

To licensed electricity suppliers
and all other interested
stakeholders

Your Ref:

Our Ref:

Email: REcompliance@ofgem.gov.uk

Date: 07 May 2020

Dear Stakeholders,

Payments received after Renewables Obligation (RO) late payment deadline of 31 October under the Renewables Obligation Order 2015 (RO Order 2015) and the Renewables Obligation (Scotland) Order 2009 (ROS Order 2009) (together, the RO Orders)

On 13 March 2020, Ofgem published a [Letter to Suppliers](#) and other interested stakeholders on proposed changes to our approach to distributing RO (England and Wales) and ROS (Scotland) payments received after the late payment deadline of 31 October in respect of relevant periods (as defined in the RO Orders) in which mutualisation is triggered.

The options proposed within the letter are summarised below:

- Option 1 – in respect of relevant periods in which mutualisation is triggered, payments received after the 31 October late payment deadline are distributed to all suppliers in proportion to the total mutualisation payments they are responsible for making in respect of that relevant period.
- Option 2 – payments received after the 31 October late payment deadline are distributed only to UK suppliers, as defined in the RO Orders, who have presented Renewables Obligation Certificates (ROCs), regardless of whether or not mutualisation has been triggered.

Ofgem's preferred approach is Option 1. This is because when mutualisation is triggered all suppliers with an obligation under RO (England and Wales) and/or ROS (Scotland) who discharged their obligation in part or in its entirety must make additional payments to cover the shortfall. As such, in years when mutualisation is triggered, a wider group of suppliers than just those who presented ROCs are impacted by mutualisation.

The letter dated 13 March 2020 asked suppliers, and anyone interested in our proposals, to review the approach to distributing late payments received after the 31 October deadline in years when mutualisation is triggered to provide feedback on four questions:

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?

We received 15 responses: 13 from energy suppliers, one from the trade association Energy UK and one from the Association for Decentralised Energy.

Any feedback specifically in relation to mutualisation calculations and enforcement action against suppliers who fail to meet their obligation will not be addressed in this letter as they are outside the scope of this review.

Responses to Question 1 – Do you agree with our preferred option (option 1)?

The majority of respondents (nine) agree with our proposal to distribute late payments received after the late payment deadline of 31 October to all suppliers with an obligation to make mutualisation payments, in respect of relevant periods in which mutualisation is triggered.

One of these nine respondents, although supportive of option 1, proposed that Ofgem recalculate mutualisation payments, i.e. reduce mutualisation payments to take account of amounts received after the 31 October deadline, instead of distributing those amounts to suppliers after mutualisation payments may have already been paid.

Another of these nine respondents proposed an approach that combines option 1 and option 2. Specifically, to redistribute the payments to all suppliers with an obligation to make mutualisation payments, but only until the shortfall that triggered mutualisation is reduced to the relevant threshold. The same respondent suggested recycling any additional payments in the same way these are redistributed in years when mutualisation is not triggered.

Of the other six respondents, one respondent expressed concerns about the potential impact of option 1 on the recycle value of the ROCs.

Another of the other six respondents requested further details around the definition of 'payments' and timings of such payments.

Our response

The proposal to reduce the mutualisation payments by an amount equal to that recovered from defaulting suppliers is a proportionate option. However, Article 75 of the RO Order 2015 and Article 50 of the ROS Order 2009 each provides for the specific circumstance in which the Authority (on whose behalf Ofgem performs its functions under the RO Orders) is required to recalculate the total mutualisation sum and the mutualisation payments. Specifically, the mutualisation sum and payments must be recalculated only when a *"designated electricity supplier which failed to discharge its renewables obligation for the relevant period makes a payment to other UK suppliers, which if had been made to the Authority under [the provisions of the RO Orders dealing with payments to the buy-out fund or late payment fund], would have increased the amounts that those suppliers would have received under [the provision dealing with distribution from the buy-out and late payment funds] from the buy-out and late payment funds, that payment being designed to*

compensate those suppliers for that loss". As such, the RO Orders do not authorise Ofgem to recalculate mutualisation payments in circumstances where payments are received by Ofgem after the late payment deadline of 31 October.

We have carefully evaluated the proposal to combine option 1 and option 2 by redistributing the portion of the shortfall that triggered mutualisation (i.e. over £15,400,000 for England and Wales and over £1,540,000 for Scotland) to all suppliers with an obligation to make mutualisation payments, and then distributing any additional payments to UK suppliers who presented ROCs in order to discharge their obligation. Under article 73(1) of the RO Order 2015 and article 48(4) of the ROS Order 2009, the total mutualisation sum is equal to the amount of the shortfall (subject to adjustments in certain circumstances). The mutualisation payment due from each supplier is therefore calculated by reference to the *full* amount of the shortfall, as opposed to only the amount of the shortfall that exceeds the threshold (of £15,400,000 or £1,540,000, as applicable). The mutualisation fund is then distributed to compliant UK suppliers who produced ROCs (pursuant to article 77 of the RO Order 2015 and article 52 of the ROS Order 2009). Assuming that at the end of the four quarters all mutualisation payments have been made in full, following Ofgem's distribution of the mutualisation fund all suppliers who presented ROCs and discharged their obligation in full by the late payment deadline will have received the same amount per ROC presented as if mutualisation had not been triggered. As such, combining option 1 and option 2 without reviewing the total mutualisation sum results in compliant UK suppliers being paid twice for the ROCs submitted within the relevant reporting period.¹ This is inconsistent with the provisions of the RO Orders, and runs contrary to the purpose of this review, which was initiated to determine how any amounts received after the late payment deadline of 31 October could be redistributed in a more proportionate way to all suppliers impacted by mutualisation.

For the same reasons, Ofgem's view is that the approach outlined under option 1 will not have an impact on the final ROC recycle value, which is recovered in full through the mutualisation process.

With reference to the definition of 'payments' under option 1, these are all payments received from defaulting suppliers and/or recovered through the liquidation process after the late payment deadline of 31 October. Under option 1, these amounts will be redistributed to all suppliers who were required to make mutualisation payments in the relevant reporting period and are still trading, regardless of when they will be recouped.

Responses to Question 2 – If not, do you feel option 2 would be a more proportionate approach? If so, please provide details and example working.

Four respondents agree with the alternative approach, that is to continue distributing payments received after the 31 October deadline only to UK suppliers (as defined in the RO Orders) who have presented ROCs, irrespective of whether or not mutualisation has been triggered. All four respondents are supportive of this approach because it is in line with the approach taken historically in respect of such payments and it provides an incentive to suppliers to discharge their obligation by presenting ROCs.

One of the four respondents proposed an approach that represents a variation of option 2. This involves recycling both late payments received after the late payment deadline and mutualisation payments to suppliers in proportion to the number of ROCs presented until

¹ Once pursuant to article 77 / article 52, and once pursuant to the "option 2" portion of the respondent's proposal

the shortfall in relation to the relevant period has been paid. Any further payments, including mutualisation payments, are then to be redistributed to all suppliers with an obligation to make mutualisation payments.

Our response

We recognise that the benefits of the approach described within option 2 are that it continues a practice that has previously been implemented and it provides another incentive for suppliers to choose to present ROCs in order to discharge their obligations. However, this approach does not take account of all suppliers who are impacted by a shortfall when mutualisation is triggered. As explained in our response to question 1, the mutualisation process has been designed to protect the ROC recycle value, as such in years when this mechanism is triggered all suppliers who presented ROCs will be able to recover the full value at the end of the four quarters. Therefore, we believe that this option is not consistent with the provisions of the RO Orders and consequently does not deliver fair outcomes for periods where mutualisation is triggered.

With regard to the variation proposed by one of the respondents, we cannot exercise discretion in relation to the redistribution of mutualisation payments as Article 77 of the RO Order 2015 and Article 52 of the ROS Order 2009 are clear in stating that mutualisation payments must be redistributed to compliant UK suppliers (as defined in the RO Orders, in summary suppliers who presented ROCs and/or made payment and so met their obligation in full by the deadline of 31 October) on a quarterly basis and by a set deadline. Furthermore, the option proposed by the respondent would result in the recalculation of the mutualisation sum and payments to be made by suppliers. As explained above in our response to question 1, the RO Orders expressly provide for the circumstances in which payments towards the mutualisation sum are to be recalculated and these do not include circumstances where payments are received after the late payment deadline of 31 October.

Response to Question 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.

Response to Question 4 - With respect to any approach identified in response to question 3, why do you believe this approach would be more appropriate?

Only one respondent proposed an alternative approach to the two options included within Ofgem's letter dated 13 March 2020, although we note that this was the respondent referred to above who requested further detail on option 1 and the alternative was proposed "in the absence of greater clarity on option 1". The respondent suggested distributing late payments received after the 31 October deadline as soon as they come in and adjusting the total mutualisation sum and payments accordingly after each round of redistribution, until the relevant shortfall has been covered.

The respondent stated that this approach provides Ofgem with greater flexibility and avoids compliant UK suppliers being paid twice for the ROCs submitted within the relevant reporting period.

Our response

As explained in our response to question 1, the RO Orders provide for the circumstances in which payments towards the mutualisation sum are to be recalculated and these do not

include circumstances where payments are received after the late payment deadline of 31 October.

Determination

We have considered the views of respondents on the questions listed above and have decided that in respect of years in which mutualisation is triggered Ofgem will distribute any late payments received after the late payment deadline of 31 October to all relevant suppliers which are still trading, as defined within the RO Orders, in proportion to the total mutualisation payments they are responsible for making (see Option 1). This is because, when mutualisation is triggered, not only suppliers who presented ROCs but also suppliers who discharged their obligations by making payments into the buy-out or late payment funds are impacted by the shortfall, as all relevant suppliers have an obligation to make mutualisation payments to cover the shortfall. Ofgem therefore considers that option 1 is the most proportionate approach and the most consistent with the provisions of the RO Orders.

We will seek to redistribute the funds held by Ofgem, which were received after the 31 October 2019 late payment deadline as soon as reasonably practicable after the publication of this letter.

Your faithfully,



Russell Ogilvie

Senior Manager – Supplier Compliance