



Energy for
generations

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ESB response to consultation on market coupling and Levy Exemption Certificates and call for evidence on wider impacts

ESB welcomes the opportunity to respond to Ofgem's consultation on market coupling and Levy Exemption Certificates and call for evidence on wider impacts.

About ESB

ESB is a leading independent power generator developing, owning and operating extensive thermal and renewable assets across the UK and RoI.

Introduction

Before responding to the specific questions in the consultation, we offer a summary of the key issues raised in our response.

We recognise that any decision to change the current rules needs to be very carefully considered. In particular, the review should be made in a holistic way that also takes account of the corresponding effects on all participants in the market and consumers.

Whilst it is our view that implicit trading should not act as a barrier to the issuance of overseas LECs, we do see some value in first looking at the detail and the extent to which relaxing the current rules will impact the market.

It is difficult to make accurate forecasts of future market behaviour in response to this review of the current rules, and in our view both scenarios discussed in the consultation require further work. In particular a full impact assessment and legal validation of associated procedures should be undertaken. We believe that the consultation covers many of the issues that require addressing. However, we are concerned that implementation of one of the scenarios discussed in Questions 6.1. and 6.2 will not deliver the desired outcome on its own, and in this respect further implementation details need to be addressed to ensure the market operates effectively. One of the issues we note in our response is the potential for the regulator to assess and monitor should there be any perceived adverse impact to customers or the market.



Weighing up the balance of risks between 'implicit evidence' and 'explicit evidence' approaches requires some anticipation of what additional LEC contributions would come as a result. It is difficult to make assumptions on these to compare the market impacts of both approaches and this creates a potential risk for the market. It would be useful to see what regulatory and market protections would be in place should there be any risk of market distortion.

Given the increasing risk of competitive pressures it is important that both current and future rules provide adequate support for domestic renewable trade. We believe this is an area that has great potential for addressing some of the inconsistencies in the current regime. In particular we are concerned about renewable supplies from Northern Ireland being subject to additional burden of proof of physical capacity. As it stands, there is a lack of consistency in treating supplies from devolved administrations with consequential increase in vulnerability of Northern Ireland supplies to additional rules and regulations. We would like to see Northern Ireland supplies given an opportunity to supply renewable energy to GB and apply for LECs in the same manner as other countries in the UK.

In addition to internal rules placing additional requirements on Northern Ireland, certain external or cross-country trade rules may create further complications for the island of Ireland and its market to fully engage and access the GB LEC market. In the consultation Ofgem state that "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". ESB considers that it is important that whatever solution is put in place by Ofgem it does not disadvantage the supply of LECs from any overseas markets that have only Financial Transmission Rights (FTRs) available on the interconnectors with GB. The SEM electricity market (covering Ireland and Northern Ireland (NI)) will change to the Integrated or I-SEM in October 2017. Under the design¹ for the I-SEM only FTRs will be available on the two interconnectors (Moyle and EWIC) between I-SEM and GB. As stated earlier, ESB is of the view that the terms of treatment of Northern Ireland supplies are not entirely consistent with the rest of the UK. Introducing a new barrier, because I-SEM – GB interconnectors have only FTR capacity available, appear discriminatory and puts NI renewables at a disadvantage compared with renewable generators both inside and outside the UK.

More generally, it is essential that any changes to the existing requirements that will follow the implementation of market coupling promote flexibility, transparency, level playing field and non-discrimination, and do not cause any detrimental effects on the integrity and marketability of LEC products.

¹ I-SEM High Level Design Decision



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.

We are of the view that implicit trading across coupled markets introduces a number of practical difficulties for accredited renewable generators that wish to apply for LECs. However, given the advanced stage of market coupling initiatives and integration across European markets it seems reasonable for Ofgem to amend or relax certain existing requirements, including the proof of physical route for the renewable energy associated with a LEC. It is evident that in the market coupling regime it is no longer possible to continue with the current evidence requirements.

We support the drive towards a regime that can accommodate both implicit and explicit trading as a way to integrate the market coupling arrangements. Nevertheless, we feel that certain market and compliance concerns need to be addressed first. This is on the basis that loosening the regime may result in an increase in offers in the market, which in turn affect the value of LECs and could lead to a number of unintended consequences. This aspect is discussed in more detail in our response to Question 6.1. below.

In particular, there is insufficient empirical evidence to show how the supply of LECs and renewables would respond to less strict regulation and how attractive the market is for overseas supplies. This could be substantiated by a stable increase in the number of LECs issued to overseas renewables in the last 5 years as well as an increase in the number of member states applying for LECs. As a general observation we note that the number of LECs issued to overseas producers has increased by at least 30% in the last five years with an exception of Switzerland. Most notable increase is recorded in the number of LECs issues to Denmark- from 61,219 in 2009-10 to 2,396,161 in 2013-14. As such, we feel that the regulator may need to assess whether the market is sufficiently protected from an unchecked volumetric increase in supply as well as from competitive risks.

In addition, the significant issue we believe should be considered is the inconsistent treatment of devolved UK supplies for the purpose of LEC eligibility. We would raise a concern that under the current regime renewables from Northern Ireland are not treated in an equivalent manner to renewable power from Great Britain in relation to the 'evidence of supply' and the requirement to demonstrate that physical route exists for the supply to reach Great Britain.

It is our view that Schedule 6 of the Finance Act 2000 is the primary legislation setting out the conditions for the Climate Change Levy and associated exemptions. The Act and representative HMRC legislation apply equally to Great Britain and Northern Ireland and we see no reason why supplies from Northern Ireland should be treated differently from other administrations in the UK. We are concerned that the additional burden of proof for Northern Ireland renewable supplies risks depriving renewable generators in Northern Ireland from contributing to the UK demand for LECs. Instead, we believe that consistent and uniform rules should apply to all LEC-eligible renewable generation within the UK.



In relation to competitive pressures from overseas LECs it is important to further recognise that an oversupply of LECs can lead to subsidising significant proportions of overseas renewables with no attached environmental benefits or input towards decarbonisation targets as well as eroding incentives for the development of indigenous renewable generation.

For this reason we feel that, while market coupling implications should not limit the eligibility of overseas LECs, a balance needs to be struck which provides sufficient access for overseas renewable power producers to harness the potential of LEC trading, without unduly compromising the market and economics of domestic low carbon generation. To that extent, it may be appropriate to examine various possibilities for introducing control arrangements. For example, interconnector capacity could be used as a market cap on the number of LECs claimed in a specific period of time. This is on the basis that the amount of power supplied to GB from a specific region could never exceed the capacity on a relevant Interconnector.

We would see no reason why such or similar mechanisms could not be used to help monitor the supply of LECs under the implicit capacity allocation regime.

Additionally, we would suggest that, where possible, both parties should be able to demonstrate matching trades and corresponding volumes.

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?

The move to implicit trading and capacity allocation under the market coupling regime should not place any additional burden on generators in relation to proving that a contracted volume of electricity was or will be used in the UK.

Evidence required under the current regime, such as metered data (less internal power), records of the power sold for supply outside the UK, contracts, declarations, and other bi-lateral arrangements should be sufficient providing these meet the conditions outlined in the Finance Act and are in line with the HMRC guidance.

As above, evidence of matching trades and corresponding volumes, where available, would address some of the concerns and demonstrate that appropriate commitment to sell and purchase renewable electricity was made by the parties.

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.

As previously indicated in our response to Q1, it is our view that changes in policy should be proportionate and act in the interest of the market and cross-border trade. We also believe



that limiting the issue of overseas LECs to electricity that has been or is to be explicitly traded could introduce disruptive market force. Firstly this would limit the choice for suppliers offering 'green electricity' tariffs. Additionally, due to the intermittent nature of renewable generation it can affect availability of the product for suppliers relying on LECs for tariff structures and taking advantage of the non-CCL benefits of LECs. The intermittent nature of renewable energy generation can lead to high volatility in the LEC market and leave suppliers short of their target procurement of LECs for a specific period. Either situation could lead to significant customer dissatisfaction and put customer interests at risk. It is worth noting that the market for LECs is driven primarily by end customer demand, and any decision to change the current rules should not curtail consumer benefits or limit customer choice.

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?

In the long-term the renewable energy certification trading could be integrated across European markets. A joined electronic registry and compliance monitoring could be co-ordinated between member states.

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

ESB does not operate as a supply business in GB. We are unable to provide any commentary on this question.

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?

As highlighted above we are supportive of this scenario, however, our response to Q 1 highlights problems which might derive from the unlimited issuance of overseas LECs. Those problems mainly become apparent in the risk that the market becomes saturated with overseas supply, leading to a collapse in the value of LEC. One of the factors that tends to control the overall supply-demand balance is that renewable energy from regions rich with cost-effective resources—but where electricity demand is low(er)—may be constrained by the availability of transmission to carry the electricity to Great Britain. Removing this requirement would significantly increase the overall number of LEC traded in the market.

Such a situation could have significant impact on the renewable generation sector and the development of new capacity, particularly in GB. A decrease in the value of LECs could lead to a number of unintended implications, such as the need to restructure the recovery mechanism for costs and charges under various schemes. It is our view that Ofgem may need to monitor and investigate should there be any perceived adverse impact to consumers or participants in the market.



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The commercial implication of this could be the difficulty for independent renewable developers to finance new renewable projects within the UK. Such an outcome would mean the loss of the local benefits which are a key aspect of Government's renewable policies.

This is an area of potential risk and it is evident that effective governance and control arrangements will form a crucial component of the new policy.

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?

While well-intentioned, we do not think the measure to limit issue of LECs to explicit capacity holders is helpful to consumers. We are concerned that this approach would stifle the choice for suppliers and risk limiting the ability of companies to promote 'green' and low-carbon tariffs.

We consider this to be a much wider risk for the electricity supply market and do not think it works in the interest of cross –border trade or end consumers.

I hope you find this response useful. If you have any questions or require clarification, please do not hesitate to contact me.

Yours sincerely,

Michael Dodd
GB Regulation Manager, ESB