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CEER

By email: generation_adequacy@ceer.eu29th April 2010**CEER Call for Evidence on Generation Adequacy Treatment in Electricity**

Dear Sir, Dear Madam

Centrica welcomes the opportunity to respond to the call for evidence issued by CEER on generation adequacy treatment in electricity.

Centrica supports the work of CEER in the development of energy liberalisation across the European Union. As a company active in the European electricity markets, Centrica has contributed to a number of CEER consultations in the past on a variety of subjects.

In response to this call for evidence, we put forward responses to each of the three questions raised in the CEER document. I trust that you find this response from Centrica helpful. Please do not hesitate to contact me if you would like to discuss any issue raised in more detail.

Yours faithfully,



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CEER Call for Evidence – Generation Adequacy Treatment in Electricity

A Centrica response

Introduction

Centrica welcomes the opportunity to respond to the call for evidence issued by CEER on generation adequacy.

In the coming years the generation sector across Europe will change, in response to national and European legislation and policies. Renewable energy will be at the core of this development as the market moves gradually away from the traditional generation model.

Centrica agrees with the general direction of the CEER paper. In particular we agree with the message that the market principle is fundamental to the generation sector and that it is important that the market continues to be seen as the best means of absorbing the various messages from both demand and supply and giving out the clearest and necessary signals to stakeholders.

We thus believe that the best way to ensure adequate electricity generation and sufficient investment across the energy industry is through competitive markets, where market stakeholders respond to market signals. New legislative and regulatory initiatives are underway that may alter these market signals and impact future investment choices, but it is essential that they are not distorted or weakened to such a degree that operational and investment decisions are taken that could adversely impact future security of supply.

Question 1: What are the key elements for ensuring generation adequacy in the competitive electricity market in EU MS and the EU as a whole?

The challenge in the years ahead will be striking the right balance between the operation of free market forces and market intervention. This balance must be achieved in such a way as to minimise regulatory distortions to the market. For this the electricity sector requires both certainty and stability in the market framework, where any amendments are introduced in a transparent manner. Modifications should also be conducted to harmonise, where needed, the market structures across Europe; a crucial step in evolving towards a single electricity market.

A number of recent legal and regulatory initiatives will be implemented in the years to come that will impact the electricity sector. Not least among these are the third package and the green package of legislation, both of which were passed in 2009. Upcoming EU legislative developments that will similarly touch the electricity sector will include the Industrial Emissions Directive, a range of financial regulations that will inter alia cover electricity derivatives, and a new pan-European market abuse

framework. All of this will mean increased regulatory oversight of the energy sector by energy, competition and financial regulators at national and European level. In order to avoid unnecessary market distortions and regulatory overlaps, it will be imperative for regulators to coordinate their activities.

The policy objective of low carbon generation has been superimposed on the electricity market at both national and European level. The growth in renewable generation especially will cause new issues that need to be managed by market stakeholders.

As already stated, renewable electricity will be at the core of many of the changes in the generation sector in the years to come, both directly and indirectly. Intermittent technologies such as wind and solar will form an important part of this. It is therefore paramount that an agreed methodology is developed for managing intermittent renewable generation for capacity reasons.

Interconnectors will also be crucial in the development of the internal market and in helping to manage the issue of intermittent generation. It is however important to note that problems of intermittency will not necessarily be conveniently contained within national borders and investment in interconnectors alone will not resolve the intermittency issue. Nonetheless it is important that existing interconnectors are used in an optimal manner, that all capacity is made efficiently available, that sufficient transparency around capacity exists and that necessary investment takes place in new interconnectors in a timely manner. This is true not only for electricity but also for gas, as gas is an important input fuel in electricity generation.

If a decision is made to monitor generation adequacy, it is imperative that a commonly agreed definition of adequacy is first developed in consultation with the industry. A consistent approach across the EU will be necessary to avoid distortions to generation investment and operations. The boxed statement within the executive summary of the CEER document states only that generation adequacy is where 'sufficient generation capacity is available to meet demand, taking into account network constraints'. If CEER or individual regulators are to actively monitor adequacy, more detail is needed to ensure a robust and transparent monitoring assessment is undertaken. In particular, the issue of intermittency must be taken into account.

As a result of market monitoring by regulatory authorities, we would expect to see a thorough consultation process undertaken prior to proposing any changes to market rules, as suggested in the CEER document. As regards market abuse, we would trust that any measures introduced to lessen the risk of market abuse would be drafted in cooperation with competition and financial market authorities to limit regulatory overlap or conflict.

Question 2: Do you observe any barriers for investing in new generation capacity? If yes, please list and explain them.

Investors face a number of challenges when assessing the viability of projects in the electricity generation sector. We set out below a number of relevant concerns.

As stated above, renewable electricity will be at the core of decisions in the wider generation market in the years to come. Many of the challenges encountered in the generation sector also relate to renewable policies and legislation, not least the priority given to renewable generation.

Return on investment in electricity generation is recovered over a long period of time. Therefore, investors need regulatory certainty; they wish to have visibility of policies and market rules as far ahead as possible. The current timeframe for certain renewable and carbon related policies is relatively short, for example there is no visibility of the carbon market framework beyond 2020. An enduring and robust carbon pricing regime would greatly facilitate investment decisions. Similarly possible uncertainties relating to renewable support mechanisms can also hinder future investments.

Centrica supports the development of renewable electricity, and is a keen investor in the sector. However it must be noted that policies in favour of renewable technologies may also distort signals for other technologies. The pursuit of a low carbon economy and increased penetration of renewable energy will change the generation mix over time. Traditional carbon based fuels will be increasingly used as flexible, supporting, back-up generation to intermittent wind generation. Care must be taken that market signals are not weakened to such a degree that necessary complementary investment in fossil fuels such as CCGTs does not take place or that existing CCGT plants close earlier than operationally necessary.

An increase in prices is never welcomed by customers. However the policy objective of a low carbon energy market will undoubtedly lead to higher prices. This must be accepted by legislators and regulators alike, who in turn must support energy companies when this is communicated to customers. Not only are prices expected to follow an upward trend, but the occurrence of price spikes is also expected to increase in response to the higher volume of intermittent generation on the system. Both these price signals will be necessary for future operational and investment decisions. Therefore, any regulatory intervention that seeks to dampen such price fluctuations could be harmful to future security of supply.

For supporting, flexible back-up generation, it is essential that price signals are clear to avoid any unnecessary shortages of power. It is important that generators are encouraged to produce during tight periods and that regulators can be confident that market abuse does not take place. However, it must also be noted that it is not beneficial to force generators to run when the spark spreads are uneconomic.

It must be recognised that regulatory investigations into wholesale markets, as have taken place in a number of Member States, themselves have potential effects on the market. Not only may there be sanctions placed on individual companies, there are also implications on the wider market, which may judge such regulatory investigations as introducing additional cost and risk, and decide against future investment.

Another regulatory intervention that distorts market signals and impedes new investment is the existence of regulated end-user prices which persist in a number of Member States. It is essential that suppliers can pass on the full cost of power to their customers, except as may be necessary for tightly defined groups of vulnerable customers. Thus regulated retail prices, especially those set below market prices, should be removed.

Difficulties and delays in gaining planning authorisation often feature in the list of obstacles to investment in all types of generation. This not only includes delays in the building of plants but importantly in the construction of connection lines. Concerning the latter, it could be asked whether anticipatory investment should be considered in some regions.

Other impediments include inequitable congestion management rules. The resolution of this is critical for optimal transmission of electricity and to enable trading of electricity across markets.

Question 3: In case of additional measures for ensuring generation adequacy, what would be the key issues to take into account?

Before deciding on whether any additional measures are required, there must be absolute clarity on the objective. The key question is 'what is generation adequacy, and how is it to be measured?' Once the objective is established, the options for meeting the objective must also be commonly agreed. If intervention is deemed necessary, then the consequences of any proposed measure must be fully assessed across the whole market. A thorough impact assessment and consultation with market participants is therefore of paramount importance if any additional measures are to be considered.

In deciding on generation adequacy, it is not simply a question of volume but the range of generation that is needed to meet market needs: baseload and peak plants, shaped or flexible supplies and highly responsive plant to meet frequency or intermittent requirements for sufficient durations. Together these all contribute to an adequately provided generation sector and security of supply to customers.

In our view, all technology options should be available for investors to consider, taking into account the market framework and resulting market signals. Unnecessary legislative and regulatory interventions will distort market signals, hinder investment decisions and may ultimately adversely impact future security of supply.