

## Regeringskansliet

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### Centrica remarks on Energimyndighetens rapport Kontrollstation 2019 för elcertifikatsystemet (ER 2018:25)

Dear Madam/Sir,

Centrica welcomes the opportunity to provide comments on the 'Kontrollstation 2019' report issued by the Swedish Energy Agency (SEA). We hope you find its acceptable that we provide our comments in the English language. Centrica is instrumental in providing route to market to investors in renewable generation assets in the Nordics and other regions across Europe, therefore we have an interest in supporting our clients.

Centrica is not supportive of the proposal of the Swedish Energy Agency for a stop-date of the Electricity Certificate System (Elcert) in 2030. We are concerned about the stability of the framework and transparency in the governance mechanisms of the Elcert. These elements are key factors for investment decisions. We also believe that the SEA provided a poor analysis of the alternatives and their payoff against the objectives in the Kontrollstation 2019 report.

Finally, we believe that a decision by the Swedish Government as recommended by the SEA would have an unfair impact on existing plants with very limited benefits to consumers. We provide evidence about our views in the response attached.

Our preference is for a volume-based stop mechanism, or a date-stop in December 2021 (when the Norwegian scheme will close) as long as the targets have been achieved by this date. This solution can easily accommodate an early closure of the quota obligation and this would avoid overcompensation of late investors. This should be agreed between Sweden and Norway.

We remain available for any question you may have concerning this submission.

Best regards,

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### **About Centrica and Centrica Energy Marketing and Trading**

- Centrica is a provider of energy and services to more than 26 million residential and business customers across the UK, Republic of Ireland and North America. We also have a presence in several Continental European markets and expanding globally.
- Centrica is targeting four focus areas for growth: Energy Supply & Services, Connected Home, Distributed Energy and Power and Energy Marketing and Trading.
- Centrica Energy Marketing & Trading is the trading arm of Centrica. We trade gas, power and LNG and provide the route to market for our upstream and power generation operations.
- We provide our clients with the best route-to-market services available to the market today, integrating sophisticated software, trading and structuring and optimizing exposures all the way from long term risk management down to physical trading seconds before delivery. In the Nordics we operate in power, gas and energy certificate markets.
- Around 600 people work for Centrica Energy Trading in our offices in London, Denmark, Germany, Sweden and Singapore.

## Executive Summary

The Swedish Energy Agency (*Energimyndigheten*, or SEA) has submitted a proposal to extend the Swedish/Norwegian electricity certificate (Elcert) scheme for the third “review period” that was originally valid until 2020 (the Recommendation).

The joint Swedish-Norwegian Elcert system is already fully subscribed and the 2030 target for renewable investments may be reached by 2021. An extension for investments up to 2030 will lead to a permanent surplus of Elcerts and depress their value.

A final decision as proposed by the SEA will negatively impact investors’ confidence. Such a decision will primarily affect existing investments which relied on the market-based support mechanism of the Elcerts and its stability to recover investment costs.

- Stability and transparency in governance are key elements for investment decisions.
- The SEA contradicts itself proposing to extend access to Elcerts until 2030 while stating that income from Elcerts is not needed for future investments.
- The Recommendation has an unfair impact on existing plants.
- Consumers already benefit from relatively low energy prices; additional savings are negligible.

Centrica supports market-based measures to support investment in Renewable Energy Sources (RES).

- Centrica supports a volume-based stop mechanism or a stop-date in December 2021 (when the Norwegian scheme will close) as long as the targets are achieved by this date. The stop mechanism should kick in when sufficient Elcerts are issued, based on the forecasted quota obligation for the remaining years the Elcert system remains open.
- Lower investment costs for renewables should ensure that future investments will continue. However, low forward prices and deteriorated confidence in the framework are likely to slow down investments. Long term PPAs with corporate offtakers are very important, but they are not an infinite resource. Therefore, it is utterly important that investors can maintain confidence in the stability of the Swedish regulatory framework.
- Our proposal would more fairly meet the SEA objectives on the Government assignment by:
  - Allowing a more targeted achievement of the objectives and not overachieve by design.
  - Providing predictability by boosting transparency measures on future investments and relying on forward Elcert markets.
  - Minimising costs while achieving a fair and equitable solution: late investors are not overcompensated compared with early investors.
  - Retaining market stability by not oversupplying the Elcert market.
  - Functioning closely together with Norwegian stop-date.

On balance a volume based stop mechanism, or a stop-date in December 2021 if the targets are achieved by this date, would achieve the objectives of the SEA assignment in fairness.

We believe that the SEA has failed to demonstrate otherwise in its report.

## Centrica concerns

### 1. Stability and transparency in the governance mechanisms are key elements for investment decisions

- The SEA highlights in its report that ‘stable political conditions are also an important factor’ to ensure investment decisions. However, the Recommendation undercuts current investors who have developed renewable projects relying in good faith on the stability of the conditions.
- The Elcert market functioning is very peculiar: supply and demand of Elcert do not change according to price as in a normal market. Demand does not increase with lower price. Supply can only react by building *more* capacity in case prices are high.
- The mechanism of price balancing supply and demand is non-existent on the demand side and one-way on the supply side: the Elcert market must be managed to remain healthy. Without active and fair management, the Elcert system will either tend to zero or high prices.
- In this sense, the extension of the quota obligation for suppliers from 2035 to 2045 in May 2017 has been considered as a signal to foster investments in RES to achieve 2030 targets. A decision to extend the access to Elcerts to investments until 2030 would provide instead a signal in the opposite direction, less than two years after the extension of the quota obligation.
- Contradictory signals contribute to a lack of confidence in the stability of the framework: the fact that a substantial change can be introduced without proper impact assessment raises question on the robustness of governance for the Elcert regime.
- The Recommendation looks like ‘a shock to the system’ rather than a natural development to be attributed to technological and competitive developments.
- In substance, the SEA Recommendation achieves the same result of closing out the support scheme – especially for existing investments – without having to incur a formal decision to remove the mechanism.
- Finally, the SEA also underestimated the impact on forward prices of Elcerts for 2020 onwards that was felt shortly after the publication of its report at the expense of stability<sup>1</sup>.

### 2. Poor analysis of the alternatives and their payoff against the objectives

- The Elcert regime was introduced in 2003 as a market-based support mechanism to foster investments in RES. The SEA states that new investments do not need this support. Despite this, the SEA fails to justify why then it proposes to extend access to Elcerts until 2030.
- The SEA report is largely based on qualitative statements/opinions with only limited facts and figures on the potential benefits for society. The lack of analysis suggests that the intention of the SEA is in first instance to terminate the existing support by depressing Elcert prices rather than achieving target of RES production whilst interfering as little as possible in the market. In fact, the SEA Recommendation heavily impacts a fundamental part of the mechanism i.e. supply of certificates.
- The Recommendation is disproportionate: it would lead to a *substantial* overachievement of the RES targets, hence to a permanent surplus of certificates in the long term. This would not be an outcome by chance, but it would be sought through the (re-)design of the mechanism.

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<sup>1</sup> Elcert March 2021 contracts dropped from 52,5 SEK on Dec 17<sup>th</sup>, 2018 to 32 SEK on Dec 19<sup>th</sup> to 21 SEK most recently.

- The alternative mechanisms have been analysed only at high level and the SEA has not carried out a proper impact assessment – quantitative and qualitative – against the objectives of the assignment from the Swedish Government.
- In the Recommendation it is stated that investments in wind power are increasingly supported by long-term Power Purchase Agreements (PPA) which reduce risk for investors and ensure bankability of the projects. Long term PPAs with corporate offtakers are very important but they are not an infinite resource. Only a few large consumers are currently active in this segment and they will not be able to support the renewable growth indefinitely.
- The SEA has not analysed if the level of forward prices is sufficient to incentivise further uptake of renewable investments. Our view is that the current levels do not make new investments commercially viable. This view is also confirmed by typical investors who have publicly stated that they will redirect their investments in renewables away from Sweden and Norway.
- The SEA acknowledges that in recent years there has been a large increase in foreign investment capital. However, the request for input to the SEA review has not been widely publicised, nor has the documentation been published in English for easier stakeholder involvement.

### **3. Unfair impact on existing plants and recent investment decisions; limited impact on consumers**

- After nearly a decade of steady cost decline for solar and wind technologies, renewable power is increasingly competitive.
- In an environment characterised by levelized costs, maintaining the access to Elcerts for new investments to 2030 will significantly damage existing renewable energy projects and the future investment climate.
- The SEA admits in its report that the current levels of RES generation have been largely driven by the Elcert regime at least until 2017. This is because investors have relied on the framework to deliver market based incomes for a substantial period.
- Existing investors are unable to take advantage of the decreasing cost of renewables that is driving Elcert prices down because their investments have been already made.
- Existing investors may have received greater support than others through Elcerts as stated by the SEA, but these incomes are for the purpose of recovering investment costs rather than making additional profits. These projects will no longer be financially viable under the SEA proposal and developers will face the risk of bankruptcy.
- Consumers already benefit from relatively low energy prices and especially large-scale industrial consumers who remain exempt from the Elcert system.
- The Elcert system was expected to cost 40 billion SEK, with the current suggestion it will only cost 20 billion SEK<sup>2</sup>. The estimated additional savings highlighted by the SEA of 7 billion SEK over a period of 25 years do not consider the value lost by the lack of confidence in the investment environment in Sweden.

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<sup>2</sup> See Prop. 2005/06:154, where the price for each Elcert was expected in the range between 100-400 SEK; the current long term prices for Elcerts are in the range of 10-20 SEK/certificate.

- A typical Swedish household would only save 13-19 SEK/year (1.19-1.8 EUR/year)<sup>3</sup> on their electricity bill for the period 2019-2045 at the expense of the stability of the investment climate. This is not a substantial cost decrease to Swedish consumers considering the incredible achievement of 46.6TWh of electricity produced by RES in the early 2020s’.
- Given that current forward prices are not sufficient to attract further investments to meet new targets, we are concerned that forward prices will now have to increase further to compensate the effective dissolution of the Elcert framework.

## Centrica alternative proposal

- Centrica supports market-based measures to support investment in RES.
- Centrica supports a volume-based stop mechanism or a date-stop in December 2021 as long as the targets are achieved by this date. The volume-based stop mechanism should kick-in when a sufficient volume of Elcerts are issued to cover the estimated quota obligation until the closure of the system. This should be agreed between Sweden and Norway.
- This solution should also accommodate an early closure of the quota obligation. It would seem strange to continue the Elcert system until 2045 even though the target has been achieved some 25 years before. The administrative cost would largely outweigh benefits.
- In this way it is also ensured that the targets are achieved by minimising costs while achieving a fair and equitable solution: late investors are not overcompensated compared with early investors, because they would receive Elcerts for a shorter period.
- Terminating the regime shortly after the political objectives have been achieved would provide fair market conditions for existing projects, especially early investments.
- Lower investment costs for renewables will ensure that future investments will continue if investors can maintain a high degree of confidence in the stability of the regulatory framework.
- A volume stop mechanism would more fairly meet the SEA objectives on the assignment:
  - Contribute to goal achievement: a volume stop would allow a more exact achievement of the target and not under/overachieve by design.
  - Good predictability: it could be argued that the time of closure of the system is uncertain, however the SEA transparency measures can be further improved. Forward Elcert markets provide further transparency on price signals. The predictability under the SEA proposal is achieved only because the value of Elcerts would tend to zero.
  - Function together with Norwegian stop-date: under the most likely scenario the Swedish targets will be achieved shortly before or shortly after the Norwegian stop-date. The fairness of the regime would be maintained both for Swedish and Norwegian plants if the dates are aligned.
  - Retain the principles of the Elcert system (market-based, cost effective, technology neutral and with no impact on public budget): a volume stop mechanism would ensure a better reflection of the underlying market conditions and retain market stability.

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<sup>3</sup> This estimate is based on a total savings of 7 billion SEK over a period of 25 years with a ‘captive demand’ of Elcerts or around 173 TWh/year and an average household consumption of 7,750 kWh/year.

The negative implications of a volume stop mechanism raised by the SEA can be easily counterargued:

- The discrimination for Swedish new plants is unlikely: although possible, it is not the most likely scenario that additional 22TWh will be built in Sweden before the stop mechanism in Norway will be entering into force. As expected by the SEA the base case scenario is that (only) 16TWh will be operational by 2022. On the contrary the discrimination towards existing plants or investment already made would be a certainty.
- In addition, a volume stop mechanism as we suggest would not
  - slow investments: we do not believe that a volume cap or an earlier date-stop would slow down additional investments in RES production. These would rely on the stability of the Swedish market and the forward market price signals.
  - lead to major costs for consumers: the SEA claims that the effect of maintaining a balance between demand and supply will lead to major costs for consumers. This conclusion lacks consideration for early investments that had been made when technology was less mature and more expensive.
  - provide redistribution in favour of late investors: ensuring that the stop mechanism would kick in based on the amount of Elcerts needed and that the quota obligation can be terminated in advance would avoid the risk of favouring late investors.
  - discriminate Norwegian new plants: under the Recommendation the disadvantage for Norwegian power plants will be the same for any plant after the Norwegian stop-date. Under the current SEA proposal this would be for 9 years.

## Conclusion

On balance a volume based stop mechanism, or a stop-date in December 2021 as long as the targets are achieved by this date, would achieve the objectives of the SEA assignment in a fair manner.

We believe that the SEA has failed to demonstrate otherwise in its report.

A holistic approach or a potential plan for the decommissioning of the electricity certificate system with fair allocation of the value of the Elcerts would be preferable to the proposal put forward by the SEA, but this would need time to be developed.

## Additional points

A proper qualitative and quantitative Impact Assessment is needed: since the announcements, forward prices for March 2021 deliveries of Elcerts collapsed about 54%<sup>4</sup>. The SEA should look at international examples where the settlement of similar regimes has been carried out.

The SEA should run an inclusive process with wider involvement of stakeholders, including foreign market participants. It would be good practice for the next steps, events, decisions and documents related to the Elcert framework to be available (also) in English.

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<sup>4</sup> See note 1.