

Changes to the Renewables Obligation (Scotland) scheme

**Consultation on changes to mutualisation
arrangements to address electricity supplier
payment default under the RO(S) scheme**

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Scottish Government
Riaghaltas na h-Alba
gov.scot

Consultation on amendments to the Renewables Obligation (Scotland)

Introduction

1. The Renewables Obligation (RO), covering England and Wales, and the Renewables Obligation (Scotland) (RO(S)), were first introduced in 2002 supporting most of the renewable capacity built across GB since that time. Renewable electricity accredited under the RO and the ROS accounted for 31% of the electricity supplied to homes and businesses across the UK in 2019/20.
2. Although the UK Government closed the mechanism for new generation in 2015 (replacing it with the Contracts for Difference (CfD) scheme), the legislation remains open in respect of existing accredited generation until 2037.
3. The separate obligations work by requiring electricity suppliers to purchase a set volume of Renewables Obligations Certificates (ROCs) which are awarded to eligible renewable generators for each unit of renewable power they produce. Suppliers who can't or choose not to buy ROCs can instead make a "buy-out" payment to Ofgem, which administers the GB Obligations. These buy-out payments are then recycled to suppliers in proportion to the number of ROCs that each supplier has submitted.
4. The separate Obligations are largely identical in their design, delivering a consistent approach and set of regulations across GB. This has always been the preference of suppliers and generators, as well as Ofgem in its role as administrator of the Obligations.

Background

5. The UK Government implemented changes to the RO for England and Wales in March 2021, and is consulting on further changes to the scheme to be introduced in future delivery years. These changes are designed to address the increasing risk of supplier default – i.e. circumstances where suppliers are unable to submit their buy-out payments to Ofgem as required by the legislation.
6. In recent years there has been an increase in the number of suppliers exiting the retail market and defaulting on their obligation under the RO – defaults manifest as shortfalls in the cash payment fund. The level of default in England and Wales¹ peaked in 2018/19 when 21 suppliers defaulted on about £88.1m, which is equivalent to about 1.5% of scheme cost². Payment default denies the scheme of funds and lowers the value of ROCs.
7. To protect the cash payment fund against the risk of payment default, the scheme features a mutualisation mechanism which recovers unpaid bills (up to a maximum of nearly £306m for 2021/22) from other electricity suppliers. The proceeds of mutualisation are recycled back to those suppliers who met their obligation with ROCs on a per-ROC presented basis, ensuring they realise full

¹ The RO comprises separate schemes in Scotland, Northern Ireland and England and Wales – the UKG consultation extends to the ES

² payment of around £34m which was made after the 2018/19 RO deadline effectively lowered the mutualisation amount for 2018/19 to about £54m.

value. Mutualisation only occurs when there is a payment shortfall which exceeds a threshold. Since 1st April 2021 this has been set at 1% of scheme costs, equivalent to £63.7m for the 2021/22 obligation year. Below this threshold, any shortfall is left unrecovered.

8. Mutualisation has occurred in each of the past three years (when the threshold was set at a fixed level of £15.4m, (£1.54 million in the RO(S)), with the sum totalling £173m in England and Wales.

9. In 2017-18 the ROS shortfall was £4.4 million and in 2018-19 £9.4 million.

11. A number of suppliers have engaged with UK and Scottish Government in recent years arguing current arrangements and mutualisation thresholds required a review, amidst concern about the rising costs on suppliers that have met their obligation to cover the increased levels of default on suppliers who have failed to do so.

Recent Changes to the RO in England and Wales

12. The UK Government made an amendment in March 2021 to its Renewables Obligation Order 2015 which increased the level of the mutualisation threshold, reducing the likelihood of it being triggered. The threshold for the RO is now set at 1% of the forecast cost of the scheme to suppliers in each obligation year (roughly £62 million for the 2021/22 obligation year). This is a significant increase from the previous threshold which was set at £15.4m

13. In August 2021 the UK Government published a further consultation which seeks views on additional changes that would deal more directly with the challenges of supplier default.

14. Three options are proposed;

1. Increase the frequency of mutualisation periods,
2. Introduce a new electricity supply license requirement to provide a level of security against a supplier's obligation. Under this arrangement, suppliers would be given the choice of which protection measure to put in place.
3. Do nothing

Purpose of this consultation paper

15. Due to the timing of the last Scottish Election, the Scottish Government was not able to mirror the UK Government Amendment to the RO legislation to raise the mutualisation threshold.

16. Stakeholders have raised concern that without making changes to the RO(S) the issue of supplier default would be allowed to persist with suppliers operating unsustainable business models defaulting on their RO obligation and leaving costs to be picked up by others.

17. The primary purpose of this consultation is to seek views on making the same changes to the RO(S) legislation and therefore aligning the mutualisation arrangements for the RO(S) with the RO.

18. We are also aware that the issue of supplier default is a growing concern and in order to be able to make timely changes to tackle this issue within the RO(S) in future, we are inviting views on the three addition options, as proposed by BEIS that could be used to tackle the issue of supplier default. In particular we welcome thoughts on any specific impacts of the proposals for suppliers and generators in Scotland.

Aligning Mutualisation Arrangements for the RO(S) with the RO

19. In the past few years there has been an increase in the number of suppliers defaulting on their RO buy-out payments. In England and Wales, £53 million went unpaid in 2018 and £88 million in 2019. Under the RO legislation, this shortfall in buy-out payments is passed onto other suppliers in a process called mutualisation once it exceeds a threshold set in the legislation. The mechanism was introduced to protect ROC prices.

20. Mutualisation has been triggered in each of the last 3 years. Whilst the level of payment default has been relatively small to date (in comparison to the overall scheme value) it nevertheless places a financial strain on those suppliers who are required to make mutualisation payments.

21. The Scottish Government is proposing to make changes to mutualisation arrangements, this will align the RO(S) with England and Wales ensuring that arrangements remain fit for purpose.

22. The first relates to the mutualisation threshold which has failed to keep pace with growth in the scheme. The Scottish Government agrees with BEIS justification that this enables mutualisation to be triggered too easily. We propose to align with the RO legislation and link the threshold with the annual cost of the scheme to suppliers.

23. Mutualisation only occurs when there is a payment shortfall which exceeds a threshold. Since 1st April 2021 this has been set at 1% of scheme costs. In the first instance, this would increase the threshold to around £62m, but it would rise or fall in future years as the cost of the scheme changes. This new arrangement would restore the balance of risk between generators and suppliers that was established when the mutualisation mechanism was first introduced. It will ensure that suppliers that have met their RO are not unduly exposed to the unmet obligations of their competitors. It is likely that this will be of benefit to their customers too as they are less likely to face pass-through costs.

Q1. Do you agree with the proposed change which will increase the mutualisation threshold to link with the annual cost of the scheme?

24. The second change was consulted on by BEIS in 2020 but not introduced into legislation. This change relates to the way the mutualisation amount is calculated. Currently, the entire payment shortfall is mutualised once the level of default exceeds the threshold. The Scottish Government agrees with stakeholders that this might be unfair on suppliers because it exposes them to the full cost of supplier default - and generators to none - by virtue of a threshold having been crossed.

Supplier payment default and mutualisation

Further amendments to address RO supplier payment default

Supplier payment default is of continuing concern to scheme participants. Electricity suppliers resent meeting the unmet obligations of their competitors, whilst generators lose out when the level of default is insufficient to trigger mutualisation, i.e. when it is less than 1% of scheme cost. Some stakeholders have therefore called on the Scottish Government, UK Government, or Ofgem, to address the situation.

BEIS has proposed the following approaches which could help to lower the risk and extent of payment default, identifying some of the likely benefits and risks associated with each. These approaches are as follows.

1. A legislative requirement for suppliers to settle their RO more frequently to lower the amount that they are able to default on - in this consultation we consider a quarterly arrangement. We also consider the case for compressed settlement timeframes, i.e. shorter than the existing 7 months settlement period that follows each obligation year.

Option 1 would require changes to the RO(S).

2. A licence-based requirement for suppliers to protect their accruing obligation against the risk of default. Under this arrangement, suppliers would be given the choice of which protection measure to put in place. Should a supplier exit the market or fail to put additional protections in place when required to do so, any existing protection measures would be put towards settling that supplier's obligation.

Option 2 might require changes to the RO(S) if Ofgem needs further powers via the RO legislation, to enable funds (or ROC's) arising from a supplier's protection measures to be transferred into the scheme.

3. Continue with existing policy. Under this arrangement, we would allow recently introduced legislative changes (i.e. updates to mutualisation arrangements) and licence changes (i.e. those which aim to increase supplier standards of financial resilience) to take effect.

Option 3 would not require changes to the RO(S).

Assessment of options considered

The Scottish Government supports any changes to tackle the issue of supplier default and would want to align the RO(S) with the RO.

We would therefore seek stakeholders' views on the options outlined above and any implications for the RO(S) to

Q2. Do you have a preferred option to tackle the issue of supplier default?

Fixed price certificates (FPCs)

In 2011, the UK Government of the day said it would switch the RO to an FPC based scheme from 2027. The FPC scheme was proposed primarily as a means of addressing ROC price volatility that was expected to emerge as generators began losing their eligibility to receive ROCs from 2027 (eligibility is time limited). Under the envisaged FPC scheme, generators would receive frequent, and therefore earlier payments for their certificates from a newly established certificate purchasing body. In turn, this would likely require suppliers to make more frequent, and therefore earlier payments to the purchasing body. Whilst it was not the stated intention of the FPC based scheme, we are aware that this could lessen the likelihood and extent of supplier payment default.

We note that the UK Government intends to issue a call for evidence on the FPC based scheme in due course, and is seeking the initial views of stakeholders on the introduction of the FPC based scheme as a way of addressing supplier payment default.

Similarly, we would welcome views on the introduction of FPC's under the RO(S).

For more detail on these proposed changes please see the attached link to the UKG RO Consultation³.

Consultation questions on Changes to mutualisation arrangements

- Q3. Do you agree with the increase to the threshold?**
- Q4. Do you agree that only the costs over the threshold should be recovered if BEIS/Ofgem make further changes to the RO legislation to require suppliers to settle their obligation more frequently?**
- Q5. Do you agree that the Scottish Government should mirror those changes in the RO(S)?**
- Q6. Do you support the introduction of FPC's either as an alternative or in addition to other measures outlined in this consultation?**

³ [Renewables Obligation \(RO\): addressing electricity supplier payment default under the RO scheme - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/renewables-obligation-consultation)

General information

Why we are consulting

Supplier payment default under the Renewables Obligation (RO) support scheme has emerged in recent years. The scheme features a mutualisation mechanism which seeks to recover unpaid bills from other electricity suppliers once they exceed a threshold. The UK Government recently legislated to increase the level of the mutualisation threshold (England and Wales only) to make it harder for mutualisation to be triggered, but this did not address the underlying causes of payment default.

This consultation, seeks align the RO(S) with changes to the RO designed ensuring consistency of approach and a level playing field for suppliers operating within both schemes.

The Scottish Government's proposals could have an impact on scheme participants:

- the owners of ROS accredited generating stations and PPA off-takers who sell renewables obligation certificates (ROCs) to suppliers and brokers;
- electricity suppliers who are under an obligation to acquire renewables obligation certificates (ROCs) or make payments into the scheme's 'buy-out' fund;
- businesses involved in the scheme (e.g. ROC brokers; financiers, advisers etc.);
- consumers who ultimately fund the scheme through their electricity bills. The Scottish Government is keen to hear the views of all stakeholders on its proposals.

Strategic Environmental Assessment (SEA)

26. We have considered the impact that this proposed change would have on environment and statutory consultees. This consultation does not require a SEA.

Your response

28. The Scottish Government welcomes the views of consultees on the proposed amendments to the ROS as set out above.

Responding to this Consultation

We are inviting responses to this consultation by 23 December 2021. The time period for this consultation is 6 weeks.

Please respond to this consultation using the Scottish Government's consultation platform, Citizen Space. Your views and response to this consultation can be submitted online at [Changes to the Renewables Obligation \(Scotland\) scheme - Scottish Government - Citizen Space \(consult.gov.scot\)](https://consult.gov.scot/changes-to-the-renewables-obligation-scotland-scheme).

You can save and return to your responses while the consultation is still open. Please ensure that consultation responses are submitted before the closing date of Thursday 23 December 2021.

If you are unable to respond online, please complete the Respondent Information Form (see “Handling your Response” below) to: ROS2021@gov.scot with the subject heading ‘ROS 2021’.

Handling your response

If you respond using Citizen Space (<http://consult.scotland.gov.uk>), you will be directed to the Respondent Information Form. Please indicate how you wish your response to be handled and, in particular, whether you are happy for your response to be published. If you ask for your response not to be published, we will regard it as confidential, and we will treat it accordingly.

All respondents should be aware that the Scottish Government is subject to the provisions of the Freedom of Information (Scotland) Act 2002 and would therefore have to consider any request made to it under the Act for information relating to responses made to this consultation exercise.

Next steps in the process

Where respondents have given permission for their response to be made public, and after we have checked that they contain no potentially defamatory material, responses will be made available to the public at <http://consult.scotland.gov.uk>.

If you use Citizen Space to respond, you will receive a copy of your response via email. Following the closing date, all responses will be analysed and considered along with any other available evidence to help us.

Responses will be published where we have been given permission to do so. Comments and complaints if you have any comments about how this consultation exercise has been conducted, please send them to ROS2021@gov.scot with the subject heading ‘ROS 2021’.

Scottish Government consultation process

Consultation is an essential part of the policy-making process. It gives us the opportunity to consider your opinion and expertise on a proposed area of work.

You can find all our consultations online: <http://consult.scotland.gov.uk>

Each consultation details the issues under consideration, as well as a way for you to give us your views, either online, by email or by post.

Consultations may involve seeking views in a number of different ways, such as public meetings, focus groups, or other online methods such as Dialogue (<https://www.ideas.gov.scot>)

Responses will be analysed and used as part of the decision making process, along with a range of other available information and evidence. We will publish a report of

this analysis for every consultation. Depending on the nature of the consultation exercise the responses received may:

- indicate the need for policy development or review
- inform the development of a particular policy
- help decisions to be made between alternative policy proposals
- be used to finalise legislation before it is implemented.

While details of particular circumstances described in a response to a consultation exercise may usefully inform the policy process, consultation exercises cannot address individual concerns and comments, which should be directed to the relevant public body.



Respondent Information Form

Please Note this form **must** be completed and returned with your response.

To find out how we handle your personal data, please see our privacy policy:
<https://www.gov.scot/privacy/>

Are you responding as an individual or an organisation?

- Individual
 Organisation

Full name or organisation's name

Phone number

Address

Postcode

Email Address

The Scottish Government would like your permission to publish your consultation response. Please indicate your publishing preference:

- Publish response with name
 Publish response only (without name)
 Do not publish response

Information for organisations:

The option 'Publish response only (without name)' is available for individual respondents only. If this option is selected, the organisation name will still be published.

If you choose the option 'Do not publish response', your organisation name may still be listed as having responded to the consultation in, for example, the analysis report.

We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

- Yes
 No



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