

# Default Tariff Cap: Policy Consultation

## Appendix 13 - Renewable tariff exemption

### Consultation - supplementary appendix

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#### Overview:

The energy market works well for consumers who shop around. Suppliers compete for these engaged consumers, offering low prices to gain or retain their custom.

But the retail energy market is not working for consumers who remain on their supplier's default tariff. Our work, and the Competition and Markets Authority's investigation, has shown there is little competitive constraint on the prices suppliers charge these consumers. As a result, they are paying more than they should be.

To address this problem, Government has introduced legislation into Parliament which would require Ofgem to design and put in place a temporary cap on all standard variable tariffs and fixed-term default tariffs. We anticipate that Parliament will approve the Domestic Gas and Electricity (Tariff Cap) Bill in the summer, and the default tariff cap will come into force at the end of 2018.

We are now consulting on how we might design and implement the default tariff cap. This supplementary appendix to the main consultation document sets out our proposals in relation to potential exemptions from the default tariff cap for tariffs which support the production of renewable energy. This document is aimed at those who want an in-depth understanding of our proposals. Stakeholders wanting a more accessible overview should refer to the main consultation document.

## Associated documents

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### **Policy consultation for Default Tariff Cap – Overview**

[https://ofgem.gov.uk/system/files/docs/2018/05/default\\_tariff\\_cap\\_-\\_policy\\_consultation\\_-\\_overview.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/default_tariff_cap_-_policy_consultation_-_overview.pdf)

### **Links to supplementary appendices**

- Appendix 1 - Market basket:  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_1\\_-\\_market\\_basket.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_1_-_market_basket.pdf)
- Appendix 2 - Adjusted version of the existing safeguard tariff  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_2\\_-\\_adjusted\\_version\\_of\\_the\\_existing\\_safeguard\\_tariff.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_2_-_adjusted_version_of_the_existing_safeguard_tariff.pdf)
- Appendix 3 – Updated competitive reference price  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_3\\_-\\_updated\\_competitive\\_reference\\_price.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_3_-_updated_competitive_reference_price.pdf)
- Appendix 4 – Bottom-up cost assessment  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_4\\_-\\_bottom-up\\_cost\\_assessment.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_4_-_bottom-up_cost_assessment.pdf)
- Appendix 5 – Updating the cap over time  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_5\\_-\\_updating\\_the\\_cap\\_over\\_time.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_5_-_updating_the_cap_over_time.pdf)
- Appendix 6 – Wholesale costs  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_6\\_-\\_wholesale\\_costs.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_6_-_wholesale_costs.pdf)
- Appendix 7 – Policy and network costs  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_7\\_-\\_policy\\_and\\_network\\_costs.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_7_-_policy_and_network_costs.pdf)
- Appendix 8 – Operating costs  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_8\\_-\\_operating\\_costs.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_8_-_operating_costs.pdf)
- Appendix 9 – EBIT  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_9\\_-\\_EBIT.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_9_-_EBIT.pdf)
- Appendix 10 – Smart metering costs  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_10\\_-\\_smart\\_metering\\_costs.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_10_-_smart_metering_costs.pdf)
- Appendix 11 – Headroom  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_11\\_-\\_headroom.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_11_-_headroom.pdf)
- Appendix 12 – Payment method uplift  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_12\\_-\\_payment\\_method\\_uplift.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_12_-_payment_method_uplift.pdf)
- Appendix 13 – Renewable tariff exemption  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_13\\_-\\_renewable\\_tariff\\_exemption.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_13_-_renewable_tariff_exemption.pdf)
- Appendix 14 – Initial view on impact assessment  
[https://ofgem.gov.uk/system/files/docs/2018/05/appendix\\_14\\_-\\_initial\\_view\\_on\\_impact\\_assessment.pdf](https://ofgem.gov.uk/system/files/docs/2018/05/appendix_14_-_initial_view_on_impact_assessment.pdf)

## Document map

This supplementary appendix to the main overview document set out our proposals for whether a renewable tariff exemption is necessary from the default tariff cap, and if so, how to exempt the respective tariffs.

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

**Figure 1: Default tariff cap – policy consultation document map**

Overview Document	
Supplementary Appendices	
<b>Methodologies for calculating efficient costs of supply</b> <ol style="list-style-type: none"> <li>1. Market basket</li> <li>2. Adjusted version of the existing safeguard tariff</li> <li>3. Updated competitive reference price</li> <li>4. Bottom-up cost assessment</li> </ol>	<b>Elements of cost that suppliers incur and allowances for efficient suppliers</b> <ol style="list-style-type: none"> <li>6. Wholesale costs</li> <li>7. Policy and network costs</li> <li>8. Operating costs</li> <li>9. EBIT</li> <li>10. Smart metering costs</li> </ol>
<b>Reflecting trends in efficient costs</b> <ol style="list-style-type: none"> <li>5. Updating the cap over time</li> </ol>	<b>Additional cap elements</b> <ol style="list-style-type: none"> <li>11. Headroom</li> <li>12. Payment method uplift</li> </ol>
<b>Scope of the default tariff cap</b> <ol style="list-style-type: none"> <li>13. Potential renewable exemption</li> </ol>	<b>Impact assessment</b> <ol style="list-style-type: none"> <li>14. Initial view on impact assessment</li> </ol>

*Links to these documents can be found in the 'Associated documents' section of this document*

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# 1. Introduction

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In this chapter, we:

- explain what the Bill requires regarding exempting renewable tariffs and highlight some of the challenges in doing so;
- outline the structure of the appendix; and,
- note that we are considering consulting on clarifying the existing regulatory framework in relation to the allocation of a supplier fuel mix across its tariffs.

1.1. The Domestic Gas and Electricity (Tariff Cap) Bill states that the default tariff cap may not apply to Single Variable Tariffs (SVTs<sup>1</sup>) that have been chosen by the customer and that appear to the Authority to support the production of renewable gas or electricity.

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

1.3. This appendix explains our thinking to date, and consults on whether it is appropriate to have an exemption for renewable tariffs, and if so, how we could approach this.

## **Challenges in designing an exemption**

1.4. Since an exemption would allow suppliers to charge more than the default tariff cap, there may be a significant incentive for suppliers to want to claim that their tariffs qualify as exempt. We would need to define any such exemption in such a way that it was clear exactly which tariffs qualify, and so that the risk of gaming was low.

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

1.6. This means that all (electricity) tariffs could be described as supporting renewable energy/electricity. Our challenge in assessing whether an exemption is

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<sup>1</sup> Unlike the rest of the Bill, which applies to SVT and default tariffs, the section referring to a renewable exemption only applies to SVTs that were chosen by the customer.

appropriate is therefore to ensure that there is a good reason why certain tariffs should cost more than the default tariff cap.

1.7. We note that there are no schemes or framework in place for renewable gas, which means definitions and compliance would have to be designed from first principles.

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

### **Renewable tariffs**

1.9. Our data suggests that there is a range of renewable tariffs available on the market. These range from suppliers who claim to offer 100% renewable electricity, others who directly invest in renewable technology innovation, green gas and carbon offset for any gas that is from fossil fuels and a further group who purchase Renewable Energy Guarantees of Origins (REGOs).<sup>2</sup>

1.10. Our initial analysis suggests that consumers can pay up to £300 more for their energy per year for an SVT with a supplier who claims to invest in renewable technology innovation, compared to a supplier who purchases REGO backed energy at a small cost.

1.11. Our analysis also suggests that more than half of the green tariffs in the market are fixed tariffs.

### **Informed choice**

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

1.13. The Bill requires that the exemption can only be provided at a tariff level, so we would not be able to consider a supplier's wider environmental credentials (such

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<sup>2</sup> The purpose of the certificate is to prove to the final customer that a given share of energy was produced from renewable sources. We issue one REGO certificate per megawatt hour (MWh) of eligible renewable output to generators of renewable electricity.

as the level of renewables across all their tariffs) in deciding whether to exempt individual tariffs.

1.14. There is a condition in the supply licence (SLC 21D, see Annex 1 for a description) which requires suppliers to be transparent to consumers about the claims of environmental tariffs and where a claim is made, ensuring that they can demonstrate the basis of the claim. However, this condition does not have any threshold for environmental benefit and therefore we do not believe we can rely on it to prevent the gaming we described above.

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

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

1.17. This consultation is split into two broad sections, firstly seeking views and evidence on whether an exemption is necessary, and then considering options for providing an exemption, should one, in principle, be necessary.

## 2. Is a renewable exemption appropriate?

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In this chapter, we seek views and evidence on whether an exemption is, in principle, necessary.

2.1. We firstly consider whether, in principle, an exemption for renewable tariffs is appropriate.

2.2. To do this we have considered:

- the Bill requirements and the policy intent (including as indicated by the select committee report<sup>3</sup>), as well as our overall duty under the Bill, which is to protect consumers in respect of the amount they pay for their energy
- the practicalities of implementing and enforcing any exemption.

2.3. In reaching our position on each of these consultation areas, we will need to consider our overall duty under the Bill, which is to protect consumers in respect of the amount they pay for their energy.<sup>4</sup>

2.4. On this basis, we consider that for any exemption to be appropriate, it should meet the following criteria:

- 1. Exempted tariffs provide support for renewables, materially beyond support provided through subsidies, obligations or other mandatory mechanisms.** Because renewable energy is subsidised and (in electricity) there are obligations on suppliers to source renewable energy, a certain amount of renewable energy will flow through the national grid regardless of whether it is sold to end-consumers through a renewable tariff. As such, to warrant an exemption, there should be evidence that there are tariffs that support renewables materially beyond what is provided through subsidies, obligations or other mandatory obligations.
- 2. The exempted tariff involves materially higher costs.** The sorts of tariffs captured by any exemption should cost the supplier materially more to provide than other SVTs, due to the renewable element of those tariffs.

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<sup>3</sup> On 13 February 2018 the Business, Energy and Industrial Strategy Committee published their [pre-legislative scrutiny of the draft Bill](#). They noted that “customers should be allowed to pay more for renewable electricity if they actively decide to do so and if the tariffs in question truly encourage renewable generation”. They also suggest the exemption should only apply to tariffs that provide “substantial environmental benefits”.

<sup>4</sup> In reaching a decision, we are unable to have regard to our wider duties to protect consumers. Instead, our focus is on whether an exemption is required in light of the requirements of the Bill.

The default tariff cap will provide protection for consumers by setting a maximum price that a supplier can charge. If it cannot be demonstrated that renewable tariffs have a higher efficient cost level (due to the renewable element), then it would suggest that the exemption is not necessary. Otherwise there is no rationale for the supplier to need to charge a price higher than the cap to offer these tariffs to consumers.

- 3. The exemption can be clearly defined and robustly monitored.** It should be relatively straightforward for Ofgem to verify and robustly monitor whether any exempt tariffs are complying with the requirements of any exemption. This is important to minimise the risk of gaming of the default tariff cap and ensuring proportionate administration costs.
- 4. The exemption should be difficult to game.** The exemption should not contain any loopholes that mean a supplier can benefit from an exemption without meeting the spirit of the policy rationale for having an exemption. For example, suppliers should not be able to gain an exemption simply by allocating all of its renewable energy to one tariff, meaning its other tariffs are “non renewable” (with a lower renewable level than the system average).

2.5. In the next chapter we explore, if we were to design an exemption, options we would consider. We assess each of the options against the criteria above.

### **Renewable electricity**

2.6. However, based on our analysis to date, **we do not consider that there is sufficient evidence that an exemption is appropriate for renewable electricity tariffs.** This is for the following reasons:

- renewable generation (both gas and electricity), for the most part, is subsidised
- the Renewables Obligation placed an obligation on electricity suppliers to source a certain amount of their energy from renewable sources, which means there is a large base-load of renewable electricity that can, theoretically, be purchased by suppliers without facing additional costs
- new renewable electricity generators also have access to various revenue streams other than consumer demand for their generation (via the capacity market and ancillary services), particularly when co-located with storage.

2.7. Therefore, we struggle to see how a tariff could materially support the production of renewable energy over and above what is already in place.

2.8. As already noted, the fact that suppliers choose to have renewables in their fuel mix is not the main driver behind renewable investment (the main drivers are subsidies and regulatory obligations). In addition, since the default tariff cap is time limited, we consider the likelihood of the exemption driving forward any further deployment of renewables (or any further long term power purchase agreements (PPAs) for renewables) to be very low.

2.9. We note that the regulatory and market space in this area is complex and we have to be very careful to avoid creating perverse/unintended consequences.

2.10. We also note that consumer demand for renewable-backed tariffs is low, so many suppliers don't 'claim' their renewable generation through the Renewable Energy REGO scheme. Around 20% of electricity in GB is unclaimed renewable electricity (known as residual renewable electricity), so all electricity suppliers can claim they supply at least 20% renewable electricity without having to take any action to eg contract with renewable generators or purchase REGOs from the market. We also note that suppliers can buy REGOs cheaply, so it is easy and cheap for suppliers to 'green' some tariffs. As such, our starting point is that simply having renewables in the portfolio is not enough to demonstrate that a tariff is providing support for renewables. We do not have sufficient evidence that existing renewable tariffs provide additional environmental benefit beyond existing renewable generation.

2.11. In addition, we do not have evidence to suggest that providing a renewable tariff costs materially more to provide, and that any additional costs can be specifically attributed to a certain tariff. It could be argued that if suppliers work with small renewable generators, they may need to manage large numbers of contracts, which could drive up costs. Similarly, they could also find it harder to balance supply and demand, as some renewable generators cannot be simply turned up or down. Again, this may drive higher costs. Some suppliers may also provide a level of customer service and hand-holding to smaller renewable generators which helps them to bring their generation online. However, we do not have any evidence to confirm that this is the case or that these costs are material and can be attributed to certain tariffs. We welcome evidence from stakeholders.

## Renewable gas

2.12. We are required by the Bill to consider whether an exemption is appropriate for gas or electricity. **We are not minded to provide an exemption for renewable gas tariffs.** We are also not minded to provide derogations. We explain our reasoning below.

2.13. Our analysis suggests renewable gas is not currently widely available and therefore we are not convinced that it would be proportionate to provide an exemption.

2.14. In relation to criteria 4, in gas, there is no equivalent of the REGOs scheme that exists in electricity, which we could use to monitor the provenance of a gas

supplier's fuel mix. We are aware of at least one industry-led certification scheme that mimics the REGO scheme, but we do not consider this to be sufficiently comprehensive and transparent.

2.15. To consider an exemption for gas we would need an independent and comprehensive scheme which validates the supplier's purchase of renewable gas to base the assessment on. In our view, given the default tariff cap is temporary, it is not proportionate to design and implement a new scheme for the purposes of the default tariff cap.

**QA13.1:** Do you agree with our minded-to positions not to provide exemptions for renewable electricity or gas tariffs?

## 3. Electricity renewable exemption options

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In this chapter, we explain that we are minded to include all SVT tariffs within scope of the default tariff cap and consider allowing suppliers to apply for a derogation from the rules. This chapter provides an assessment of this option, and four potential approaches to a renewable exemption.

3.1. In this chapter we explore a number of options for providing a renewable electricity exemption and the reasoning behind our minded-to positions. We have assessed these options against the criteria in Chapter 2.

3.2. It is important that if we introduce an exemption it is practical and feasible to do so. This includes making sure it does not allow suppliers to circumvent the default tariff cap and not provide protection to consumers who should receive it. Therefore, to provide an exemption we would need a common set of criteria to define the renewable tariffs which could be applied across all suppliers and which accurately capture those tariffs which provide environmental benefits (beyond existing subsidies and obligations). The criteria would also need to be robust to gaming and we would need to be able to easily monitor compliance against them.

3.3. The Bill also requires that an exemption may only apply to SVTs which have been chosen by the consumer and appear to the Authority to support the production of renewable gas or electricity. Therefore all default tariffs, whether an SVT or a default fixed term, are in scope of the price cap and not eligible for a renewable exemption.

3.4. To provide an exemption we first considered whether we could adapt our existing rules for renewable energy (see Annex 1). SLC21D provides a principle, in that it defines 'additionality' as an environmental benefit that is a result of "consumers choosing to purchase the tariff in question and not solely brought about as a result of subsidies, obligations or other mandatory mechanisms". One option would be to allow tariffs to be exempt if they meet the requirements of SLC21D.4a.<sup>5</sup> We have discounted this approach because SLC21D.4 does not set a bar in terms of the magnitude of environmental benefit that a tariff must provide for a supplier to be able to make an environmental claim. This is not an issue for the current purpose of SLC21D.4, which is about ensuring that any claims made are backed up by additional environmental benefits, and that this can be clearly explained to the consumer. However, for the purposes of an exemption, we would need a threshold that ensures the additional cost of the tariff is justified against the level of the default tariff cap.

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<sup>5</sup> 21D.4 If the licensee makes an Environmental Claim in connection with a Tariff...

a) the licensee must ensure that the claimed environmental benefit is a result of consumers choosing to purchase the Tariff in question and not solely brought about as a result of subsidies, obligations or other mandatory mechanisms; or

The licence definition is also too broad, since it refers to environmental benefits, whereas the Bill specifically references support to renewable generation.

3.5. We have looked at four options for the design of renewable exemption rules.<sup>6</sup> Each comprises a different way of addressing the challenges we have described. These are:

- Option A, 100% renewable tariffs
- Option B, X% of tariff being from unsubsidised renewable sources
- Option C, Y% of the generation associated with a certain tariff being backed by long-term power purchase agreements (PPAs)<sup>7</sup> with renewable generators
- Option D, Z% of tariff costs spent on renewable investment or R&D.

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

3.7. However, each of these options has challenges, and it is not clear to us that any of these options would be capable of defining a tariff that materially supports renewables and is robust to gaming.

3.8. As a result, **we think it would be appropriate to include all SVT tariffs within the scope of the price cap and consider allowing suppliers to apply for a derogation from the default tariff cap.** This would allow us to evaluate on a case-by-case basis how a tariff may fulfil our criteria.

3.9. The next section first discusses the derogation approach and then outlines our assessment of the four exemption options. We assess each of these approaches against the criteria outlined in the previous chapter.

### **Derogation based on a set of conditions or outcomes**

3.10. Under this option, a supplier can apply to Ofgem for an exemption from the price cap for a tariff if the supplier can demonstrate that tariff has met a certain set of criteria.

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<sup>6</sup> Definitions of renewable electricity and gas already exist in regulations. To consider a renewable exemption, for electricity, we propose to use the Renewable Energy Guarantees of Origin (REGO) Statutory Instrument as our starting point.

<sup>7</sup> In this context, a PPA is a legal contract between an electricity generator and an energy supplier regarding the sale and purchase of energy.

3.11. A derogation could be granted if a supplier could demonstrate its renewable tariff delivers the following outcomes:

- Outcome 1:** By consumers choosing to be on the tariff, the supplier provides support for renewables, materially beyond what is provided by subsidies, obligations or other mandatory mechanisms.
- Outcome 2:** The tariff costs the supplier materially more to provide compared to standard tariffs, due to the provision of renewable electricity under that tariff.
- Outcome 3:** the supplier is able to provide unambiguous evidence that it has met principles 1 and 2 for the purposes of Ofgem monitoring whether the supplier is complying with those principles.

3.12. We welcome views on these outcomes and the criteria for a derogation.

3.13. Table A13.1 below sets out our analysis of this approach using the four criteria that we have assessed options against.

**Table A13.1: Assessment of a derogation approach against our criteria**

<b>Criteria</b>	<b>Our views</b>
<b>Support for renewables</b>	We would expect the derogation to require that renewables are supported by the tariff.
<b>Difficult to game</b>	In general, a derogation approach should be harder to game than prescriptive definitions. However, there could be different (valid) interpretations of compliance, so we'd need to accept that there could be differences in how suppliers apply for a derogation.
<b>Costs more</b>	We would expect to include a criteria to require that tariffs can only be exempt where they cost more to provide.
<b>Can be clearly defined and robustly monitored</b>	It should be relatively easy to define the criteria for the exemption. However, if we use an outcome approach to setting these criteria there can be different (valid) interpretations of compliance, so we'd need to accept that there could be differences in how suppliers apply those criteria. This would mean there won't be a single source of information that we can check to validate compliance. To an extent we could mitigate this risk by engaging closely with suppliers on their approach to compliance. We could also require suppliers to prepare an annual statement on how they have met the criteria or require an independent audit, but we would still need to be able to verify compliance on a case by case basis.

3.14. Under the four exemption options, we have identified issues either related to whether the tariffs in question would genuinely support renewables or whether it would be feasible to monitor compliance. Using a derogation approach sets a high bar for an exemption, however, at the same time it does provide flexibility to exempt tariffs in the light of new evidence.

3.15. Some additional benefits of requiring a derogation are that:

- it will be easy to monitor who has a derogation
- it will be more difficult for suppliers to game the exemption, because we'd need to be satisfied ahead of granting the derogation that it can't be gamed and that a supplier's interpretation of the principles aligns with ours.

3.16. However, the derogations process will place a resource burden on licensees that apply and Ofgem. There will also be a delay between a supplier applying for a derogation and receiving it.

**3.17. On balance, we are minded to not have an exemption but consider allowing a supplier to apply to Ofgem for a derogation from the rules where the supplier could demonstrate its electricity tariff satisfies a set of criteria or outcomes.** This approach provides flexibility for a supplier to demonstrate that its tariff provides additional renewable support, it is consistent with our broader approach to regulation, and it ensures consumers are protected unless there is sufficient evidence that the protection can be removed.

### **Exemption options**

3.18. Our evidence suggests it would be difficult to design a prescriptive requirement which meets the criteria outlined in paragraph 2.4. The prescriptive approach would make it easier to monitor and ensure compliance. However our analysis suggests this approach would be at high risk of successful gaming and risks not providing substantial additional support for renewable generation.

3.19. Below we outline and assess the four exemption options against the criteria.

#### *Option A: 100% renewable tariff*

3.20. Under this option, a tariff would be exempt where the tariff is 100% backed by renewable generation, evidenced by the supplier having enough REGOs to match the energy they supply to consumers on that tariff. In Table A13.2 below we assess this option against the criteria in Chapter 2.

3.21. We do not consider this option is a suitable approach to providing an exemption. It would be too open to gaming (by suppliers allocating all their renewable energy to on tariff) and may exempt tariffs that do not provide additional

support for renewables because these tariffs would be built using existing supplier subsidies and obligations.

**Table A13.2: Assessment of a 100% renewable tariff based approach against our criteria**

<b>Criteria</b>	<b>Our views</b>
<b>Support for renewables</b>	These tariffs may provide negligible additional support. For example, the renewable energy could be solely from renewable generation built due to subsidies and supplier obligations, and the supplier may have no direct relationship with those generators. Also, the renewables provided through that tariff could be at the detriment of other tariffs in the supplier's portfolio (ie a supplier with 20% renewables could arbitrarily say that 20% of their customers are getting 100% renewable energy, and the other 80% are getting 0% renewable energy).
<b>Difficult to game</b>	It would be relatively easy to game for the reasons discussed above (ie suppliers can choose which tariffs they allocate any renewables in their portfolio to).
<b>Costs more</b>	The additional costs could be negligible as REGOs can be purchased very cheaply. We understand that for very little cost suppliers can purchase the number of REGOs needed to make a customer's supply 100% renewable. <sup>8</sup>
<b>Can be clearly defined and robustly monitored</b>	This option should be easy to clearly define and robustly monitor. As noted, REGOs clearly define what renewable electricity is, and suppliers could demonstrate that their tariff is 100% renewable by having enough REGOs to cover the energy provided through that tariff. We already collect data from suppliers on REGOs. One complication is that we'd need to see energy provision broken down by tariff, and be confident that the REGOs in question relate to the tariffs that are exempt.

*Option B: X% of tariff being from unsubsidised renewable sources*

3.22. Some of our concerns with Option A are linked to the fact that the majority of the renewable energy on the national grid has already benefited from subsidies. It may be possible to mitigate some of these concerns by only exempting tariffs that include a proportion of renewable energy from unsubsidised renewable sources.

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<sup>8</sup> The REGO price is set by the market, so there is no set price and it would differ over time.

3.23. We do not consider this option is a suitable approach to providing an exemption. It could exempt tariffs on the basis of them being partly composed of old hydro generating stations (ie not supporting new renewable investment). Suppliers may also be able to game the exemption by notionally allocating unsubsidised renewable energy, which was purchased for the benefit of all of their tariffs, into a single renewable SVT.

**Table A13.3: Assessment of an unsubsidised renewable tariff based approach against our criteria**

<b>Criteria</b>	<b>Our views</b>
<b>Support for renewables</b>	This option may capture tariffs more likely to provide support than Option A, as some of the renewable energy may be coming from renewables that have been built due to consumer demand as opposed to being due to subsidies. However, this assertion is far from certain. For example, some hydro generators were built prior to subsidies for renewables being in place, and unsubsidised generation could get value as an ancillary service and potentially from the capacity market). Our evidence suggests only a negligible amount of generation is from unsubsidised sources and, given the investment lead times, this is unlikely to increase dramatically over the time period that the cap is in place.
<b>Difficult to game</b>	It would be relatively easy to game to the extent that (similar to Option A) suppliers can choose which tariffs they allocate any unsubsidised renewables in their portfolio to. Although this generation would not have been subsidised, as noted above, this could just be old hydro generation that was built many years ago. In reality the supplier may purchase the old hydro power for the benefit of their wider portfolio of tariffs, and then notionally allocate it to a single renewable SVT for the purposes of gaming the price cap. That said, given that there is a negligible amount of unsubsidised renewable generation, suppliers will be less likely to have large amounts in their portfolio that they can then shift between tariffs in the manner described above.
<b>Costs more</b>	All things being equal, one would expect it to cost more to buy unsubsidised renewable energy than subsidised renewable energy. In reality, it may not necessarily cost materially more. The cost of renewable generation depends on the technology. It can also be difficult to compare like for like, due to the large upfront costs for some technologies, but very low operating costs. A report by the International Renewable Energy Agency (IRENA) suggests <sup>9</sup> that costs are falling rapidly, noting the

<sup>9</sup> [https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2018/Jan/IRENA\\_2017\\_Power\\_Costs\\_2018.pdf](https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2018/Jan/IRENA_2017_Power_Costs_2018.pdf)

	trend is that by 2020 “all mainstream renewable power generation technologies can be expected to provide average costs at the lower end of the fossil-fuel cost range. In addition, several solar PV and wind power projects will provide some of the lowest-cost electricity from any source.”
<b>Can be clearly defined and robustly monitored</b>	The main challenge on definitions would be defining ‘unsubsidised renewable electricity’. We may be able to monitor compliance by checking that the generation in question is not on the central FIT register or the renewable and CHP register, or subject to a Contract for Difference (CfD) (register is managed by the Low Carbon Contracts Company (LCCC)). It is harder to check whether it received any EU-level grants. Alternatively, monitoring could be a ‘declaration-based system’, possibly verified by independent auditors (noting that we use this approach elsewhere).

3.24. There is a small risk that this option would create a perverse incentive whereby generators forego their subsidies in favour of better returns by selling unsubsidised renewables at a premium to suppliers who want to include it in an exempt renewable tariff.

*Option C: Y% of the generation associated with a certain tariff being backed by long-term PPAs<sup>10</sup> with renewable generators*

3.25. The default tariff cap will provide an upper limit for what suppliers can charge customers for each unit of energy. One of our concerns is that it may not cost suppliers materially more to provide 100% renewable energy, and therefore an exemption from the default tariff cap may not be necessary. This is because it is possible to buy energy from the wholesale markets and then purchase REGOs (at low cost) independently from the electricity.

3.26. However, if a supplier’s business model relies on long-term power purchase agreements with specific renewable generators, there may be additional costs involved for that supplier in how they match the generation profile with the customer demand profile on a given tariff.

3.27. Another approach would be to exempt tariffs where a supplier could prove a certain percentage of the generation for that tariff relies on long-term power purchase agreements with specific renewable generators.

3.28. We do not consider this option is a suitable approach to providing an exemption. Suppliers may be able to game the exemption by notionally allocating

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<sup>10</sup> In this context, a PPA is a legal contract between an electricity generator and an energy supplier regarding the sale and purchase of energy.

PPAs, which put in place for the benefit of all of their tariffs, into a single renewable SVT.

**Table A13.4: Assessment of a generation being backed by long-term PPAs based approach against our criteria**

<b>Criteria</b>	<b>Our views</b>
<b>Support for renewables</b>	This option may capture tariffs more likely to provide support than Option A, as generators may be more likely to invest in renewables if they believe they will be able to secure long-term PPAs.
<b>Difficult to game</b>	It would be relatively easy to game, as (similar to Option A) suppliers can choose which tariffs they allocate any power purchase agreements in their portfolio to. For example, the supplier may have a small number of PPAs that were purchased for the benefit of their entire portfolio, and they may then notionally allocate those PPAs to a single renewable SVT for the purposes of gaming the price cap.
<b>Costs more</b>	As noted above, if a supplier's business model relies on long-term PPAs with specific renewable generators, there may be additional costs involved for that supplier in how they match the generation profile with the customer demand profile.
<b>Can be clearly defined and robustly monitored</b>	The main challenge on definitions would be defining 'long-term power purchase agreement'. Monitoring would be complicated by the requirement to validate that the amount of energy provided under an exempt tariff is matched by long-term power purchase agreements.

*Option D: Z% of tariff costs spent on renewable investment or R&D*

3.29. Under this option, a tariff would be exempt if a proportion (which we would set in the licence) of the amount that consumers pay for that tariff is invested into renewable generation. For example, if we set the figure at 10% and the average annual price of a consumer on that tariff was £1,000, the supplier would need to invest £100 per customer on that tariff per annum into renewable generation.

3.30. Some technologies are more costly than the established and commercialised technologies, so investment in them may genuinely 'support' these renewables beyond what is provided through subsidies and existing regulatory obligations.

3.31. In the short term, for any given amount of investment, these technologies would presumably provide less environmental benefit than cheaper and more established technologies. However, if they are supported now, then over the longer-term it could help to commercialise and bring down the costs of these technologies.

3.32. However, our understanding is that suppliers do not allocate investment on a tariff-by-tariff level, so to set an exemption on this basis could push suppliers to arrange their investment in an unusual manner.

3.33. Investment may usually be 'lumpy', with large investments in some years and lower investments in others. It is unclear if the reality of how investments are made would be compatible with how this exemption would need to be defined and monitored.

3.34. If a supplier's tariff was exempt, there is a risk that suppliers may invest unnecessarily or inefficiently in order to meet the required level of investment necessary to remain exempt.

3.35. We would also need to decide whether the costs of purchasing renewable energy counts as an investment.

3.36. We do not consider this option is a suitable approach to providing an exemption. It would likely be difficult to clearly define and robustly monitor compliance with the exemption. It would also be too open to gaming, as suppliers could notionally allocate their renewable investment, which was invested for the benefit of all of their tariffs, into a single renewable SVT.

**Table A13.5: Assessment of a renewable investment approach against our criteria**

<b>Criteria</b>	<b>Our views</b>
<b>Support for renewables</b>	Subject to the gaming risks explained below, this option may be better at capturing tariffs that result in investment into renewable generation.
<b>Difficult to game</b>	It would be relatively easy to game, as (similar to Option A) suppliers can choose which tariffs they allocate renewable investment in their portfolio to. Also, because of the complexity in defining renewable investment, it could open up other avenues for gaming.
<b>Costs more</b>	Because of the gaming risks discussed above, then any additional costs might simply reflect the diversion of investment that a supplier was planning to make across their other tariffs.
<b>Can be clearly defined and robustly monitored</b>	The main challenge on definitions would be defining 'renewable investment', which could prove challenging in light of the various complexities identified above. It would also likely be difficult to monitor compliance, because of the complexities associated with defining 'renewable investment'.

### **Our position and consultation questions**

3.37. As stated in paragraph 3.8 we are minded-to not have an exemption but consider allowing a supplier to apply to Ofgem for a derogation from the rules where the supplier could demonstrate its tariff satisfies a set of criteria or outcomes. We do not have sufficient evidence that an exemption for renewable tariffs is appropriate. The exemption options we have considered do not address our concerns around supporting renewables and risk of gaming.

**QA13.2:** What are your views on whether to provide a derogation for renewable electricity tariffs?

## 4. Consultation response and questions

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We want to hear from anyone interested in this document. Send your response to the person or team named at the top of the front page.

We've asked for your feedback in each of the questions throughout it. Please respond to each one as fully as you can. The full list of consultation questions is available in Chapter 7 in the main consultation document.

Unless you mark your response confidential, we'll publish it on our website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk), and put it in our library. You can ask us to keep your response confidential, and we'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you want us to keep your response confidential, you should clearly mark your response to that effect and include reasons.

If the information you give in your response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. If you are including any confidential material in your response, please put it in the appendices.

**Question A13.1:** Do you agree with our minded-to positions not to provide exemptions for renewable electricity or gas tariffs?

**Question A13.2:** What are your views on whether to provide a derogation for renewable electricity tariffs?

## Annex 1: Current regulatory framework

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This annex outlines the relevant existing rules and obligations relating to renewable energy.

### *Renewables Obligation (RO)*

1.1 The Renewables Obligation (RO) is one of the main support mechanisms for large-scale renewable electricity projects in the UK. Smaller scale generation is mainly supported through the Feed-In Tariffs (FIT scheme).

1.2 The RO scheme is administered by Ofgem. It came into effect in 2002 in England and Wales, and Scotland, followed by Northern Ireland in 2005. It placed an obligation on UK electricity suppliers to source an increasing proportion of the electricity they supply from renewable sources. The RO closed to all new generating capacity on 31 March 2017.

1.3 Renewables Obligation Certificates (ROCs) are certificates issued to operators of accredited renewable generating stations for the eligible renewable electricity they generate. Operators can trade ROCs with other parties. ROCs are ultimately used by suppliers to demonstrate that they have met their obligation.

1.4 Where suppliers do not present a sufficient number of ROCs to meet their obligation in the reporting period (one year), they must pay an equivalent amount into a buy-out fund. The administration cost of the scheme is recovered from the fund and the rest is distributed back to suppliers in proportion to the number of ROCs they produced in meeting their individual obligation.

1.5 There are two main systems to encourage the transparency of renewable energy for consumers:

### *Renewable Energy Guarantees of Origin (REGO)*

1.6 The REGO scheme provides transparency to consumers about the proportion of electricity that suppliers' source from renewable generation.

1.7 We administer the scheme for generation in Great Britain and Northern Ireland. We issue one REGO certificate per megawatt hour (MWh) of eligible renewable output to generators of renewable electricity. Once issued, the certificate's ownership can be transferred.

1.8 The purpose of the certificate is to prove to the final customer that a given share of energy was produced from renewable sources. Suppliers may purchase REGOs to increase the proportion of renewable electricity within a tariff. As such, the primary use of REGOs in Great Britain and Northern Ireland is for Fuel Mix Disclosure

(FMD). FMD requires licensed electricity suppliers to disclose to potential and existing customers the mix of fuels (coal, gas, nuclear, renewable and other) used to generate the electricity supplied.

*Standard Licence Condition (SLC) 21D*

1.9 In 2009 we published Green Supply Guidelines that were implemented through the voluntary 'Green Energy Supply Certification Scheme'. Initially a number of suppliers were certified through this scheme. However, an increasing number of tariffs with environmental claims remained uncertified, and consumers were often unclear about the benefits of these tariffs. As such, in 2014 we consulted on proposals to help consumers make informed choices about the renewable tariffs they may buy, and to ensure suppliers can compete fairly with each other. In December 2014 we published our decision to modify the Standard Licence Conditions (SLCs) of the electricity supply licence by inserting a new condition, SLC 21D.

1.10 SLC 21D requires suppliers to provide clear statements about whether its tariffs will or will not benefit the environment, provide clear information about its fuel mix and environmental benefits, and put information on its website that puts this information into context. It also requires that where an environmental claim is made, that the claimed benefit is a result of consumers choosing to purchase the tariff in question and not solely brought about as a result of subsidies, obligations or other mandatory mechanisms.