

# Energy UK response to Ofgem's Consultation on proof of UK consumption of overseas electricity

14 March 2016

## About Energy UK

Energy UK is the main trade association for the energy industry, with over 80 members; representing energy generators and suppliers of all sizes. Our members supply gas and electricity and provide network services to both the domestic and non-domestic market. Energy UK members own over 90% of energy generation capacity in the UK market and supply 26 million homes and 5 million businesses, contributing over £25 billion to the UK economy each year. The industry employs 619,000 people across the length and breadth of the UK, not just in the South East, contributing £83bn to the economy and paying over £6bn annually in tax. Introduction

## Introduction

Energy UK welcomes the opportunity to comment on Ofgem's consultation on proof of UK consumption of overseas electricity. Ofgem's decision on market coupling and Levy Exemption Certificates (LEC), which was published in January 2016, stated that Ofgem would recognise that evidence of both explicit and unconstrained implicit trading may be used to prove that a given unit of overseas renewable electricity is consumed or to be consumed in the UK for the purposes of the Climate Change Levy (CCL) exemption for renewables.

This current publication on proof of consumption is consulting on three further aspects:

1. The specific evidence that may be presented for implicit trades

From the Energy Economics report, Ofgem has identified types of evidence that may be used to prove GB supply or consumption of overseas electricity under implicit trading.

2. The applicability of the CCL decision on implicit trade eligibility to other schemes

Ofgem states under para 3.3 that it is "minded to apply our decision to allow unconstrained implicit trading across coupled markets for LECs under the CCL scheme to Guarantees of Origin (GoO) recognition under the Fuel Mix Disclosure (FMD) scheme, feeding into similar determinations under the Feed-in Tariff (FIT) scheme."

3. The applicability of the new GoO recognition process to implicit trades

Ofgem states under para 4.5 of this consultation that it is "minded that the process will remain as per the GoO recognition process consultation that has just closed." As this 'minded to' decision refers to the GoO recognition process rather than the policy intent.

As this consultation closes on the 11<sup>th</sup> March 2016 we anticipate that it is unlikely that Ofgem will be able to publish a response before April. So although they have not given a blanket statement on the applicability to other schemes, based on the 'minded to' positions indicated above, we understand that the policy intent is to allow GoOs to be used against other schemes (i.e. FMD, FiT & Contracts for Difference (CfD)).

From the 1<sup>st</sup> April 2016 there is a cap in place restricting the ability of suppliers to offset FiT and CfD contributions. However, in 2015/16 there is no cap on the amount of GoO's that used to offset the FiT contributions of a supplier. This means that a supplier could potentially offset their entire FiT contribution using implicitly traded GoOs, leaving other suppliers to pay for the full cost of the FiT creating uncertainty in the market. This raises concerns both in terms of competition and industry best practice.

We consider that the potential impact from this gap in policy could be significant. It is therefore imperative that Ofgem provide greater clarity on what is meant by 'unconstrained' implicit trades and consider the impact implicitly traded GoOs could have on the robustness of other schemes.

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](mailto:kyle.martin@energy-uk.org.uk).

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## Response to individual questions

### **Question 1: Do you agree that the types of evidence we have identified are adequate? Do you foresee any problems with obtaining them, particularly if the power has been exchanged multiple times?**

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. We also agree that the 'limited assurance level' as defined in the ISAE 3000 (or equivalent) is suitable for the audit process.

We note that Ofgem has suggested that it may use half hour time periods for measuring the sale and purchase of electricity on a coupled market as evidence of implicit trading has not formally been consulted on. The Energy Economics report also did not propose the use of half hourly time periods for measuring the sale and purchase of electricity. With no formal consultation process we consider that this proposal could cause significant issues for industry where contracts for GoOs have been entered into. Ofgem should also consider that administrative burden of these proposals before making a final decision.

The evidence of implicit trades needs to be referenced to a specific half hour or an hour of trading (if this approach is taken forward). Any guidance from Ofgem should make this point clear. In particular, it is not clear what is meant by purchase on a power exchange in the 'same time period'. If the intent is for suppliers and participants to provide evidence of a unique trade, then unless this is defined to a specific hour or half hour of trading, there could be the potential that the number of GoOs presented for FIT exemption will not match the physical flow of electricity being bought in via interconnectors. This would lead to a potentially significant increase in consumer costs for compliance year 2015/16 as suppliers could purchase large volumes of European GoOs to offset domestic FIT costs. It would also have the effect of undermining the FMD for the same reason.

As this concept of using half hour time periods for measuring the sale and purchase of electricity on a coupled market as evidence of implicit trading was only raised at the Ofgem stakeholder event on the 7th March we have concerns that not all market participants will be aware of the issue. Therefore, if these proposal are taken forward Ofgem need to ensure this is effectively communicated to industry.

### **Question 2: Are you are aware of other specific types of evidence that they might present for these purposes? If so, what are they? Please be as specific as possible, and explain why you think this specific type of evidence would be adequate.**

We consider that the following types of evidence, as noted in the consultation, are appropriate for this purpose:

- Evidence of sale / purchase on coupled market:
  - Evidence of implicit sale of renewable on a power exchange within a coupled market country.
  - Evidence of implicit purchase amount of electricity by a supplier on a power exchange in the UK in the same time period.
  
- Matching GoOs for corresponding amount of renewable electricity cancelled for supply to GB.

Ofgem might want to also consider evidence of a contractual path between the GB supplier and overseas renewable generator. We would expect the contracts to make it clear that their counterparty/counterparties must ensure compliance with the legislation and guidance and have the data ready for Ofgem to scrutinise if it carried out any audits.

**Question 3: Are you aware of any issues that may preclude applying the decisions of the consultation on LECs and market coupling to proof of GB supply of overseas electricity under FMD, FiT and CfD as well? If so, please provide details on the issues you foresee.**

In 2015/16 there is no cap on the amount of GoO's that used to offset the FiT contributions of a supplier. This means that a supplier could potentially offset their entire FiT contribution using implicitly traded GoOs, leaving other suppliers to pay for the full cost of the FiT creating uncertainty in the market. This raises concerns both in terms of competition and industry best practice.

Once caps are put in place for the offsetting FiT and CfD obligations in 2016/17 there will still be an impact on suppliers with unlimited implicitly traded GoOs resulting in substantially higher risk margins for suppliers. Suppliers would find it very difficult to forecast what their market share would be under FiT and CfD, therefore, calculating their liability becomes harder. Ofgem should also consider how it notifies industry when the cap for the amount of GoOs which can be used to offset FiT and CfD obligations is reached.

**Question 4: Can you foresee any issues that may arise from maintaining the same process for LECs as per the 2008 CCL guidance? If so, please give details.**

No Comment.

**Question 5: Can you foresee any issues that may arise from maintaining the same process for GoOs as per the GoO recognition process currently being consulted on how implicit trades are permitted? If so, please provide details.**

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 CCL context ensures both schemes are consistent and that there is no double-counting of GoOs.

We consider that the existing process should be used where possible as it is beneficial to maintain a consistent approach to recognising GoOs. We also note that Ofgem's consultants are suggesting a fivefold increase in GoOs to be submitted for the year with revised guidance not likely to be updated until after April, therefore, we have concerns over the administrative process for industry, auditors and Ofgem.