

## COMMENTS FROM IBERDROLA TO THE CEER CONSULTATION ON GENERATION ADEQUACY

27th of April 2010

Iberdrola agrees with the statements in the CEER proposal as well as with EURELECTRIC comments to this proposal, but we would like to make some additional remarks in the following sense:

- Iberdrola believes that a well functioning market is more efficient and more desirable than a regulated environment. As a consequence, electricity market should be managed based mainly on market rules trying to avoid as much as possible regulatory interferences.
- Nevertheless, we must recognize that current and future environmental constraints are going to require a policy/regulatory intervention. GHG reduction commitments as well as other emissions limitations, together with goals in the penetration of renewables are configuring a market very different from the original design.
- Accomplishing CO2 objectives will involve investments in CO2 free technologies such as renewables, nuclear or CCS. All of them will require a positive policy/regulatory climate which in turn will affect the rest of technologies. It is important that the level playing field, distorted by this regulatory intervention, is restored at least partially.
- Electricity sector is capital intensive and assets are due to recover their investments costs during its long-lasting useful live. This means that decisions are made taking into account the most probable evolution of the market in which the assets will develop. It is therefore essential to have a clear perspective of the future regulatory environment. Changing regulatory situations make risk perception bigger and as a consequence, costs will be higher and this can lead to a situation where even decisions to invest will not be made. European environmental regulation is changing in 3 to 8 years period and investments in 25-30 years-life power plants have to adapt to new situation without any compensation.
- Some European markets are (and most will be soon) experiencing a situation in which investments made under certain framework are obliged to survive under a completely different environment. In some markets, subsidized renewable energy having priority access to the grids is reducing the planned energy output of thermal power plants. For this reason, thermal plants will have to run in a different way than was forecasted when built, because most renewables are of intermittent nature and the system needs thermal plants as back up and to provide load and frequency

regulation services: much less number of fired hours; a higher number of startups and close downs; running many hours at a minimum far from its optimal output; etc. This in turn will affect the reliability of the plants and, in the end, to the reliability of the system.

- It is very unlikely that markets by its own, i.e. energy only markets, will be able to cope with this situation. Some markets have even additional regulatory distortions such as price caps and constraints to decommission or even mothballing plants, as it happens in Spain. Moreover, in Spain it is also forecasted to give priority of dispatch to indigenous coal, putting the rest of thermal plants (gas and imported coal plants) in even worse situation.
- The generation mix should be adapted to the new situation, but there are at least two big difficulties: first, many of the plants now in service have been recently built, so they still have a lot of time left to recover their investments; second, and more important, these plants have proven to be necessary to keep the system secure as back up. In summary, there should be fair expectations to recover the costs of these plants.
- From all these evidences, it seems clear that in general, or at least in some markets, it is important to review markets arrangements, considering the necessity of complementing income from the energy market with some kind of extra remuneration for the services of regulation and back up.
- In summary, Regulators/Governments should take into account the following issues:
  - Existing plants are necessary to keep the system reliable
  - Existing plants are (or may get into) in a difficult economic situation (which will get worse in the future) since revenues from energy markets are not allowing the appropriate return (some countries with negative prices; others with a large number of hours at zero price)
  - Investors may see that regulatory intervention has changed market rules and return on properly made investments has become almost impossible
  - Security of supply may be put at risk on these aspects:
    - Some of the existing plants may be decommissioned or mothballing, since they are not able to recover even operating costs
    - New investments will be necessary: new thermal plants to allow the penetration of intermittent renewables; and new CO<sub>2</sub> free plants. Both type of installations require a stable and predictable regulatory framework
    - These new investments may not come on line if the regulatory risk perceived by investors is high, with severe negative consequences on the security of supply.

- Regulatory scheme should take care of this situation in a manner that restores the non-discriminatory situation for all the plants, allowing them to recover costs from a properly designed market. Some market models can need capacity payments to work well.
- Security of supply needs a stable regulatory framework and a long term energy planning which give potential investors the needed clear signal to proceed with the appropriate investments. As an example, in Europe we have two objectives of reducing GHG emissions by 20% and to reach a renewable penetration of 20% respectively. But, it is possible that this reduction of CO2 objective may increase up to the 30%. This new objective will certainly mean a higher proportion of low carbon production of electricity and might require at its turn to review the objective for renewables. Equipments needed on these two different situations are different and the signals for future investments should be as clear as possible. It is important to stress that investors are due to compete among themselves for a place in the market, so that better and more efficient plants will be in service at any time, but it is impossible for them to compete against regulatory decisions that cannot be anticipated on the right time.
- Lastly, it is important to remark the importance of interconnections related to the security of supply. Countries with large capacity of interconnection are in a situation which allows them to rely on imports in moments of stress in their systems. But peripheral countries, or/and those having a limited capacity of interconnections with their neighboring countries should treat security of supply from a different perspective since they have to assure the supply mainly by their own means, and therefore they should be more cautious when dealing with investments in infrastructure needed for future supply. This situation worsens if constraints are set on imports and full import capacity is not utilized, as is the case in the France-Spain interconnection. European authorities, Commission as well as Regulators, should take a clear move towards promoting more interconnections, at least where these situations occur.