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ERGEG

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Regulation (EC) 1228/2003 Compliance Monitoring – Second Report by ERGEG

Dear Sir, Dear Madam

Centrica welcomes the opportunity to contribute to ERGEG's September consultation on the second report on compliance monitoring with Regulation 1228/2003. This general response that may be placed on the ERGEG website is supplemented with a confidential appendix containing more specific information.

Centrica is a strong advocate of European energy market liberalisation. In addition to our activities in our home market of Great Britain, Centrica's existing European electricity activities are concentrated in the north west of Europe in the Benelux market area and more recently in Germany. We are also active in the Spanish market and participate on the French wholesale market. Thus we have visibility of a number of electricity markets and interconnectors.

Essential in the development of liberalised market is a consistent compliance by undertakings with the legal and regulatory requirements placed upon them. Thus compliance monitoring by national regulatory authorities is a key assessment tool of market liberalisation and the development of competition.

Centrica considers it important that compliance is assessed on a regular basis by the national authorities and that the lessons learned are shared between them in the interest of developing a consistent implementation of the European legislation and regulation, and facilitating the development of the single energy market.

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Our response follows the structure of the consultation document itself.

I trust that this general response and the confidential appendix are helpful. Please do not hesitate to contact me if you would like to discuss any issues raised in more detail.

Yours faithfully,

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Regulation (EC) 1228/2003 Compliance Monitoring – Second Report by ERGEG

A Centrica Response

1 General Comments

Question 1 – What are most effective and rapid actions achieving compliance where non-compliance and deviations from the legal provisions in the Regulation and the CM Guidelines have been identified.

Whilst the report does monitor compliance across interconnectors with the requirements of the legislation and guidelines, it portrays this only in terms of a percentage figure. The method by which this figure has been arrived at for each interconnector is unclear. Neither are there any explanations of what particular aspects are deemed non-compliant, nor potential reasons for this. Without such information it is difficult for individual respondents to comment on the most effective and rapid actions for achieving compliance where non-compliance is presently the case. Furthermore, in some instances, projects may already be in place through which compliance will be improved or even ensured. This is not reflected in the monitoring report.

ERGEG has included a number of recommendations in the report. These range from actions for the Commission to more detailed ones for network operators, from longer term initiatives to more rapid actions. Such a breadth of recommendations is to be welcomed, for a combination of actions will be necessary to help resolve the variety of issues facing electricity interconnectors across the EU.

Where possible, solutions should build on existing policies and processes. In the area of transparency for example much has been done, especially in some regions, on implementing the advice contained in ERGEG's Guidelines for Good Practice on Information Transparency. However whilst information is now often published, it is not necessarily always correct or placed in an accessible location in a user friendly format. It is essential that websites are clearly identified and navigable. Similarly, compliance should also assess how accurate data is and how often it is updated. We provide some examples on this in the confidential appendix.

In the area of information transparency, much of the information needed by market participants is already held by transmission system operators (TSOs). As ERGEG states, TSOs are in a key position as market facilitators and bear a high responsibility for the implementation of the Regulation and CM Guidelines. As they already hold much of the required information a quick solution is to require the TSOs and their associated auction bodies to make the information public, also setting out the manner and method as well as the timetable for publication.

Once rules for publication of such information are approved, it is imperative that they are published and market participants made aware of the new conditions under which they must operate. In some instances this does not

occur within the expected timescales. An example is contained in the confidential appendix.

It is essential that governance is harmonised between national regulatory authorities in order that they can jointly address concerns and other issues on interconnectors. Small improvements in this area could lead to substantial benefits.

The additional duties and powers that are envisaged to be awarded to national regulatory authorities through the third energy package will greatly assist the monitoring and enforcement of compliance with legislation. It is likely that some incidences of non-compliance currently exist due to the low level of regulatory powers and hence the inability of some regulators to engage as constructively as others with market players. It is hoped however that national regulatory authorities and transmission system operators will be encouraged by the third package to address problem areas in advance of formal implementation of the package.

Question 2 – Do you have any suggestions on any further needs for more precise and detailed provisions in the Regulation and the CM Guidelines, possibly also beyond the findings in the Second Compliance Report.

It is understood that some of the difficulties of implementation and compliance stem from difficulties or differences in interpretation of the legal text. ERGEG has already carried out work in some areas to provide additional explanation and clarity on the legal text and this should continue. Similarly the formalisation of new Guidelines would be beneficial, adding to the CM Guidelines already in place. By consulting with market participants in the preparation of such explanations, ERGEG can help ensure their applicability in market operations.

ERGEG itself states that on occasion there is too much room for interpretation given in the present legal framework. It would be beneficial to see ERGEG's interpretation of these areas and a consultation with market participants to engage on how to address these issues both at EU level but also at national level where implementation takes place.

As priorities, we would encourage the development of explanatory notes and guidelines for transparency and firmness of capacity, building on work done by ERGEG in developing Guidelines for Good Practice and position papers.

Other areas where we would welcome regulators' advice are curtailment and flow management rules.

Currently TSOs only have to reimburse to a value of 100% or 110% of the booked interconnector capacity when there is a curtailment. It could be argued that this should be more punitive and should increase as we get closer to the nomination day. This would incentivise the TSOs to reduce and plan outages in advance. It would also better cover the cost of un-hedging positions by market participants. It could also be argued that a figure of even 110% does not fully reflect the opportunity costs to the supplier of having to

undo its position on both sides of the border following a curtailment notice by a single TSO.

As a basic rule of thumb, the country from where the power is flowing is the authoriser, and the country of import should accept the decision on flow management. This does not always work in practice. We have numerous examples of flows being authorised by the exporting TSO, only for the importing TSO in the neighbouring Member State to reject it without providing any reason to the exporting TSO or the rest of the market. This occurs although the capacity is available and the price spread dictates that the flow direction is optimal. At the very least, we believe that the basic premise of authorisation of flows should be agreed upon between the TSOs and that where flows are rejected, reasons should always be provided. Due to tight deadlines, trading is done on the basis of receiving notice of flow authorisation from the outbound TSO. Rejecting flows is detrimental to the market and trust placed in the market rules by participants.

Further examples of rejected flows are contained in the confidential appendix.

Linked to this issue is that of compensation for non executed trades on interconnectors where the fault is proven to lie with one (or both) of the national network operators. In some instances, TSOs refuse to acknowledge errors in their operations that have led to trades not being executed. These issues are beyond those of unexpected capacity reductions (which are compensated for those agents who have purchased capacity rights) and are due to operational mistakes and failures such as the TSO not processing a trader's schedule or bid properly. We would question the right of a TSO to refuse compensation for direct damages and opportunity costs in such an instance.

In reference to the Triad system, we believe that this system should be reviewed and removed as it works against market competition and reduces market efficiency. For the whole Triad period, regardless of actual market conditions between France and the UK no-one will risk any flows out of the UK in block 5 in order to avoid the triad cost.

2 Specific Comments

There is a lack of detail in the report on the basis by which national regulatory authorities have made their assessments. Further information would be beneficial to market participants. How the individual percentage terms have been arrived at is unclear. Each individual item is not likely to merit the same weighting when assessing overall compliance by an individual interconnector. It would thus be beneficial to understand the reasons behind any weighting calculations carried out. This could vary by interconnector to take account of the relevance of any particular issues for the Member States concerned. For example where congestion does not occur, the weighting of any criteria assessing compliance with congestion management rules should be nil or at least very low.

In some instances it is stated that national regulatory authorities do not consider the legal text to be applicable. Again, it would be beneficial to understand the reason behind such a statement. We believe that any such statement should be justified by the authority and/or transmission system operator.

Where a particular element of the Regulation or Guidelines is genuinely not applicable to a particular interconnector, then this should be clearly stated and the EU wide compliance figure be based only on the remaining interconnectors which are required to comply with that particular element. Otherwise, the inclusion of non-applicable data will distort the overall compliance assessment. Where an element is not applicable then the tables provided in the annex of the report should state 'Not Applicable' rather than 0%, which would also be the statement for non-compliance where it is legally required.

It is clear from the report that there remain varying degrees of interpretation of the legal text by the national regulatory authorities. Where regulators cannot agree on the legal interpretation, it is difficult to see how a coordinated approach for regulating and monitoring the interconnector can follow.

Where interpretation difficulties occur between two neighbouring national regulatory authorities, we would encourage the use of a college of regulators to carry out the interpretation and monitoring. Such a college should include the regulators of the countries involved but also at least one independent regulator.

The Regulation allows interconnectors to use the revenue from congestion in one or more of three ways – guaranteeing the firmness of allocated capacity; investment to maintain or increase interconnection capacities; or as a source of income to be taken into account when the regulator approves network tariff methodologies. The report sets out the ratios chosen for each of these options by each national regulatory authority. It would be interesting to understand the reasons behind these ratios and in particular whether they are kept constant for each interconnector. Given that assuring firmness of capacity is considered such an important issue, it could be seen as surprising that only three regulators allocate any portion of interconnector auction revenues to ensuring firmness of capacity, with one regulator only awarding 2%.

In some instances, national rules may limit the operator's allowed revenues, via a price control process or similar mechanisms. In the absence of such limitations where prices are determined via auctions, we do not believe that the national regulator should be allowed to intervene unless it has proof that the auction itself was flawed. Thus, a national regulator should not be permitted to take any 'corrective' action; if it merely considers the auction price to be too high (or indeed too low).