

Consultation on market coupling and Levy Exemption Certificates and call for evidence on wider impacts

Consultation

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Response deadline: 19 June 2015

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Overview:

The Climate Change Levy (CCL) Regulations state that the Authority need not issue a Levy Exemption Certificate (LEC) unless it is satisfied that it represents electricity that is "consumed or to be consumed" in the UK. Providing proof of UK consumption of overseas electricity is not straightforward under market coupling. It relies, after all, on the implicit allocation of cross-border interconnector capacity by the power exchanges based on price differentials, as opposed to market participants explicitly booking and nominating interconnector capacity.

In this context, we are holding an open consultation to seek stakeholder views. As a separate exercise, we are also calling for views and evidence on the use of LECs to prove UK consumption of overseas electricity under schemes other than CCL, and on the wider impacts that may arise from this.

Context

There is currently a shift at European level towards greater market coupling and trading of electricity through implicit auctions. This is not addressed in our current guidance for Levy Exemption Certificates (LECs) for the CCL scheme.

In particular, many stakeholders are keen to understand more about routes for consumption in the UK and what evidence would be required to demonstrate this when this type of trading is used. The provision of such evidence is central to the scheme requirements.

Associated documents

The Finance Act 2000:

<http://www.legislation.gov.uk/ukpga/2000/17/contents>

The Climate Change Levy (General) Regulations 2001 and all subsequent amendments are linked at:

<https://www.gov.uk/government/publications/excise-notice-ccl1-a-general-guide-to-climate-change-levy>

Ofgem Climate Change Levy exemption for renewables: Guidance for generators and suppliers:

<https://www.ofgem.gov.uk/ofgem-publications/58822/revisedguidancefor1nov08.pdf>

HMRC Excise Notice CCL1/4: electricity from renewable sources:

<https://www.gov.uk/government/publications/excise-notice-ccl14-electricity-from-renewable-sources/excise-notice-ccl14-electricity-from-renewable-sources#renewable-source-electricity>

Guidance for Licensed Electricity Suppliers – Feed-in Tariffs (Version 6.0)

<https://www.ofgem.gov.uk/ofgem-publications/85460/fit-supplier-guidance-version-6.0-final-1.pdf>

Decision to modify the Standard Licence Conditions (SLCs) of the electricity supply licence by inserting a new condition, SLC 21D

<https://www.ofgem.gov.uk/publications-and-updates/decision-modify-standard-licence-conditions-slc-electricity-supply-licence-inserting-new-condition-slc-21d>

Consultation on proposed changes to the recognition process for EU Guarantees of Origin (GoOs) for GB Fuel Mix Disclosure (FMD)

<https://www.ofgem.gov.uk/publications-and-updates/consultation-proposed-changes-recognition-process-eu-guarantees-origin-goos-gb-fuel-mix-disclosure-fmd>

Draft guidance on 'Green Excluded Electricity'

https://lowcarboncontracts.uk/system/files/27022015_-_draft_guidance_-_green_excluded_electricity.pdf

Contents

1. Introduction	4
Background	4
The Climate Change Levy and Levy Exemption Certificates	4
Use in other schemes	4
Market coupling	4
CCL guidance on implicit trading and LECs	5
Consultation and call for evidence	6
2. Proof of flow under market coupling	8
3. Proof of supply in other schemes	10
4. Market impacts	11
Appendix 1 - Consultation response and questions	12
Questions	13
Appendix 2 - Feedback questionnaire	14

1. Introduction

Background

The Climate Change Levy and Levy Exemption Certificates

- 1.1. Ofgem E-serve are responsible for the administration of Levy Exemption Certificates (LECs), as part of the Climate Change Levy (CCL) renewables exemption scheme. Under this scheme, accredited generators from overseas are eligible for LECs. The LECs are then traded with the electricity they represent. Ultimately, licensed electricity suppliers use them as part of fulfilling the requirements of the CCL renewables exemption.
- 1.2. The CCL regulations state that Ofgem E-Serve does not need to issue a LEC unless it is satisfied that the certificate represents electricity that is “consumed or to be consumed” in the UK. Therefore, applicants need to demonstrate up-front that there is a potential pathway for the electricity to flow to the UK and to sign an annual consumption declaration. They must ensure they can show the relevant documentation at any subsequent audit.
- 1.3. The relevant documentation is a clear contractual chain linking a specific generator (to whom the LECs are issued) to a supplier in Great Britain (GB)¹. Historically, the main evidence the Authority has been presented with has included evidence of the booking and/or nomination of sufficient interconnector capacity linking the continent to GB.


Use in other schemes

- 1.4. LECs are currently the only instrument demonstrating the UK supply of overseas electricity. That is why LECs are used for several non-CCL purposes to prove UK supply of overseas renewable electricity. This includes the Feed-in Tariff (FIT), the Green Tariff conditions, and Fuel Mix Disclosure (FMD). Additionally, we are currently discussing with the Low Carbon Contracts Company (LCCC) the potential use of LECs in the Contracts for Difference (CFD) scheme.

Market coupling

- 1.5. There is currently a shift at European level towards greater market coupling and trading of electricity through implicit auctions. This optimises the

¹ For electricity supplied in Northern Ireland, the competent authority is the Northern Ireland Authority for Utility Regulation (NIAUR).



Consultation on market coupling and Levy Exemption Certificates and call for evidence on wider impacts

allocation of cross-border capacities between markets in different countries. It does so by using a coordinated price formation mechanism, based on the overall orders placed on different exchanges.

- 1.6. Under market coupling, cross-border interconnector capacity is allocated implicitly by the power exchanges based on price differentials between the coupled markets. As such, market participants do not explicitly book or nominate the interconnector capacity required for a particular cross-border trade.
- 1.7. Market coupling has been a reality in GB since 2011, when day-ahead market coupling was introduced across the BritNed interconnector (linking GB and the Netherlands). In February 2014 day ahead market coupling was extended to the Interconnexion France-Angleterre (IFA) interconnector (linking GB and France). Since then, the North-Western European (NWE) project has price coupled the day-ahead GB market with those of 18 European countries².
- 1.8. Forthcoming EU legislation (the Regulation on Capacity Allocation and Congestion Management (CACM)) will require all cross-border capacity in the day-ahead market to be implicitly allocated through auctions, and through continuous trading in the intraday market. The CACM Regulation was agreed by EU Member States on 5 December 2014. It is expected to come into force in summer 2015. It is expected to be fully implemented within about three years of it coming into force.
- 1.9. Once this has happened, the explicit booking and nomination of interconnector capacity will only be possible in the forward timeframe. However, the forthcoming regulation on Forward Capacity Allocation (FCA) will further formalise these trading arrangements in due course. FCA will require forward capacity to be explicitly allocated in the form of either physical or financial transmission rights. In the case of financial transmission rights, these may be either options or obligations. If only financial transmission rights are available on a border, it is not clear how proof of UK consumption of overseas electricity would be provided.

CCL guidance on implicit trading and LECs

- 1.10. Our published guidance on the CCL does not currently address market coupling or the implicit trading of electricity. We understand that many stakeholders are keen to understand more about routes for consumption in the UK and what evidence would be required to demonstrate this when this type of trading is used.

² Belgium, Denmark, Estonia, Finland, France, Germany, Austria, Latvia, Lithuania, Luxembourg, the Netherlands, Norway, Poland, Sweden, Italy, Slovenia, Spain, and Portugal

Consultation and call for evidence

- 1.11. Given the nature and complexity of this issue, we have decided to hold an open consultation to seek stakeholder views on the use of LECs to prove UK consumption of overseas electricity for the CCL under market coupling, and in particular, the evidence required in this case.
- 1.12. In addition, we are using this opportunity to seek views and evidence on the use of LECs to prove UK consumption of overseas electricity under schemes other than CCL, and on the wider impacts that may arise from formalising our GB supply evidence requirements under market coupling.
- 1.13. This document consists of two parts: Part A relates to the consultation presented in paragraph 1.11, and Part B relates to the call for views and evidence presented in paragraph 1.12.
- 1.14. The views and evidence presented by stakeholders for Part B will in no way influence the decisions we will take in relation to Part A.



Part A

Consultation on market coupling and Levy Exemption Certificates

Consultation

2. Proof of flow under market coupling

- 2.1. We are seeking stakeholder views on the possibility and evidential requirements for proof of UK consumption of overseas renewable electricity for the CCL exemption under market coupling.
- 2.2. Under market coupling, cross-border interconnector capacity is allocated implicitly by the power exchanges based on price differentials between the coupled markets. As such, market participants do not explicitly book or nominate the interconnector capacity required for a particular cross-border trade. Therefore, there is no specific flow of electricity across an interconnector linking the continent to GB that can be uniquely matched with a particular transaction between market participants.
- 2.3. However, the CCL Regulations make it clear that the LEC should 'represent' electricity that is consumed in the UK. HMRC guidance³ gives several conditions a utility must meet to be regarded as having acquired renewable source electricity. These include that "a clear audit trail exists, predominately based on metering, invoices and contracts (although where the quantities of electricity supplied in both directions are equal HMRC recognise that, in practice, nothing may move through the meter⁴)".
- 2.4. We want to find out what types of evidence market participants may produce to provide a clear audit trail under market coupling, and also whether there are any barriers to producing such evidence.

Question 1: Where renewable electricity is traded implicitly across coupled markets, is it possible to evidence the electricity is consumed (or to be consumed) in the UK? Please explain your answer.

Question 2: What evidence might generators use to demonstrate that an overseas LEC represents electricity that is consumed or is to be consumed in the UK when that electricity has been traded implicitly across coupled markets?

Question 3: Are stakeholders aware of any reasons for limiting the issue of overseas LECs to electricity that has been or is to be explicitly traded? Please explain your answer.

³ Excise Notice CCL1/4: electricity from renewable sources

⁴ This is in the context of sell and buy back arrangements, but is taken to also apply to the flow of electricity across interconnectors, i.e. even when interconnector capacity is nominated, quantities of electricity that 'flow' in both directions may cancel each other out in practice

Part B

Call for evidence on the use of LECs in renewable electricity schemes and on wider impacts

Call for evidence

3. Proof of supply in other schemes

- 3.1. We are also seeking stakeholder views on the use of LECs to provide proof of UK supply of overseas electricity under other schemes. LECs are currently the only instrument demonstrating the UK supply of overseas electricity. For this reason, LECs are used for several non-CCL purposes, in schemes for which such proof is required:
- For **Fuel Mix Disclosure (FMD)**, EU Guarantees of Origin (GoOs) are used to prove the share of renewable source electricity generated in the EU and purchased for supply to customers in GB. However, since the GoOs do not carry proof of GB supply, they are matched with their corresponding LECs.
 - Under the **Feed-in Tariff (FIT)** scheme, some overseas renewable electricity is excluded from the 'relevant market share' for suppliers. This is recognised by Ofgem E-Serve using LECs and GoOs (as per FMD), and adjusts the proportion of payments made by each supplier to cover the costs of the scheme.
 - Under the **Contracts for Difference (CFD)** scheme, eligible overseas renewable electricity is also excluded from the calculation of suppliers' relevant market share. Again, this alters each supplier's contributions to the overall CFD costs. The main differences with the FIT scheme calculations are that eligible overseas electricity is limited to that produced in EU Member States from stations that commissioned after 1 April 2015, and that the overall amount is capped.
 - **Green Tariff licence conditions:** As from 1 April 2015, Standard Licence Condition 21D (SLC 21D) will require that overseas electricity supplied under a green tariff meets the same conditions as required for FMD.
- 3.2. In all these schemes, proof of UK consumption of overseas electricity in a given financial year is provided by presenting evidence of the associated LECs being redeemed (supply to businesses for CCL) or retired (other supply). This evidence has to be presented by 1 July following the financial year in question, in line with FMD.
- 3.3. CCL Regulations state that when a supplier makes a supply under a renewable source contract, they must notify the Authority of the relevant LEC identifier. However, the use of LECs as proof of supply in other schemes may be influencing suppliers to redeem or retire LECs earlier than they would if used for CCL alone.

Question 4: Are stakeholders aware of alternative ways of demonstrating proof of GB supply of overseas electricity that do not involve LECs, and, if so, what are they?

Question 5: Do stakeholders currently acquire LECs purely for non-CCL purposes?

4. Market impacts

- 4.1. Given the nature and complexity of this issue, we are seeking stakeholder views on the potential market impacts of formalising our GB supply evidence requirements under market coupling.
- 4.2. Specifically, we are seeking views on the potential impacts on the electricity markets, for example volume of overseas renewable electricity to be imported into the UK, possible price differentials between UK and overseas renewable electricity, and any potential distributional impacts. The latter could include, for example, the effect on domestic consumers compared to non-domestic consumers.
- 4.3. Following on from this, we would like stakeholders' views on the potential impacts on the various schemes that currently use LECs as proof of supply.

Question 6: What do stakeholders foresee as potential impacts if:

6.1 Overseas renewable electricity can be demonstrated as consumed (or to be consumed) in the UK where it has been implicitly traded, and LECs are issued for this accordingly?

6.2 Overseas renewable electricity was only accepted as consumed (or to be consumed) in the UK (and LECs issued accordingly) where there is explicit booking and nomination of interconnector capacity?

It would be helpful to have responses to this question cover what the impacts would be on:

- **The electricity markets (volume, price, distributional issues)**
- **CCL and UK Renewable Electricity schemes, including FMD, FIT, CFD, and SLC 21D**

Appendix 1 - Consultation response and questions

1.1. We would like to hear your views on any of the questions in this document.

1.2. Please send us your responses by 19 June 2015 to:

CCL and REGO Manager
Ofgem
9 Millbank
London. SW1P 3GE.

CCLandREGO@ofgem.gov.uk

1.3. Unless marked confidential, all responses will be published in our library and on our website, www.ofgem.gov.uk. You can ask for your response to be kept confidential, and we will respect this, (subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004).

1.4. If you want your response to be kept confidential, please clearly mark the document(s) to that effect and include your reasons for requesting confidentiality. It would be helpful if you could submit your responses electronically and in writing. Please put any confidential material in the appendices to your responses.

1.5. Next steps:

- Having considered the responses to the consultation element of this document (Part A), we intend to publish a decision document and update our CCL guidance in line with this.
- We may also consult on the specific decisions contained within the updated guidance we publish.
- The responses we get for Part B will help inform wider policy discussions with DECC and HMRC.

1.6. Please direct any questions or requests for clarification about this consultation to the addresses given in paragraph 1.2.

Questions

Part A: Consultation on market coupling and Levy Exemption Certificates

Question 1: Where renewable electricity is traded implicitly across coupled markets, is it possible to evidence the electricity is consumed (or to be consumed) in the UK? Please explain your answer.

Question 2: What evidence might generators use to demonstrate that an overseas LEC represents electricity that is, or is to be, consumed in the UK when that electricity has been traded implicitly across coupled markets?

Question 3: Are stakeholders aware of any reasons for limiting the issue of overseas LECs to electricity that has been or is to be explicitly traded? Please explain your answer.

Part B: Call for evidence on the use of LECs in renewable electricity schemes and on wider impacts

Question 4: Are stakeholders aware of alternative ways of demonstrating proof of GB supply of overseas electricity that do not involve LECs, and, if so, what are they?

Question 5: Do stakeholders currently acquire LECs purely for non-CCL purposes?

Question 6: What do stakeholders foresee as potential impacts if:

6.1 Overseas renewable electricity can be demonstrated as consumed (or to be consumed) in the UK where it has been implicitly traded, and LECs are issued for this accordingly?

6.2 Overseas renewable electricity was only accepted as consumed (or to be consumed) in the UK (and LECs issued accordingly) where there is explicit booking and nomination of interconnector capacity?

It would be helpful to have responses to this question cover what the impacts would be on:

- The electricity markets (volume, price, distributional issues)
- CCL and UK Renewable Electricity schemes, including FMD, FIT, CFD, and SLC 21D

Appendix 2 - Feedback questionnaire

1.1. We believe that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about how this consultation has been conducted. We are keen to get your views on the following:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. Please add any further comments?

1.2. Please send your comments to:

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9 Millbank
London
SW1P 3GE

andrew.macfaul@ofgem.gov.uk