

Centrica's response to the Ofgem consultation: Developing Guidelines for Green Supply

The legislation surrounding the production and certification of "green" energy has evolved over recent years, such that each unit of green energy produced now attracts various different certificates (each reflecting slightly different attributes and used for different purposes). Simultaneous with this, the market for selling green energy to customers has evolved, with green offerings now being supported in a number of different ways. This is understandable in the context of an emerging market and a complex range of certificates. However, as customer awareness of climate change issues has grown and the market for green energy has matured, Centrica now believes that it is not only the right time, but also necessary to evolve the market standards for green energy learning from the experience to date, to provide greater clarity to customers and a higher hurdle for green claims.

This consultation represents a unique opportunity to create clarity as to what constitutes a valid claim in relation to a worthwhile green product offered to energy consumers. If we do not take this opportunity there is a risk that green products will lose all credibility. We are already facing a situation where, for good reasons, customers, consumer pressure groups (notably the NCC) and NGOs are beginning to question the validity of green energy claims. This is hardly a surprise because, for the most part, the "green electricity" that is being sold in the market is nothing more than that which the Government requires suppliers to do anyway.

This situation can be turned around but, to do so, Centrica believes that a more radical rethink of the structure of green energy products is required than is currently being discussed in the Ofgem consultation paper and in industry discussions to date.

Our suggested approach is based on the following two principles:

1. **Additional environmental benefits** must arise as a result of the sale of a green product to a customer, and
2. It is possible to devise a ratings scheme which **educates customers** on the comparative environmental benefits of competing green products.

Additional Environmental Benefits

In choosing a green product, the customer must be certain that some additional environmental benefit (by way of carbon emissions reduction) will occur as a result of their choice. On this basis, additionality should be the only factor relevant to making claims that a product is green and as to its environmental benefits. Additionality can be shown in a number of ways: ROC retirement, contribution to green funds and carbon offsetting (and other ways may arise through innovation).

This approach means that claims as to the source of supply become irrelevant for, as long as the related ROC is separated from the supply and used to meet the Renewables Obligation, there is no assurance as to additional environmental benefits. We believe that there are a number of difficulties which arise if source of supply is taken into account. First, it creates too great a link between the generation of electricity and the green supply product such that the customer can be misled into believing that the electricity delivered to their household is from renewable sources (even with the reference in marketing copy which states that the renewable electricity is delivered to the national grid).

Secondly, the verification of the source of supply requires consideration of the certificates awarded to renewable electricity. The current wealth of legislation in this area (which has evolved through a combination of UK and EU initiatives) means that each MWh of electricity from renewable sources attracts three certificates. Namely, the ROC, which can be separated from the electricity and is primarily used to meet the Renewables Obligation, the REGO, which stems from a European Directive and is being used to back 'green offerings' and support fuel mix disclosures and the LEC which is intended to allow non domestic customers to buy relief from the Climate Change Levy. Certain electricity from other sources attracts the REGO and/or the LEC but is not eligible for ROCs. Centrica believes that the ability to use the REGO to back a green offering is inappropriate for a number of key reasons:

- Almost all renewable energy in Great Britain is generated in order for electricity suppliers to comply with their RO. The separate sale of the electricity which corresponds to such ROCs, as electricity coming "from renewable sources", may not be fully understood by customers, who are likely to be unaware of the ROC element and may believe that it is their purchase of the electricity from renewable sources that is making a difference and attracting the investment in renewable generation.
- Certain electricity generation that is eligible for REGOs does not even qualify for ROCs. This is for good reason. In general the electricity has come from either large hydroelectric facilities in Scotland which were specifically excluded from the RO on the basis that the generation was paid for by British taxpayers in the past, or imported through the Interconnector where the renewable generation has been rewarded through a support scheme on the Continent.
- If we continue to use REGOs as a demonstration of "green-ness" then, based on the underlying logic used by Ofgem, a consequence is that other "zero carbon" or "low carbon" sources of power could also be used via FMD declarations. This would enable the 60TWh of current annual output of Britain's nuclear plants to be sold as green products, thus swamping the market with supplies of many times the prospective annual demand for green electricity, making a nonsense of the whole concept of green energy products.
- Finally, the vast majority of REGO-qualifying electricity also benefits from LECs. In order to sell REGO-backed electricity to a residential customer (if the source of the electricity is important in making a green claim), any associated LECs must be retired, resulting in a cost associated with the LECs pertaining to that customer. This results in residential customers wastefully paying about £20 per green customer per annum which produces no environmental benefit and is actually subsidising the Exchequer¹.

Fundamentally, the problem with using REGOs and/or zero-carbon or low-carbon FMD declarations as the acid test of green-ness (and noting that several electricity products on the market today have no other claim to green-ness whatsoever) is that no incremental environmental benefit of any kind (additionality) occurs as a result of the customer signing up for such a product. Centrica therefore advocates a test of green-ness that is entirely based on additionality and moves away altogether from

¹ If LECs were not retired on behalf of a "green electricity" residential customer, they would be available for sale to business customers (in the form of levy-exempt power), who would then be exempt from the Climate Change Levy. LECs channelled into the business market therefore decrease the overall tax revenue to the Exchequer. Residential customers paying for LEC retirement therefore subsidise the Exchequer.

REGOs and low-carbon FMD declarations (by removing the need to demonstrate the source of the electricity in order to make a green claim).

Customer Education

We welcomed the proposal to introduce a star rating system with increasing levels of green benefits having successively higher numbers of stars as we believe that a system of that general nature would enable all customers to understand how green products rank against each other and for the more environmentally aware customers to be able to easily identify and move to increasingly green products over time².

Given our views on using the source of supply to assist in the designation of a green supply product, we are particularly uneasy with the proposals arising from the discussions at the industry workshops which seek to label the source of electricity. For example, a product, sold at little or no premium, already claims to “come from renewable sources”, it is difficult to explain the purpose of an even greener product. If such a system were the outcome of this review, in our view this would be a missed opportunity with nothing achieved which would really drive customer behaviour change and no meaningful environmental benefit delivered.

We believe it is possible to devise a simple ratings system which will:

1. allow for easy comparison and differentiation of green products whilst also putting those products with limited environmental benefits into context,
2. educate consumers on being green and help to explain to them that there are shades of being green, and
3. be based on simple, objective factors, and
4. be flexible enough to cope with future innovation.

In the box below, we set out in simple terms how a rating scheme could be devised – all the factors used to drive the ratings are based on additionality with an incremental number of stars being awarded for greater green benefits (ie increasing additionality).

	1 star	2 star	3 star	4 star	5 star Renewable supply
£min contribution to green fund					
		or			

A system such as this is not unlike that used for hotels where a particular star rating denotes a particular level of comfort and a minimum range of particular facilities – and even though a customer may not know exactly what facilities are required for each star, when choosing a hotel, the customer is likely to pay attention to the number of stars awarded.

² Our views on the system proposed in the Ofgem consultation are set out in response to Q5 below.

Similarly, when customers buy electrical appliances, as a result of the EST appliance rating scheme, they can be clear that the A rated appliance is better for the environment than one of a lower rating and this knowledge will drive the purchasing decision. As far as the customer is concerned, it is not necessary to know what technical factors make the A rated appliance better: but thanks to the rating, he has the knowledge which allows the comparison to be made.

Similarly with green supply products, we do not believe it is necessary for the customer to have to understand about ROCs, LECs and REGOS in order to choose between green products – but an objectively grounded ratings system which provides a ranking for such products will give the customer enough information to inform their choice without precluding suppliers from seeking to offer this information to interested customers.

Clearly the basis upon which each star should be awarded would need careful consideration but we believe that only objective factors relating to additional carbon emissions reductions should be the basis for the award of stars. The first star should set the minimum level for what constitutes green - a simple product which delivers a modest amount of carbon emission reduction benefit which can be provided at no significant cost and which raises awareness with the customer. We believe that a one-star tariff should be set at a fairly low threshold since suppliers will use such tariffs to get customers onto the “first step of the green journey”. Further stars would be awarded for increasing environmental benefits driven by increasing additionality.

In presenting the table above, we have suggested that carbon offsets should not be allowed to drive as high a rating as ROC retirement. Given the relative costs of offsetting compared to ROC retirement, the additional benefits of supporting renewable technology development above carbon offsets, and the need for the UK to promote domestic action on carbon emissions reduction rather than rely entirely on CDM/JI, we believe that 100% offset should never give rise to as high a star rating as 100% ROC retirement.

This type of system has further benefits: it can be flexible to reflect future innovation and it can have additional attributes attached to the basic star rating to denote other, objective factors displayed by the green product in question – thus providing further shades of differentiation. This is precisely what has happened in relation to hotel star ratings where hotels are now able to achieve more stars than were available when the scheme was first introduced and it is possible to have a star rating supplemented by a “highly commended” badge. Similarly with the appliance rating scheme, an A+ rating has become available.

We believe that this type of system would deliver on both counts of customer education and environmental benefits in a way that simply labelling the source of electricity will not.

Turning to the specific questions raised in the consultation paper in relation to which specific answers have been requested:

CHAPTER TWO

Question 1: What should Ofgem's role be in terms of providing guidance on green supply tariffs?

We noted above that this is a unique opportunity to ensure that green supply offerings are taken forward on a basis which ensures credibility for the offerings, provides customer education and promotes behaviour and environmental change. We noted that this requires a radical rethink of the structure of green products and a willingness to learn from past experience.

In particular, Centrica believes that the proposal to use labels/marks to reflect the source of the underlying supply within a green supply proposition (as being "renewable" or "low carbon") will only serve to drive a continued loss in credibility. Labelling along those lines as currently proposed does not make any significant environmental difference.

Ofgem may struggle to reach consensus in this area, given the wide variety of different interests between the interested parties, and should instead aim for a solution which is credible and which aims to deliver environmental change. Ofgem's role should be to identify the minimum threshold for green supply offerings and a method of identifying or denoting offerings which meet or go beyond that threshold and rely on competition in the supply market to deliver against that.

Question 2: Should the guidelines be mandatory or voluntary?

We believe this could be delivered through a voluntary system – given the fact that competition is established in the downstream markets, it is likely to become a feature of competitive differentiation and suppliers not initially using the scheme may find themselves wanting a rating for their schemes if they are losing business to other, rated and accredited products. So, if the scheme is pitched right and suppliers are able to use it successfully to promote green supply offerings which have credibility (ie they make a difference), then Ofgem should expect it to be adopted across the industry. We would expect Ofgem and EST to publicise and promote the guidelines and rating scheme, such that it will become increasingly difficult for licensed suppliers to sell green products that do not have a rating (the parallel with hotel ratings is once again useful here).

Being a voluntary scheme, it should be possible for suppliers to choose to submit particular tariffs/products for accreditation (rather than all their products) and use the accreditation mark for those products. We would expect the body running the accreditation scheme and the ASA to monitor advertisements to highlight where suppliers are claiming to be accredited but they are not and where suppliers are, through use of language or visuals, making claims in relation to a particular tariff/product suggesting its environmental benefits are equivalent to or greater than an accredited product/a particular rating under the accreditation scheme

Question 3: Should tariffs to non-domestic customers be covered by the guidelines?

A single set of guidelines covering both domestic and non-domestic customers would be the most sensible – there is customer demand in both parts of the market for green supply offerings and it is important that there is no opportunity for confusion.

Non-domestic customers, arguably, need greater clarity on the environmental benefits achievable with green supply products given their higher consumption and are likely to welcome the information an accreditation scheme can bring – for the same reasons as domestic customers. We would therefore support both domestic and non-domestic propositions being covered by an accreditation scheme.

Our proposed scheme could be applied to both domestic and non-domestic offerings – it may be that the top rating is reached in the non-domestic market before offerings of a similar nature are available or demanded within the domestic market but the simplicity of one system for both markets makes sense.

Where LEC-backed power is sold in the business market, it should be possible to describe this electricity as “levy exempt”, but it should not be possible to describe the electricity as “green” or “renewable” unless there is demonstrable additionality as described above.

Question 4: Should tariffs involving non-renewable non or low-carbon technologies (including Good Quality CHP, clean coal and possibly nuclear) be included within the guidelines?

As noted above, we do not believe that it is credible to use the source of electricity supplied as the basis of a “green” tariff. Simply labelling the source of electricity produces no environmental benefit at all.

The ratings scheme we propose does not need to refer to/cover these type of technologies as they are immaterial to the basis upon which a rating (under our proposed scheme) is awarded.

Question 5: Should suppliers include additional information on customers' bills to support the achievement of transparency?

Under Centrica's proposals, green supply offerings will be rated on the levels of additionality and that rating would become the basis of a customer choosing a product of one rating over another. To the extent that a rating at a particular level can be based on one of a range of factors, the supplier may choose to explain the basis of their rating but should not need to – as the star rating should provide the minimum information needed for the customer.

Under our scheme, the most relevant factor would be the rating achieved by a particular tariff and that is most relevant at the time the product is promoted. Given the likely benefit of being an accredited tariff, suppliers are highly likely to include that fact and the rating achieved in the promotional material relating to that tariff – requiring suppliers to put that information on the bill is too late and unnecessarily prescriptive.

Suppliers already have to provide their fuel mix at sign up and once each year and, if suppliers wish to give further information about renewables or green supply, then that is a matter for each competitor possibly in response to consumer demand (eg for details on how monies paid into a green fund are being deployed).

Question 6: Should an agreed standard of evidence be defined and, if so, what should this be?

Ratings would be driven by contribution to green funds, carbon offsets and ROC retirement. Suppliers would need to hold evidence of these for rated products which could be shared with the accreditor when seeking the initial rating and for any audits carried out.

For ROC retirement, suppliers would need to formally retire the requisite ROCs on the ROC Register to achieve the rating for a green supply offering.

Carbon offsets would only drive a rating if they met DEFRA guidance on offsets – we expect this to effectively mean that only projects backed with EUAs, CERs or ERUs would be recognised (and not VERs).

See the answer to Q9 below for our view on green funds.

Question 7: Is it appropriate for requirements relating to evidence of supply to follow the same requirements as that required for evidence of supply for the fuel mix disclosure?

Almost all renewable energy in Great Britain is generated in order for electricity suppliers to comply with their RO. The separate sale of the electricity which corresponds to such ROCs, as electricity coming “from renewable sources”, may not be fully understood by customers, who are likely to be unaware of the ROC element and may believe that it is their purchase of the electricity from renewable sources that is making a difference and attracting the investment in renewable generation.

Under the ratings scheme we propose it would not be necessary to track the source of supply and for the reasons set out at the start of this paper, we do not believe that such an approach is credible.

Question 8: Is Renewable Obligation Certificate (ROC) retirement an appropriate indicator of additionality?

ROC retirement is an appropriate indicator of additionality but is not the only one. Additionality can be shown in a range of ways as follows:

1. retiring ROCs
2. contribution to green funds (the funds must deliver demonstrable emissions reductions)
3. carbon offsets (only offsets meeting the future DEFRA guidance should be recognised). In effect this means projects backed with EUAs, CERs or ERUs. VERs must not be recognised, or
4. other approaches which demonstrate additional environmental benefits regarding carbon emissions reduction. These approaches must not make a profit for the supplier concerned and must not be invested by that supplier in its own business.

Retiring ROCs has the effect of increasing the price of ROCs and the amount that has to be paid into the buyout – thus increasing the amount that suppliers have to pay to comply with the RO and increasing the amount of money distributed to renewable generators. The RO scheme was designed to stimulate the building of more renewable technology. We are aware of the argument that retiring ROCs does

no good because the shortages of renewable generation are not something that can be overcome by an increase in the price of ROCs. But there are signals from the Energy White Paper that the issues around planning and grid access for onshore wind are being going to be tackled.

In any case, the argument does not make sense so long as some of the barriers to deployment remain economic ones. Both biomass and offshore wind are good examples of technologies which would benefit from an economic boost. To date this may not have been seen but that does not mean the concept is flawed rather that it is a function of the time taken to drive a change in behaviour or investment. The timescale over which the RO was designed to operate (25 years) reflects that investment signals are not expected to be an immediate trigger but will be effective over time.

LECs should not be eligible as a source of additionality for the reasons described above. Where LEC-backed power is sold in the business market, it should be possible to describe this electricity as "levy exempt", but it should not be possible to describe the electricity as "green" or "renewable" unless there is demonstrable additionality as described above.

Question 9: Do you agree that there should be clear rules covering the use of funds for transparency and verification and, if so, what should the criteria for this include?

Under our proposed ratings scheme, contribution to green funds would only drive achievement of the first star rating. Although green funds could be present in schemes of a higher rating, we do not propose that beyond the first star, funds should drive the rating.

If the first star rating is dependant upon contribution to a green fund it would be necessary to set a specified minimum contribution to a fund (£ per customer) to achieve that. In addition, green funds must contribute to projects which deliver emissions reductions (rather than being for a more general environmental benefit which is not so related) and must not make a profit for the supplier concerned or be invested by that supplier in its own business.

Given we only suggest that the fund should drive the first rating (to get the customer to take their first steps on the green journey), we propose these minimum standards for the green fund to make audit and accreditation not too onerous.

CHAPTER THREE

Question 1: Do you agree with Ofgem's view that an "at a glance" mark is appropriate for green tariffs?

If the "at a glance" mark is a single badge which is either awarded or not, we believe that this is too black and white in this area because:

1. it will provide little/no opportunity for customers to understand the differences between competitor products and their relative beneficial effect on the environment,
2. it runs the risk of setting the bar too high meaning that no or a very few (and likely expensive) products would receive the mark – thus reducing customer confidence in what is offered in this area/stifling opportunities for

suppliers until customers are prepared to pay for very green propositions, and

3. it runs the risk of setting the bar so low that every possible tariff qualifies and the mark becomes meaningless.

Furthermore, if the "at a glance" mark is awarded in relation to the source of supply (ie "renewable" or "low carbon"), for the reasons stated above, this will achieve nothing by way of environmental benefit and, in our view, would be the wrong outcome of this consultation process.

Question 2: Do you agree with Ofgem's view that the accreditation scheme should enable the "ranking" of tariffs or should it be a pass or fail?

The key aims of any accreditation scheme in this area should be to allow for easy comparison and differentiation of products (to the extent they provide different green/carbon benefits) and to educate consumers.

A ranking scheme will help to explain to consumers that there are various shades of being green, and that the higher tariffs may be more costly to achieve whilst also putting the lower rated products in context.

A rating system whereby an incremental number of points/stars are awarded for greater green benefits can help to educate consumers that being green is an incremental issue rather than being achieved once and for all (ie that there are different levels of being green). It will also put the lower rated products in context when customers learn that more stars are possible.

Question 3: Is it appropriate for the accreditation rating to distinguish between carbon and other environmental benefits?

A rating scheme should only focus on whether the offering delivers additional carbon emissions reduction (as set out above) as that is an objective criteria and drives at the very heart of what is hoping to be achieved here.

Other environmental factors (such as what a green fund contributes to) should not drive a rating but may, as is the case with competitor differentiation, be part of the choice that a customer makes when choosing between products of equivalent rating.

Question 4: How should the "stars" be allocated in respect of the carbon indicator and for other environmental benefits?

We have set out a suggestion for a simple rating system at the start of this response which is based on the principle of additionality being key and aiming to keep the scheme as simple as possible (both as regards operation and customer understanding). On this basis, we propose the following principles for the awarding of stars/ratings:

1. Nothing can be called "green" unless it passes the following test from the perspective of the customer: "If I sign up for this green offering, will something good happen in terms of reduced carbon emissions that would not have happened if I did not sign up for this green offering?" (additionality). This becomes the one and only acid test of green-ness and reflects the basis upon which customers are likely to choose a green supply proposition.

2. At the lowest level (for a "one-star" green product), additionality should be quite broadly defined to enable innovation and customer choice - involving additional ROC retirement, good quality carbon offsets, contributions to a green fund the application of which can be shown to deliver a non-trivial emissions reduction, or other approaches (as long as these approaches don't simply fund the ongoing business activity of the firm). The bar for one-star green electricity should be set fairly low to enable customers to step onto the first rung of the ladder but must always be based on some form of additionality.
3. To achieve star ratings above the one star level, tangible carbon emissions reduction in terms of additional ROC retirement or good quality carbon emissions offsetting must be demonstrated. In recognition of the fact that renewable generation produces additional benefits above that of carbon offsets (domestic action rather than reliance on others, development of tomorrow's generation technologies, etc), the highest star ratings should be reserved for products with high levels of ROC retirement, and a five star rating should be reserved for products that retire 100% ROCs (i.e. all of the generation comes from renewable sources and none of the generation is being used to meet the RO).
4. A supplier can only make the claim "This supply is renewable" if the product is 100% ROC-backed and retired, irrespective of the "source" of the power. It should also be possible to say as part of a "green" claim for a lower level of ROC retirement that "This supply is X% more renewable than electricity supplied to customers on a standard tariff" if the product is part ROC-backed and retired.
5. We propose that increasing stars are awarded for increasing levels of offset but that, given the relative costs of offsetting compared to ROC retirement, and the additional benefits of supporting renewable development above carbon offsets, it may be that 100% offset can never give rise to the same star rating as 100% ROC retirement.

Question 5: Do you agree with the proposed criteria for the different stars put forward by Ofgem?

We do believe that a rating system whereby an increasing number of stars are awarded for increasing environmental benefits is the best way forward in this area. However, the rating system proposed in Ofgem's June Consultation paper is too complicated and, as well as relying upon the source of supply (with which we do not agree) could be prone to manipulation:

1. It is not a simple incremental assignment of stars from 1 to 5 – instead it is a scheme for up to 3 stars and then a further 4th and/or 5th star – this will be referred to in terms of total number of stars which could be misleading to customers/prone to manipulation by suppliers. For example, wind would likely fail to get a star for efficiency – getting 4 in total – the same as nuclear potentially.
2. The 4th and 5th stars are assigned for subjective and/or irrelevant factors (load factors/efficiency of the generation plant, transmission losses, visual amenity) which do not necessarily relate to carbon savings or the overall environmental benefits of the tariff. In addition, these factors create too direct a link between the customer and the generation.

Question 6: What alternative criteria could be used?

See the introduction and our answer to question 4 above.

Question 7: Do you agree with Ofgem's view that the scheme should apply in respect of:

- low carbon and renewable technologies;
- full range of environmental tariffs; and
- tariffs for the domestic and non-domestic markets?

As we believe the source of electricity supplied to be irrelevant in assigning ratings within an accreditation scheme, our proposal would allow all types of generation to be included with additionality based on carbon emissions reductions driving the ratings for both domestic and non-domestic customers – other environmental attributes become areas for competitor differentiation only.

Question 8: Do you agree with Ofgem's view that the scheme should be funded by suppliers?

We recognise that suppliers wishing to gain accreditation for their tariffs should probably pay to get them accredited and to be able to use any associated mark/rating – indeed this is not dissimilar to the way that the ASA is funded. However, we do not believe it is appropriate for the set up costs (including branding and advertising to raise awareness of the scheme) to be funded by suppliers given it will be a voluntary scheme.

Summary

Centrica considers that the timing of this consultation is optimal as:

- (i) Industry has never had a better understanding of the complex legislative regime that has evolved piecemeal over the last few years surrounding ROCs, LECs and REGOs;
- (ii) supplier and customer awareness of climate change issues has increased dramatically in recent years; and
- (iii) customers are now more keen to make a difference than ever before so we need to ensure they have the necessary information to assist their choice.

In other words, industry and the consumer base are in an ideal position to act on a clear and meaningful new regime that will promote additional environmental action.

Centrica strongly believes that if the above approach is adopted it would have the following positive results:

- (i) the customer would be purchasing the product it believes it is paying for i.e. a benefit to the environment;
- (ii) environmental benefits would invariably result;
- (iii) REGOs and LECs could be used solely for the main purposes envisaged in the underlying enabling legislation. That is, as evidence in support of fuel mix disclosure in the case of the REGO and as a means of exemption from CCL in the case of the LEC.

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