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

Consultation by Ofgem

Response by E.ON

Summary

- It is possible to evidence that electricity is consumed or is to be consumed in the UK when traded implicitly across interconnectors. This can be demonstrated by evidence of the right to flow electricity through an interconnector, perhaps with evidence of trades on exchanges both sides of the interconnector.

- Whether traded implicitly or explicitly, LECs should only be issued or redeemed up to the maximum physical capability of the interconnector. Declaring that LECs represent electricity that is consumed or to be consumed in UK to a level above the physical capability of an interconnector is not credible.

- The physical capability of interconnectors should therefore represent a cap on the total amount of overseas LECs issued or redeemed in UK, with LECs for implicit trades allocated on a pro rata basis if they exceed this cap.

- We note that some interconnector owners are developing products along these lines, where rights associated with a LEC are assigned to a participant. We support the development of such products and believe that evidence of the transported flow and the assigning of rights to a participant could be used as evidence that the LEC represented electricity that is consumed or is to be consumed in the UK.

- Ofgem should consider the impact on UK customers and taxpayers of increasing the supply of overseas LECs beyond the physical capability of interconnectors.

- As more LECs are issued CCL tax receipts will fall (which presumably will need to be recovered from elsewhere) and offsets for suppliers' FiT and CfD costs will increase, this will raise costs for UK customers overall.

- A predictable limit to the amount of overseas LECs in the UK (the physical capability of interconnectors) will reduce suppliers' forecasting risks which will be reflected in lower costs to customers.

Consultation questions

Part A

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.*

1. When renewable electricity is traded implicitly across interconnectors it is possible to evidence that electricity is consumed or to be consumed in the UK.

2. When electricity is traded implicitly, with flows determined by the market coupling algorithm, there is no explicit identification of the owner of that electricity. However, an implicit trade can still result in a physical flow of electricity; this flow is in the name of the interconnector owner/operator rather than a generator.

3. The existence of this physical flow (or capability of it) can be used to evidence overseas renewable electricity that is consumed or to be consumed in the UK. We believe this physical capability is best determined by the Available Transmission Capacity (ATC) at each relevant interconnector (those connecting GB with non-GB markets).

4. We discuss in more detail proposals for evidence in response to Q2 below. As a point of principle, it should only be possible to declare that electricity is consumed or to be consumed in the UK up to the level of physical capability (ATC) of an interconnector. This could be a combination of implicit and explicit trades but the overall physical capability should represent a maximum.

5. Declaring that LECs represent electricity that is consumed or to be consumed in UK to a level above the physical capability of an interconnector is not credible and risks bringing the market into disrepute. Furthermore, the impact on UK customers must be considered (see response to Q6 below).

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?*

6. In our response below we focus on the evidence required to prove that electricity is consumed or to be consumed in the UK. We assume all other necessary proof of the validity of the LEC, such as proving the renewable generation in the source country, is already provided.

7. The existence of a physical flow (or capability of it) at the interconnector could be used as evidence that an overseas LEC represents electricity that is or is to be consumed in the UK. In an implicit trade this physical capability is not directly attached to the LEC, but the party owning the LEC could show evidence of the right to flow electricity through the interconnector, perhaps with evidence of trades on exchanges both sides of the interconnector.

8. As highlighted above, the maximum amount of LECs issued should be determined by the ATC at the interconnector in a period, the period should be aligned to the CCL scheme itself (calendar month). Therefore the total amount of LECs to be issued or redeemed for implicit trades should be determined by the ATC of the interconnector in a period, less the total explicit trades that have been nominated. If more LECs have been requested for implicit trades than this cap allows, the number of LECs issued should be reduced accordingly and allocated on a pro-rata basis.

9. We note that some interconnector owners are developing products along these lines, where rights associated with the acquisition, transportation, disposal or redemption of a LEC are assigned to a participant. We support the development of such products and believe that evidence of the transported flow and the assigning of rights to a participant could be used as evidence that the LEC represented electricity that is consumed or is to be consumed in the UK.

10. Ofgem should also consider whether any restriction on the use of overseas LECs should apply to the issue of LECs or the redemption of them. Limiting the issue of LECs at source may appear simple, and does facilitate more straightforward auditing, however this is likely to increase the administrative costs for trading parties and may limit the tradability of LECs.

11. Instead, we believe Ofgem should apply any restriction when LECs are redeemed. This would involve guidance stating that suppliers can only redeem LECs at the end of each compliance period up to the volume of the physical transmission rights acquired via explicit or implicit trading on interconnectors. This separation of the actual trading of electricity over an interconnector from the proof required to justify use in UK schemes such as CCL, FiT or CfD, will reduce administration costs. It will also give Ofgem the opportunity to review the renewables registry more closely when retiring LECs that have not been redeemed at the end of each compliance period.

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.*

12. We do not see any reason to limit the issue of overseas LECs to electricity that has been explicitly traded.

13. However, overseas LECs should be issued only up to the level of the ATC on the interconnector. Issuing more LECs than can physically be delivered through an interconnector is not credible and raises costs for UK customers.

Part B:

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?*

14. We have described above methods to demonstrate proof of GB supply for the LEC scheme, this proof could conceivably be used directly in other schemes if no LEC were issued.

15. However, given the requirement to demonstrate proof in order to issue a LEC and the incentive to redeem the LEC for CCL purposes (see response to Q5 below) we see no reason to introduce other methods of demonstrating proof of supply in GB.

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

16. The price of a LEC is determined by both the CCL and non-CCL value. The CCL value of a LEC is a significant proportion of the total value. Therefore it is unlikely that organisations would acquire LECs solely for non-CCL purposes.

17. The only circumstance where use of LECs purely for non-CCL purposes seems likely is if all CCL customers were already using LECs to offset their CCL.

18. However, given the price of an overseas LEC reflects both its CCL and non-CCL value, only suppliers with both CCL and FiT/CfD paying customers can realise this full value.

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*

19. Issuing or allowing redemption of LECs for renewable electricity traded implicitly is likely to increase the supply of overseas LECs in the UK. The less restricted this is, the greater the increase in supply is likely to be.

20. As highlighted throughout this response, the impact on customers must be considered. CCL paying business customers can use LECs to offset their CCL costs so will benefit from an increase in the supply of LECs from overseas. However, CCL tax receipts will fall and must be recovered from taxpayers elsewhere; it is not clear that a reduction in price of overseas LECs resulting from an increase in supply would offset this fall in tax receipts.

21. For domestic or non-CCL paying customers, the impact of an increase in the supply of LECs from overseas is likely to be negative. This is because overseas renewable electricity can be used by suppliers to offset their FiT and CfD liabilities. The total cost of FiT and CfD schemes must still be

recovered, so a supplier using overseas renewables to offset these costs on behalf of its customers simply moves the costs to customers of other suppliers. 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.

22. When selling electricity to customers, suppliers will forecast the costs of schemes such as FiT and CfDs when setting their prices. The more uncertain these costs, the more expensive it is to manage them which could result in higher costs to customers. The ability to offset these costs with overseas renewables adds to the complexity in forecasting them.

23. As we highlight throughout this response, limiting the issue of LECs to the physical capability of interconnectors will not only be more credible, it will also limit any negative impact on domestic customers and reduce suppliers' administration costs (and therefore prices to customers) as suppliers know the physical capacity of interconnectors represents a maximum amount of offsets in circulation.

24. The value of an overseas LEC in the UK is considerably higher than in other countries: the price of an overseas LEC with Guarantee of Origin (GoO) is around €10 today in the UK market, the equivalent value is considerably lower in other countries (around €1 for a GoO in Germany or Netherlands). This imbalance in the value of renewable electricity across Europe means continental renewable electricity is likely to flow into GB at the maximum rate possible.

25. As highlighted throughout this consultation, we do think there is a case to issue LECs to renewable electricity traded implicitly over the interconnector. However, it is also important to pursue efforts to remove the bias in value of international renewables that results in high flows into GB.

26. Interconnected markets and international trade is of fundamental importance in the European energy markets but this trade must be based on products of equivalent value. Distortions in the UK market described above, coupled with other distortions such as the UK's carbon price floor, which aren't reciprocated in other countries, result in UK customers paying more for their energy.

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June 2015