recipients*

- 4.22. One stakeholder expressed concern that, in trying to implement a one-size-fits-all cap, there is a major risk that vulnerable consumers could experience adverse outcomes. For example, vulnerable consumers might not realise savings from switching which could make a material difference to their particular situation yet they may also suffer the consequences of suppliers cutting any discretionary schemes and customer service functions. The default tariff cap will provide price protection but it will not be the lowest price in the market. As we have said in our vulnerability strategy, we encourage vulnerable consumers to shop around and get the best possible deal. We expect suppliers to comply with existing obligations for vulnerable consumers. We will take any risk of detriment to vulnerable consumers very seriously.

- 4.23. A supplier suggested moving WHD safeguard customers who pay by standard credit onto the direct debit level of the default tariff cap would have “negative implications for customers. Acquiring a WHD [standard credit] customer would come with a very associated large loss”. The supplier also noted this might mean they will have less choice in the market.
- 4.24. Another supplier noted that after 1 April 2019, any customer on a default tariff who becomes eligible for the WHD will be on the version of the default tariff cap that is appropriate for their payment method, therefore being disadvantaged compared to those who had become eligible at an earlier period. Additionally, the supplier was concerned that for customers who would have ceased to be eligible for the vulnerable safeguard tariff there is no mechanism to switch them to the correct version of the default tariff cap for their payment method, and they will continue to receive a benefit they are no longer eligible for. The supplier then proposed that we should allow customers on the vulnerable safeguard tariff to be put on the relevant default tariff prices for their payment method.
- 4.25. One stakeholder pointed out the potential danger of a ‘triple penalty’ for consumers who have been unable to engage and proactively apply for the WHD, and therefore have missed out on the vulnerable safeguard protections, and now will also lose out on this third additional level of protection.
- 4.26. Suppliers should always be aware of their obligation to treat all domestic customers fairly, they need to make an extra effort to identify and respond to the needs of those in vulnerable situations. We expect that all WHD customers will be treated fairly by all suppliers in the marketplace.
- 4.27. We acknowledge that a small number of consumers from the WHD broader group may find their circumstances change and that they no longer qualify for the WHD, yet they will still benefit from the direct debit level of the default tariff cap that they were moved onto. However, this number is likely to be very small and, as the default tariff cap is a temporary measure, the situation will be limited in time.

#### *Future protections for vulnerable consumers*

- 4.28. Another stakeholder suggested that Ofgem should state the timeframe for a separate consultation to establish views on the protections for vulnerable customers that will continue once the wider default tariff cap is withdrawn.
- 4.29. We are committed to ensuring vulnerable consumers receive the appropriate protections now and in the future as the market evolves. We will consult industry and wider stakeholders on any decisions in this area in line with our statutory obligations.
- 4.30. Through our work on Future Retail Market Design<sup>8</sup> we are also currently considering whether the arrangements underpinning this market – including the ‘supplier hub’ principle that places the supplier as the primary intermediary between the consumer and the energy system – will be fit for purpose over the longer term. We need to make sure that any future retail market design can unlock the full potential for innovation and competition, whilst ensuring all consumers – including the vulnerable – remain

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<sup>8</sup> Ofgem (2018), Future supply market arrangements – response to our call for evidence: <https://www.ofgem.gov.uk/publications-and-updates/future-supply-market-arrangements-response-our-call-evidence>

protected no matter how they engage in the future market. As energy is an essential service, we need to ensure all consumers can access a reliable supply of gas and electricity at a reasonable price, with an appropriate level of service. A focus of future market design will therefore be to ensure that consumers on default arrangements are appropriately protected over the longer term. We will continue engaging with stakeholders on this work over the coming months. We will also look to engage with stakeholders in new ways, to ensure they are able to shape proposals as our thinking develops.

*Miscellaneous/clarifications*

- 4.31. Another supplier queried whether the proposal to move WHD safeguard tariff customers to the default tariff cap applies only to standard credit and direct debit customers, or whether this would also apply to PPM customers. We can confirm that our proposals only apply to standard credit and direct debit customers on the WHD safeguard tariff, not PPM customers.
- 4.32. One stakeholder noted that the decision on whether or not to extend the default tariff cap must be published on or before 31 October in the relevant year, meaning that there may be as little as two months' notice of its extension or termination. They also noted the requirements under Section 9 of the Act for Ofgem to conduct a review of whether excessive tariff differentials may emerge for some consumers, and whether enduring protections are needed for vulnerable consumers before the cap ends. The stakeholder suggested that we adopt the working assumption that the cap may be terminated as early as December 2020 in our planning for developing successor protections for vulnerable consumers.

## 5. Guidance: renewable derogations from the default tariff cap

This chapter sets out the guidance on derogations we have published in our external guidance document for ease of reference.

### When would a derogation be considered?

- 5.1. A derogation may be granted if a supplier demonstrates that its renewable tariff delivers on the following high-level outcomes:
- **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 attributable to the support that the tariff provides to renewables.

### Submitting a request and timelines

*How to apply*

- 5.2. Suppliers applying for a derogation need to complete the questionnaire and templates<sup>9</sup> that have been published alongside this guidance document. This guidance document should be read alongside the questionnaire and templates.
- 5.3. The renewable financial information template contains specific guidance on what information should be provided on a question-by-question basis. Suppliers should ensure they provide as detailed a cost breakdown as possible and complement this with evidence. The renewable financial information template contains a range of cost categories and indicate where explanations and evidence are required. The list of costs is non-exhaustive and there is space for suppliers to add additional costs. Where costs are specified in the template suppliers will still need to provide evidence and justifications that these costs are valid in their particular case.
- 5.4. Once the templates are complete, they should be sent to Ofgem at [renewablederogations@ofgem.gov.uk](mailto:renewablederogations@ofgem.gov.uk). Please do not PDF the templates when you submit them.

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<sup>9</sup> Ofgem (2018), Guidance: Derogation requests for renewable tariffs from the default tariff cap: <https://www.ofgem.gov.uk/publications-and-updates/guidance-derogation-requests-renewable-tariffs-default-tariff-cap>

5.5. We will confirm receipt of your application.

#### *Timelines*

5.6. As a transitional measure we will run a two-stage derogation process, fast-tracking priority derogation requests to provide a decision on a time-limited derogation, followed by a more in-depth review of derogation requests to provide a decision on a more enduring derogation.

5.7. If we receive many requests within a week of inviting them, we may run a prioritisation process. The two stage process and prioritisation criteria are set out in Annex 2 the guidance document.

5.8. If you submit your request by 13 November 2018 we will aim to provide a minded to decision by 1 December 2018, but otherwise we'll aim to provide a decision as soon as possible.

5.9. Ahead of providing a decision or a minded to decision, we may consult on our proposed decision.

5.10. If you have any questions, send these to [renewablederogations@ofgem.gov.uk](mailto:renewablederogations@ofgem.gov.uk).

#### **Our assessment of any requests**

5.11. Each request will be considered on a case-by-case basis. Our assessment will be based on checking that appropriate evidence has been provided by the supplier to demonstrate that the tariff meets the three outcomes to be eligible for a derogation.

5.12. It is important that the default tariff cap continues to protect SVT customers, particularly those in vulnerable situations. Our assessment of derogation requests is intended to ensure that only genuine cases receive a derogation. We are mindful of gaming risks that would undermine the protections the cap. We will carefully assess whether the tariff in question meets the requirements before granting derogations because of the risk to undermining these protections.

5.13. We may follow up with the licensee making the request initially to clarify points relating to the derogation request and for the licensee to satisfy itself that there is a need for a derogation. We may ask an applicant for additional information that we need to assess a derogation request.

5.14. If, during the assessment, we identify any potential risks that may arise from the proposed scheme, for example any possible negative impact on consumers (including protections for disengaged customers and all customers' ability to make an informed choice about paying more for their energy to support renewable generation), we would raise the issues with the supplier and seek evidence on how they will mitigate the risks before considering whether a derogation can be granted.

5.15. For consistency, we take into account the nature of derogations we have already granted, the circumstances under which they were granted, and the conditions attached to them. Besides evidence submitted by the applicant, we may also consider evidence gathered through our monitoring activities and from other sources including from third parties, when necessary.

- 5.16. Ofgem will maintain a record of derogations that have been granted and may in some cases decide to incorporate additional derogation monitoring activity (for example review periods).

*Demonstrating each of the outcomes*

- 5.17. We will consider the case for granting a derogation based on whether all of the outcomes have been met.

*Outcome 1: the tariff is an SVT*

- 5.18. The Act defines an SVT as “a rate or amount charged for, or in relation to, the supply of gas or electricity under the contract that is not fixed for a period specified in the contract.”

- 5.19. The supplier should demonstrate that the tariff meets this definition. This could be through providing the relevant definitions from the contract they enter with their customers.

*Outcome 1 cont.: the consumer chose to be on the SVT*

- 5.20. To receive a derogation, the supplier will need to demonstrate that consumers made an active choice to be on the SVT. We do not propose to be prescriptive in setting out how suppliers must demonstrate this. However, we can clarify the following:

- we consider that a consumer has not made an active choice if they have defaulted onto the SVT from a fixed-rate tariff or are on a deemed contract<sup>10</sup>
- we expect a supplier to demonstrate that at the point the consumer chose to join the SVT, it was clearly advertised as a tariff that supports renewables.

- 5.21. The onus will be on suppliers to demonstrate that consumers made an active choice to join the SVT. One way in which suppliers could demonstrate this could be through requiring consumers to specifically opt-in to the tariff that is derogated, with those consumers that do not opt-in being consequently moved to a default tariff that complies with the cap.

- 5.22. We will consider the impact of the proposed derogation on the protections for disengaged customers provided for by the default tariff cap, and how the supplier will ensure that only customers who have made an active choice to pay more for their energy from renewable sources are covered by the scope of any derogation.

*Outcome 2: the SVT supports renewables*

- 5.23. We will assess each application based on the evidence submitted to demonstrate that the tariff supports renewables to a materially greater extent than that required under

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<sup>10</sup> 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.

existing government schemes, licence obligations, or other mandatory mechanisms, with the objective of increasing renewable generation or production capacity.

5.24. Whether a tariff and associated activity supports renewables beyond existing schemes and obligations may depend on the specific circumstances. It is for each supplier to set out how a tariff meets outcome 2 and provide appropriate evidence.

5.25. This list is not exhaustive, but below we set out factors and information we will take into consideration in our assessment:

- The Act specifically refers to tariffs which support the production of gas, or the generation of electricity, from renewable sources. We will not consider other activities such as electricity storage or carbon offset activities that do not directly support renewables.
- We will not consider activities and costs associated with subsidies, obligations or other mandatory mechanisms, for example, costs for purchasing Renewable Energy Guarantees of Origin (REGOs; the costs of which we note are immaterial); participating in the Feed-in Tariff (FIT) scheme (even where voluntary); funding the Contracts for Difference (CfD) scheme; or purchasing Renewable Obligation Certificates (ROCs) – even where purchasing more than obligated to (noting that now the Renewables Obligation is closed to new generators, over-purchasing ROCs wouldn't encourage new generators to enter the market).
- For any activities or costs associated with purchasing renewable gas certificates we will consider whether the generation has received support from existing subsidies, eg the Renewable Heat Incentive. Where generation has received support from a subsidy we do not expect to consider the purchasing of renewable gas certificates as additional support.
- We will consider whether the support for renewables arises due to the SVT; if a supplier would carry out an activity regardless, then we would not consider it as support for the purposes of the derogation request. For example, this includes PR and general communication activities.
- We will consider whether we think suppliers are attempting to game the derogations framework, such as by assessing whether suppliers are potentially allocating activities or costs from their wider portfolio. For example, if activities across a supplier remain the same but there has been a recent reorganisation of renewable generation to certain tariffs.
- We will consider the extent to which there is long-term commitment to the renewables sector and activities that are supporting renewables.
- We will consider the types of renewable generators the activities support and details of the support. For example, suppliers should provide a description of the generators (eg, small generators below 1MW) and length of PPA support.

*Outcome 3: the supplier incurs materially higher costs*

5.26. When assessing whether costs are materially higher we will take into account the evidence the supplier provides regarding the renewable specific costs related to the tariff and also the overall cost of the tariff.



- 5.27. Suppliers should explain and provide evidence relating to the costs they face solely from the support they provide to renewables, and which they would not otherwise face. Activities that do not support renewables (in accordance with the guidance above regarding outcome 2, such as purchasing REGOs), will not contribute towards costs associated with supporting renewables.
- 5.28. Suppliers should 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. Our assessment of materiality and the reasoning for why a supplier is requesting to price above the cap, will be on a case by case basis, with the onus being on the supplier to clearly separate and justify why costs are renewable specific additional costs. We expect a supplier to separately demonstrate that there is a relationship between these materially higher renewable costs and the need to price the tariff above the cap.
- 5.29. We may, on a case by case basis, require suppliers to provide information on the efficiency of their spending on supporting renewable generation. Regardless of any assessment we may carry out on the efficiency of costs, where a supplier asserts that they are incurring materially higher cost, they will have to clearly evidence where these costs are incurred and that they are materially higher cost when compared to non-renewable equivalents. We expect the supplier to verify that renewable costs are valid and evidenced, including that they:
- are related to activities that are in scope in terms of supporting renewables (for example, costs for purchasing Renewable Obligation Certificates (ROCs) would not be valid, as we do not consider that purchasing ROCs provides additional support for renewables in the context of our definition of outcome 2)<sup>11</sup>
  - haven't been incurred in an attempt to game the derogations framework (for example, by unnecessarily spending on renewables in the run up to requesting a derogation in an attempt to reach a level of costs that is considered material).
- 5.30. The following list is not exhaustive but sets out other factors and information we may take into consideration in our assessment:
- Costs must be reported in the templates to a sufficiently detailed level. Costs must be directly linked to an activity associated with supporting renewables and clear assumptions and supporting evidence provided. For example, just providing a proportion of a group of shared costs will not be sufficient. Also, explaining these are higher in general because of the renewable component of the tariffs would not be sufficient justification or evidence. The renewable financial information template provides further guidance on how costs should be broken down.
  - Given our case by case approach to efficiency we recognise there is a buyer beware risk and expect suppliers to not overstate Ofgem's assessment of the tariff in customer communications. However, we reserve the right to consider efficiency, particularly where we consider costs have been inefficiently incurred in

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<sup>11</sup> 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.



an attempt to demonstrate material costs thereby gaming the derogations framework.

### **Confidentiality and disclosure**

- 5.31. Any information provided to Ofgem relating 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. However, you should note that there are exceptions to the statutory restrictions, including where the disclosure is necessary to facilitate the statutory functions of Ofgem (eg the publishing of information to promote the interests of consumers) or other public bodies.
- 5.32. You should note that Ofgem 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') or the Environmental Information Regulations 2004 ('EIR'). However, Ofgem will always consider whether the statutory restrictions on disclosure apply to the requested information and therefore whether one or more of the FOIA/EIR exemptions apply.
- 5.33. Before deciding whether to publish any information relating to the affairs of a particular licence holder, Ofgem is required to consider whether it is appropriate to redact any information on the basis that the information would or might, in our opinion, seriously and prejudicially harm the interests of that person ('confidential information'). Where appropriate, we may seek further representations from licence holders at a later stage in respect of any specific information Ofgem is proposing to publish.

### **Next steps**

- 5.34. We acknowledge that as the market develops and adapts to the default price cap, our approach to derogations may need to be amended. Consequently, we will keep this guidance under review and may update it from time to time, consulting on any updates as appropriate. In particular, we will reflect on our experience with the first derogation requests to determine whether any immediate changes are necessary.