



By email only

CCL and REGO Manager
Ofgem
9 Millbank
London
SW1P 3GE
19th June 2015

Dear Sir/Madam,

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

RWE npower Group plc holding company for supply licences welcomes the opportunity to respond to the Ofgem consultation on market coupling and Levy Exemption Certificates and the call for evidence on wider impacts. Please find our response enclosed and a few high level comments below.

We believe that it is possible to meet both the HMRC and Ofgem requirements with market coupling and that there should be no restricting of flow to explicit, or additional charges to intermediary parties such as interconnectors.

Furthermore, limiting the issue of overseas LECs to electricity that has been or is to be explicitly traded, would restrict access to the benefit of Climate Levy Exemption on the continent and as such this is not consistent with an open-border approach to this scheme.

There are alternative ways of demonstrating proof of GB supply of overseas electricity that do not involve LECs including the existing Fuel Mix Disclosure scheme. The Guarantee of Origin scheme also exists to deal with the difficulty of tracking individual units of electrical energy within a complex system and its use in the CCL context ensures both schemes are consistent and there is no double-counting. Although not used for source labelling, there are also other forms of power and incentive schemes including Renewable Obligations, Feed in Tariffs (FiT), Green Supply, Contracts for Difference (CfD).

Similarly, in the domestic sector, for domestic sourcing, the generator declaration (REGO for renewables) is used as the source of provenance for consumer purposes. If a green (or similar) claim is made and a LEC was produced with the generator declaration then the LEC is retired, to prevent any double counting. This is also the same for foreign GoO/LEC.

This response is not confidential and if you would like to discuss our response, please do not hesitate to contact me.

Yours faithfully

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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.

Yes, we believe it is possible to evidence consumption in this scenario based on the guidance from both Ofgem and HMRC, and that no change in the current guidance is needed to do so, although it is likely that short points of clarification would be helpful for market participants.

The Ofgem guidance on this point is that a path should exist, through which the electricity generated is notionally capable of reaching the UK. HMRC guidance from CCL1/4 3.6 is that “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 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.” Taking this guidance into account, our understanding is that the relevant test is whether it is possible to demonstrate that electricity traded implicitly across coupled markets was not consumed in the UK. We understand that with the proper contractual arrangements in place it is not possible to demonstratively trace such power to a non-qualifying source.

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?

npower believes that there is evidence that generators can 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.

A contractual path should be in place which demonstrates the contractual chain from generator to supplier, as is the case with any other LECs. A physical path should be demonstrated to exist through which the electricity could notionally flow.

By its nature, implicit trading is just that: implicit. Electricity and capacity are traded together in day-ahead auctions. By the anonymous nature of these auctions, and the fact that significantly more electricity is traded than physically flows, it is meaningless to think of ownership of the implicit flow. Rather there is a gross contractual link between the two markets.

The actions of grid operators and interconnector operators in coupling markets serve to provide the physical path required, in the same way that grid operations in the UK provide a physical path for UK-produced LECs. Within the UK we understand it is accepted that connection to a national transmission grid is sufficient to demonstrate the physical path, and we believe the function of market coupling is to extend this physical path further to the connected markets.

The contractual path can be demonstrated through transactions entered into on relevant exchanges. There should be evidence that the LEC producer has sold electricity into the coupled market through a power exchange in one of the coupled countries and that a supplier, or an onward recipient of the LECs has bought electricity on an exchange in the coupled market.

Where Guarantees of Origin 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. Similarly, for electricity generated outside of the EU, Generator Declarations also help to reassure that the electricity has not been counted as consumed in the country of origin.

The provision of the physical path described above does not confer ownership of that path or any “associated rights”. The capacity to flow (the option to flow) is sold at the point of the day ahead auctions. Any trades entered into by Shipping Agents to facilitate a transfer are done so only on an agency basis for the purposes of making nominations and allocating congestion income. The arrangements for such transactions, if they occur at all, are opaque so it is impossible to know exactly what happens, but true transfer of ownership of that energy never takes place: an agent in such

circumstances buys out of obligation and sells out of obligation, never having any rights to choose what happens to that electricity and as such never truly taking property rights. The electricity contractually is traded between a buyer on an exchange in one country and a seller on an exchange in another. As such we do not believe that there is any need for a third party product from interconnector operators.

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.

npower believes that by limiting the issue of overseas LECs to electricity that has been or is to be explicitly traded, would restrict access to the benefit of Climate Levy Exemption on the continent.

We believe that this is not consistent with an open-border approach to this scheme. As it is possible for electricity that has been implicitly traded to be consumed in the UK, this should not be excluded from the scheme.

We also believe that to do this could be subject to challenge from either generators on the continent or suppliers in the UK, who would miss out on the benefits of the LECs which would have otherwise been issued. The practical implementation and enforcement of such a decision would be extremely difficult, requiring coordination of TSOs across many borders. Implicit trading is widespread and well established both on the continent and between the continent and UK. Market coupling and the move towards a single European market are key projects for the EU and a restriction to implicit appears to go against this tide. There may also introduce distorting effects on cross border trade across Europe, discussed further in our answer to 6.2.

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?

Yes, we believe that there are alternative ways of demonstrating proof of GB supply of overseas electricity that do not involve LECs.

Although not used for source labelling, we recognise the presence of a connection between other forms of power and incentive schemes for example Renewable Obligations (RO), Feed in Tariffs (FiT), Contracts for Difference (CfD) and Green Supply.

Also, by its nature electricity is intangible and individual parcels of energy cannot be physically tracked. As such, renewable schemes rely on certificates rather than physical tracking. Those certificate schemes should at best work together, and should certainly not contradict each other.

The existing Fuel Mix Disclosure scheme aids in the demonstration of proof. Where a Guarantee of Origin 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 CCL context ensures both schemes are consistent and that there is no double-counting.

In the domestic sector, for domestic sourcing, the generator declaration (REGO for renewables) is used as the source of provenance for consumer purposes. If a green (or similar) claim is made and a LEC was produced with the generator declaration then the LEC is retired, to prevent any double counting. Similarly for foreign GoO/LEC.

The same would apply with Generator Declarations associated with energy generated outside of the EU.

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

We believe that stakeholders do acquire LECs purely for non-CCL purposes in a limited number of cases, despite it appearing uneconomic to do so.

We understand that there are residential and (CCL-exempt) I&C supplies which use LECs as evidence of renewable source electricity. In the business sector, the LEC is purchased and redeemed and claims are made with respect to matching consumption with LECs.

Some customers seek to acquire LECs even though they do not have to pay the CCL tax. For example we have had and still have although it is now on run down once we were constrained to selling 4 Core tariffs, a residential product which is supported by LECs, but then retired to prevent double counting in the business sector. Residential customers do not pay CCL. However, the product evidences the greenness of the electricity via a combination of origin and the LEC, which is subsequently retired. Some I&C councils also demand LECs even though they are CCL exempt. Again it is to evidence their renewable 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?

npower believes that on electricity markets we see little impact if overseas renewable electricity can be demonstrated as consumed (or to be consumed) in the UK were it has been implicitly traded, and LECs are issued for this accordingly.

We believe that this is part of the attraction of this particular approach. The mechanism of only allocating LECs to explicit flow has 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.

On regulation, we do not believe the law or guidance needs to change to allow this to happen, and the administration of such a system would be no more complex than that for LECs redeemed for electricity which has been solely explicitly traded.

On CCL, there are no transparent numbers available but our expectation is that the CCL amounts received by HMRC would not change significantly. The incentive to redeem LECs is strong, and the practice well established, so we expect that LEC redemption is very efficient, and that all (or nearly all) LEC redemption capacity is being used. Because of this, an import of more continental LECs may displace other UK LECs but should not alter the overall CCL income received by HMRC.

We believe that there must be integrity of the tax system and tax harmonisation issues. This might create confusion for the Fuel Mix Disclosure (FMD) because of the implicit pairing of the LEC and REGO. This may also complicate Green and Renewable and Low Carbon prominence in the Domestic and Business sectors.

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?

npower believes that the mechanism of only allocating LECs to explicit flow has the potential to distort cross border trading of electricity and capacity.

Imports would (and sometimes are at present) made to the UK which, in the absence of LECs, would not otherwise occur. We currently see this behaviour where interconnector import flows to the UK are reduced for the implicit portion of capacity, while the explicit imports remain. 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.

On regulation, we would expect such a restriction to be extremely complex to administer. Evidence of explicit flow across every possible border between a generator and a supplier would need to be checked, requiring coordination across many TSOs on the continent, potentially distorting trade at those borders too. As we move towards CACM and the EU Target Model interconnectors could (and arguably should) be scheduled entirely on the basis of implicit flow. Given that in such a world some electricity of overseas origin could still be consumed in the UK, such a restriction would not be viable, and as such could only be seen as a short-term measure.

In relation to questions 6.1 and 6.2, you requested further information to discuss the impact on:

- the electricity markets
- CCL and UK Renewable Electricity schemes, including FMD, FIT, CFD, and SLC 21D

As discussed above, we believe that due to the strong incentive to redeem UK-generated LECs, that there is little redemption capacity which is not used. As such we would not anticipate a significant impact on CCL

The Feed In Tariff benefit is part of a pooled arrangement: use of GoOs and associated LECs to avoid Feed In Tariff obligations reduces an individual suppliers' contributions where the contribution from the market remains unchanged. Given that all suppliers in the coupled approach have equal access to imported renewable electricity, no single large supplier should benefit more than another. It is possible that the number of small suppliers able to fully mitigate their liability to the Feed In Tariff payments would increase, which would then be picked up more by the remaining larger suppliers unable to do so.