

Energy UK response to Ofgem consultation on market coupling and Levy Exemption Certificates and call for evidence on wider impacts

23 June 2015

About Energy UK

Energy UK is the Trade Association for the energy industry. Energy UK has over 80 companies as members that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested over £11 billion in the British economy.

Introduction

Energy UK welcomes Ofgem's consultation on the wider impacts of market coupling and Levy Exemption Certificates. We consider that this consultation has two distinct topics which, although linked will require a thorough review of the impacts regarding compliance with EU law and the policy intent of the Climate Change Levy. We strongly support a holistic approach being taken by Ofgem when considering how market coupling will impact Levy Exemption Certificates. Energy UK's response will address the issue of implicit trading arrangements across interconnectors as well as setting out the potential impacts to the Levy Exemption Certificate market. A summary of our key points can be found below:

- Energy UK considers that it is still possible to evidence that electricity that has been generated outside of the UK has been subsequently consumed in the UK with implicit flows on interconnectors. As there is no natural cap on these types of contracts the flow of Levy Exemption Certificates could potentially exceed the interconnector capacity. If Ofgem does not decouple LECs from physical flows and therefore require a physical path to confirm the electricity is consumed in GB (which would be in line with CCL guidance) then a physical cap equivalent to interconnector capacity may be an appropriate solution.
- The impact of Levy Exemption Certificates with market coupling needs to be considered holistically with DECC and HMRC also being consulted on the impacts to the Levy Exemption Certificate market and the collection of Tax revenue. A detailed impact assessment should be carried out along with further industry consultation prior to a position being finalised.
- We note that existing guidance from HMRC, CCL Regulations; FiT Guidance and the CfD Supplier Obligation provide different interpretations as to how overseas Levy Exemption Certificates are treated with regard to whether the electricity needs to be delivered/consumed in the UK on a non-discretionary basis. The ambiguity between guidance documents must be resolved in order to produce a holistic solution to implicit trading arrangements and the issuance of overseas Levy Exemption Certificates.

Energy UK welcomes the opportunity to further discuss the points raised within this consultation with Ofgem. Should you require further information or clarity on the issues outlined in this paper then please contact Kyle Martin on 020 7747 1834 or kyle.martin@energy-uk.org.uk.

Kyle Martin

Energy UK
Charles House
5-11 Regent Street
London SW1Y 4LR
Tel: 020 77471834
www.energy-uk.org.uk

Consultation response

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.

The implementation of market coupling introduces a challenge for evidencing the generation and consumption of electricity as flows move from explicit to implicit trading. We consider that where a path exists so that the electricity generated is notionally capable of reaching the UK and parties are able to evidence this through matching trades on the coupled power exchanges then this would provide proof that equivalent power volumes have been bought/sold to the supplier/generator. However, as there is no natural cap on these types of contracts the flow of LECs could potentially exceed the interconnector capacity.

We note that existing guidance from HMRC, CCL Regulations; FiT Guidance and the CfD Supplier Obligation provide different interpretations regarding how overseas LECs are treated with regards to whether overseas generated electricity needs to be delivered/consumed in the UK on a non-discretionary basis. A summary of these documents can be found in Annex 1.

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?

Energy UK considers that the requirement to evidence that electricity was generated overseas and subsequently consumed/delivered to customers in GB needs to be robust and transparent. Market Coupling facilitates this criteria by allowing the flow of electricity across the transmission/distribution system making the transfer of renewable electricity and therefore LECs possible between countries which is in line with HMRC guidance CCL1/4 4.3. However, this method assumes that Ofgem is content to decouple LECs from physical flows. As there is no natural cap on these types of contracts the flow of LECs could potentially exceed the interconnector capacity. If Ofgem does not decouple LECs from physical flows and therefore continue to require a physical path to confirm the electricity is consumed in GB (which would be in line with CCL guidance) then a physical cap equivalent to interconnector capacity may be an appropriate solution.

In order to fulfil the contractual path, there should be evidence that the LEC producer has sold electricity into the coupled market through a power exchange in a coupled country. Similarly there should be evidence that the supplier or an onward recipient of the LECs has bought electricity on an exchange in GB. Evidence from the power exchange would show that this energy had been sold/purchased which could be used to show the transfer of the electricity across the interconnector (implicit trading on the interconnectors would mean a move away from a physical market to a traded market in terms of evidencing requirements).

The guidance from the CCL Regulations, FiT Guidance and the CfD Supplier Obligation does however suggest that electricity must be calculated at the point at which such electricity is first delivered from a generating station to a distribution or transmission system within the United Kingdom as well as stating that electricity generated overseas would need to be supplied to customers in GB. It's also worth noting that the CfD supplier obligation makes a distinction as to the date when renewable generation is considered green excluded electricity. Therefore the ambiguity between guidance documents will need to be resolved in order to produce a holistic solution to implicit trading overseas LECs.

Where Guarantees of Origin (GoO) have been issued in support of the Renewable Source Electricity, these should be cancelled for consumption in the country of origin, and submitted for use with Fuel Mix Disclosure in the UK. However, it should also be noted that the use of LECs as 'evidence of supply' within the FMD process provides a simple and clear method for ensuring there is no double-counting of renewable electricity, one which has been used by World Resource Institute (WRI) as a best practice case study. Care should be taken and a clear holistic impact assessment carried out before any move within in the UK to what could potentially be an operationally more complex system.

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.

We consider that under HMRC's guidance there are no reasons why explicit or implicit overseas LECs should be limited providing robust evidence requirements are met. This is detailed in our response to Question 2 above.

With trades on the interconnectors moving from explicit to implicit trading arrangements and therefore the potential for an unlimited number of LECs able to flow into the GB market there needs to be a holistic review taken by Ofgem in consultation with DECC and HMRC to fully appreciate the impacts this would have on the CCL. The CCL is a UK specific policy which was designed to provide an investment signal to renewable energy (implemented via a tax regime). It has been used to encourage both the uptake of renewable electricity by consumers and developers of renewable generation projects. As long as there is a positive LEC price the CCL would continue to provide a signal for renewable energy investment. However, it is difficult to see how the CCL would continue to provide a signal for renewable energy investment if overseas LECs were not capped (as is currently the case with capacity booking used to show traded power volumes) therefore potentially reducing the price of the LEC to a level that no longer provided these signals. As there is no natural cap on these types of contracts the flow of LECs could potentially exceed the interconnector capacity. If Ofgem do not decouple LECs from physical flows and therefore require a physical path to confirm the electricity is consumed in GB (which would be in line with CCL guidance) then a physical cap equivalent to interconnector capacity may be an appropriate solution.

We consider that an open market approach could impact the CCL in the following way:

Unlimited LECs would also result in substantially higher risk margins charged to GB customers. Suppliers would find it very difficult to forecast what their market share would be under FiT and CfD, therefore calculate what their liability was going to be.

With the LEC being part of a European market mechanism the increase in LECs would reduce the price of the LEC through increased competition therefore reducing the cost of purchasing LECs for suppliers (and therefore customers). It is possible that increasing LEC imports may mean that CCL is met 100% by GB and non-UK LECs taken together to exceed the CCL demand. This could reduce an element of customer bills if customers can purchase LECs at circa £0 to fully offset CCL liability. However, any UK customer benefit from reduced CCL liability will be mitigated by reduced CCL tax recovered by HMRC. Therefore this is a transfer of value from tax payers to customers which in balance is not a societal benefit for the UK overall.

Allowing an unlimited number of overseas LECs to enter the UK would reduce the value of the LEC which currently forms part of the revenue stream for renewable generators. This would be detrimental for GB renewable generation and must be taken into account when considering how overseas LECs will impact the GB LEC market under implicit trading arrangements. The impact on low carbon projects bidding for a Contract for Difference (CfD) would be more significant as these contracts are competitively allocated which put a greater emphasis on the revenue of the LEC as part of the revenue stream.

If unlimited overseas LECs were to be accepted there would also be an issue where £MWh to recover FiT and CfD costs would increase potentially leaving a small amount of suppliers paying the total cost of these schemes. The net effect is an increase in costs to UK customers overall: instead of paying just the FiT and CfD costs, UK customers are paying the same FiT and CfD costs plus the non-CCL value of any imported renewable electricity. We also note that these schemes are not currently operating in Northern Ireland. However, when the CfD is launched then this issue of non-UK LECs distorting the supply market would also apply to Northern Island.

As set out above, there are a number of potential impacts resulting from overseas LECs being uncapped. We would strongly advise Ofgem to carry out a full impact assessment on the effects of LEC issuance under implicit trading arrangements. This should consider the guidance from HMRC, CCL Regulations, FiT Guidance and the CfD Supplier Obligation. Ofgem's evidence requirements will

determine the amount of LECs issued to overseas generators. Any solution may also need to consider State Aid requirements.

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?

The existing GoO scheme aids in the demonstration of proof that the electricity is produced from renewable energy sources. Where a GoO is cancelled in its original country, and not double-sold, the associated electricity cannot be deemed to have been consumed in any country other than that in which the GoO is ultimately recognised. The GoO scheme exists to deal with the difficulty of tracking individual units of electrical energy within a complex system, and its use, where applicable, in the Climate Change Levy (CCL) context ensures both schemes are consistent and that there is no double-counting of GoOs.

However, it should be noted that the use of LECs as 'evidence of supply' within the FMD process provides a simple and clear method for ensuring there is no double-counting of renewable electricity, one which has been used by World Resource Institute (WRI) as a best practice case study. Care should be taken and a clear holistic impact assessment carried out before any move within in the UK to what could potentially be an operationally more complex system.

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

Energy UK is not aware of this happening. However, if a company was to purchase LECs for Non-CCL purposes the value of the FiT and other exemptions would need to be larger than the value of the CCL exemption. This is not currently the case but is possible in the future if the volume of overseas LECs reduced the price towards £0.

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?

If the mechanism only allocated LECs to explicit flows, then this could have the potential to distort cross border trading where imports would be made to the UK which, in the absence of LECs, would not otherwise occur. In the implicit mechanism the flow is based purely on the cost of electricity. We believe this is consistent with the ethos of the wider market coupling initiative but nonetheless any change toward this approach should also be assessed against the impacts on renewable power within the UK as outlined in our response to Question 3.

However, the guidance from the CCL Regulations, FiT Guidance and the CfD Supplier Obligation does however suggest that electricity must be calculated at the point at which such electricity is first delivered from a generating station to a distribution or transmission system within the UK as well as stating that electricity generated overseas would need to be supplied to customers in GB. It's also worth noting that the CfD Supplier Obligation makes a distinction as to the date when renewable generation is considered green excluded electricity. Therefore the ambiguity between guidance documents will need to be resolved in order to produce a holistic solution to implicit trading overseas LECs.

Analysing the impact of implicitly traded overseas LECs and the impact to the market is extremely difficult to quantify and will be subject to how the issuance of LECs are managed under implicit trading arrangements.

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?

There is the potential for distortions at the borders if the LEC value forms part of the flow economics. It is worth adding that we expect these mechanism to be extremely difficult to administer, requiring coordination across many Transmission System Operators on the continent, potentially distorting trade at those borders too. We currently see this behavior where interconnector import flows to the UK are reduced for the implicit portion of capacity, while the explicit imports remain.

We consider that there would be little impact on the CCL with any reduction in continental LEC imports being met by UK produced LECs.

Annex 1

Excise Notice CCL1/4: electricity from renewable sources

We generally accept that, where it is impossible to trace the source of a particular parcel of electricity, the possession of Renewable LECs sufficient to cover the quantity of electricity acquired determines that the electricity is from a renewable source. However, where supplies of electricity to the holder of a Renewable LEC can be exclusively and demonstratively traced to a non-qualifying source, possession of the Renewable LEC will not alter this fact and the electricity cannot be treated as renewable source electricity for the purpose of the balancing and averaging calculation.

Climate Change Levy (General) Regulations (2001)

“47 - (14) For the purposes of the Act the amount of a supply of renewable source electricity is to be calculated at the point at which such electricity is first delivered from a generating station to a distribution or transmission system within the United Kingdom (excluding territorial waters).”

FITs Guidance for Licensed Electricity Suppliers (march 2015)

“8.5. The market share of a Licensed Electricity Supplier is determined by calculating the amount of electricity supplied to customers in Great Britain by the Licensed Electricity Supplier less the amount of electricity it sourced from renewable sources generated outside of the UK and supplied to customers in Great Britain. This is then compared to, and expressed as a percentage of, the amount of electricity supplied by all Licensed Electricity Suppliers to customers in Great Britain less the amount of any electricity they sourced from renewable sources which is generated outside of the UK and supplied to customers in Great Britain.”

CfD - The Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015

3.—(1) An electricity supplier may apply to the CFD counterparty for a determination that an amount of electricity supplied by that supplier is green excluded electricity.

(2) An application under paragraph (1) must be made within six months of the conclusion of the quarterly obligation period in which the electricity was supplied and must contain evidence of—

(a) that supply;

(b) the country where the electricity was generated;”

“(c) the date on which the generating station which generated the electricity first became operational was after 31st March 2015.”

4 – (1) (b) (iii) ““CAP” is the amount of the cap which applies in respect of green excluded electricity supplied during that quarterly obligation period.”