ofgem

Making a positive difference
for energy consumers

To licensed electricity suppliers
and all other interested
stakeholders

Your Ref:

Our Ref:

Email: RECompliance@ofgem.gov.uk

Date: 13 March 2020

Dear Stakeholder,

**Payments received after Renewables Obligation (RO) late payment deadline of 31 October**

Background

Under the Renewables Obligation (RO) Orders (namely, the Renewables Obligation Order 2015, the Renewables Obligation (Scotland) Order 2009 and the Renewables Obligation Order (Northern Ireland) 2009), UK licensed electricity suppliers have an obligation to source a specified proportion of the electricity they supply from renewable sources.

In order to comply with their obligations, suppliers must present to Ofgem on an annual basis, a specified number of Renewables Obligation Certificates (ROCs) per MWh of electricity supplied. Suppliers must each make a buy-out payment for each ROC that they do not present for compliance towards an obligation. Suppliers have until 1 September each year to present ROCs and until 31 August to make buy-out payments.

Should a supplier fail to discharge their obligations by 1 September, they have until 31 October to make late payment(s). The late payments must be made in cash – they cannot be made by supplying ROCs. Late payments are subject to statutory daily interest on top of the amount owed. This is calculated on a daily basis at a rate of 5% plus the Bank of England base rate on the first date of the late payment period.

Ofgem has received payments from suppliers after the 31 October deadline in respect of RO (England & Wales) and RO (Scotland) 2018-19 RO obligations. Historically, Ofgem has redistributed such payments as if they were received as part of the late payment fund (i.e. redistributed to each UK supplier, as defined in the RO Orders, in proportion to total number of ROCs presented). This process has highlighted that an alternative approach to recycling payments received after the late payment deadline (in respect of RO (England & Wales) and RO (Scotland)) may be more suitable in respect of years in which the mutualisation mechanism[1] is triggered. The purpose of this letter therefore, is to set out a proposed approach for future handling of such payments for stakeholder comment.

[1] Mutualisation is the mechanism whereby a shortfall in the RO Scotland and/or RO England & Wales buy-out funds which meets a certain threshold ("relevant shortfall") requires all compliant and partially compliant suppliers who have an obligation under the RO (Scotland) or RO (England & Wales) to make additional payments to make up the shortfall. A "relevant shortfall" is £15.4m in England & Wales and £1.54m in Scotland. Mutualisation does not apply to the RO (Northern Ireland).

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It should be noted that the mutualisation mechanism does not operate in Northern Ireland, although Northern Ireland suppliers will receive a share of the mutualisation funds if it does occur. As such, the proposals in this letter relate to payments received after the late payment deadline in respect of RO (England & Wales) and RO (Scotland) only. If a payment in respect of an RO (Northern Ireland) obligation is received after the late payment deadline, this will be redistributed to each UK supplier, as defined in the RO Orders, in proportion to the total number of ROCs they presented. This is in line with the approach taken historically in respect of such payments.

Recycling mechanism

The RO Orders provide that money received by Ofgem into the buy-out or late payment funds should be distributed to suppliers using the 'single recycling mechanism', whereby Ofgem redistributes funds to eligible suppliers in proportion to the total number of ROCs that each has presented across the three obligations (England & Wales, Scotland and Northern Ireland). For example, a supplier that presented three percent of the total number of ROCs across the three obligations would get back three percent of the total buy-out funds. The same applies to payments received in to the late payment fund. In practice the buy-out fund is redistributed at a different time from the late payment fund.

In some previous years, Ofgem has received payments in respect of RO obligations after the 31 October late payment deadline. The RO Orders are silent on how Ofgem should treat this money. In all previous years with the exception of the 2017-18 year, mutualisation was not triggered and in these years Ofgem took an administrative decision consistent with its statutory general duties and powers to redistribute any payments received after the late payment deadline in the same way as late payments are redistributed. The shortfalls in respect of those compliance periods impacted suppliers who presented ROCs only, as they absorbed the shortfall by receiving a reduced recycle value per ROC. As such, redistributing payments received after the late payment deadline ensures that those suppliers receive some of the money back (as we may not receive all outstanding payments after the late payment deadline) that they would have otherwise received if the relevant supplier(s) had complied with their obligations and made payment on time.

In the 2017-18 year, mutualisation was triggered for the first time on the RO and ROS schemes. Ofgem received some payments following the late payment deadline in respect of that compliance year and applied the same approach to these payments as outlined above. The following sections of this letter set out options available for future handling of such payments in respect of years in which mutualisation is triggered.

Future approach

At this stage, we are not proposing to change our approach to recycling payments received after the late payment deadline in respect of compliance years in which mutualisation is not triggered, or in respect of Northern Ireland obligations. However, we reiterate that the legislation does not specifically provide for the handling of payments received after the late payment deadline. As such, we reserve our position in this regard both in respect of periods in which mutualisation is triggered and those in respect of which mutualisation is not triggered.

Over recent years, an established practice has developed for periods in which mutualisation is not triggered. We are, however, seeking views from interested stakeholders on how Ofgem should handle payments received after the late payment deadline in respect of compliance years for which mutualisation is triggered. This is because when mutualisation is triggered, all compliant and partially compliant suppliers with obligations under RO (England & Wales) and RO (Scotland) must make additional payments to make up the shortfall. This is therefore a wider group of suppliers than just those who presented ROCs who are impacted by mutualisation. We have set out below what we believe to be the most consistent approach to managing these payments going forward, for periods where mutualisation is triggered.

Options proposed

Option 1

We propose that in respect of years in which mutualisation is triggered and Ofgem receives payments after the late payment deadline in respect of the jurisdiction(s) in which mutualisation is triggered, the general principle is that these payments are recycled to all suppliers in proportion to the total mutualisation payments they are responsible for making (i.e. if supplier A is due to make 2% of the total year's worth of mutualisation payments, they will receive 2% of the payments received after the late payment deadline).

We propose that under this approach, if no mutualisation payments have yet become due, payments received after the late payment deadline will be treated in the same way and will be recycled to all suppliers who are due to make mutualisation payments and are still trading. If a supplier who is or was due to make mutualisation payments is no longer trading, they will be removed from the calculation and the amount will be divided between the remaining suppliers proportionately.

**Example fictitious scenario for option 1**

- As of the late payment deadline[2], there is a shortfall of £100m (enough to be a "relevant shortfall"[3]).
- We have four suppliers who are compliant with their RO obligations, two of which presented ROCs and two of which made buy-out payments.
- Initially, the shortfall is absorbed by the two suppliers who presented ROCs through a reduced ROC recycle value.
- We then run mutualisation for the £100m shortfall. Assuming all four suppliers have an equal obligation, they each are required to pay a total of £25m over four quarterly payments.
- At the end of the four quarters, assuming all payments have been made in full and on time, a total of £100m has been received over the four quarters in to the mutualisation fund which has been redistributed to the two suppliers who presented ROCs (i.e. a total of £100m between them).
- As such the £100m shortfall initially absorbed by the two licensees who presented ROCs has now been paid back to them.
- This means that the net effect on all four suppliers is an additional charge of £25m each. Therefore, all suppliers are impacted equally.
- Assuming now a payment after the late payment deadline is received of £50m.
- As all suppliers have been impacted equally by virtue of the mutualisation process, this £50m will be redistributed to all suppliers who were due to make mutualisation payments (this includes both suppliers who presented ROCs and those who made buy-out payments in order to comply with their obligations).
- If a payment is made after the late payment deadline but before mutualisation payments are made or whilst mutualisation payments are in progress, the payment will be redistributed in exactly the same way as once mutualisation is complete, all suppliers will have been impacted equally by the shortfall amount. In these cases, we will, if possible, intend to redistribute that money as part of the next round of mutualisation redistribution (if there is one).
- As such, redistributing payments received after the late payment deadline to all suppliers who were required to make mutualisation payments is a fair outcome.

[2] 31 October
[3] Please refer to footnote 1

Option 2

The alternative option is to continue implementing the approach that has been taken in previous years (as described above), namely that payments received after the 31 October late payment deadline are distributed only to UK suppliers, as defined in the RO Orders, who have supplied ROCs, irrespective of whether or not mutualisation has been triggered.

The benefits of this approach are firstly, that it continues a practice that has previously been implemented and secondly, that it is another incentive for suppliers to choose to present ROCs in order to discharge their obligations.

However, as explained above, this approach does not take account of all suppliers who are affected by a shortfall when mutualisation is triggered. For that reason, option 1 is Ofgem's preferred approach.

**Views sought**

We welcome stakeholder views on the following:

1. Do you agree with our preferred option (option 1)?
2. If not, do you feel option 2 would be a more proportionate approach? If so, please provide details and example working.
3. If you disagree with option 1 and option 2, what do you feel would be a more consistent or more proportionate approach? Please provide details and example working.
4. With respect to any approach identified in response to question 3, why do you believe this approach would be more appropriate?

**Next steps**

Ofgem has received some monies following the 2018-19 RO late payment deadline. As such, once we have determined our chosen approach, we will publish a further open letter confirming Ofgem's chosen approach and will use that approach to redistribute this money to suppliers. As such we would be grateful for your feedback on our proposed approach by no later than close of business **27 March 2020.** Please send your feedback to RECompliance@ofgem.gov.uk.

Yours faithfully,

Russell G. Ogilvie

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