

SUBMISSION FROM CENTRICA

Executive Summary

- Centrica is a global energy company with a strong Scottish hub. Our exploration and production headquarters are based in Aberdeen.
- The UK is facing energy security challenges in the coming years, particularly maintaining adequate electricity supplies.
- We believe that to maintain UK electricity supplies we need an effective capacity market that procures sufficient volume in the coming years. This should be a key priority across the UK.
- We also need to secure the future of the North Sea, to ensure long-term domestic supplies of UK gas for electricity and heating and to maintain the jobs and economic contribution of the sector.

1. About Centrica in Scotland

Centrica would like to thank the Economy, Energy and Tourism Committee for the opportunity to provide evidence on Security of Energy Supply. We are happy to provide any further evidence or information should the Committee want it.

Scotland is one of Centrica's major hubs and Aberdeen is the home of our UK and NL exploration and production business, where we employ over 400 people in the city and produce enough gas to meet the annual demand of over three million homes.

Centrica secures energy supplies from across the world for the UK and creates jobs and investment in Britain as the UK's largest energy supplier. Independent economic analysis of our business shows that we:

- Support £2.7bn of Scottish GDP¹
- Buy £1.6bn worth of goods and services from over 750 Scottish businesses
- Support 22,000 Scottish Jobs, including our supply chain and induced job creation

The North Sea will continue to be a key part of our portfolio and we will invest further in the region to help maximise its potential. Additionally our power generation business includes a 20% interest in the Torness and Hunterston B nuclear stations, which together meet 46% of Scotland's electricity demand. Our UK wind portfolio also includes a 50% stake in the 26MW Glens of Foudland onshore wind farm which meets the demand of 16,000 Aberdeenshire homes.

As well as our upstream business, our Scottish Gas downstream division supplies energy to around 800,000 households and provides energy services to around 500,000 households.

¹ The Economic Impact of Centrica in the UK (2012) Oxford Economics.

2. Centrica Response to the Four Inquiry Themes: Supply, Demand, Transmission Network and Market Functioning

2.1. Supply

Supply and whether there is sufficient generation to meet demand, in particular to the end of the decade. What role will new generation that is under construction, or has been consented play? The Scottish Government aims to have a “largely decarbonised electricity system by 2030”. What does this mean in practice, and are there sufficient tools in place to bridge the move from fossil fuels to renewables?

We recognise there are security of supply challenges across the whole of UK, and that the Committee is aware of these. Up to one-third of the UK power generation fleet is expected to come offline by 2020 due to age or environmental regulation. Additionally, North Sea gas reserves continue to dwindle.

The Capacity Market is the right mechanism to secure GB² electricity supplies, but it is critical that it procures sufficient volume and ensures investment in new power stations. National Grid relies on flexible gas capacity being available to back up renewables when they are not generating. This means that there are gas-fired power stations that don't run for much of the year, but are vital to keeping the lights on. A consequence of the growth in intermittent renewables has been the creation of a loss-making environment for gas stations in the UK - evidenced by the number of plant closures and very little new investment in gas generation. The Capacity Market should address this challenge as gas fired power stations are the right technology to transition us from a high to a low carbon world over the next 30 years. Gas is a bridging fuel, producing half the emissions of coal, that will help the UK meet its carbon reduction targets.

The increased presence of intermittent renewables on the system will require National Grid to also manage short-term fluctuations in generation output to a greater extent than today. These fluctuations are, and will continue to be, managed by National Grid through procurement of balancing services, such as STOR and SBR. National Grid should continue to review the merits of these measures. However, if these measures do continue to be implemented they should be done on a UK market wide basis – as procurement of balancing services on a national or regional basis will tend to result in higher costs, as competition to provide the services will be diminished.

2.2 Demand

How predictable peak demand is at present, and how is this likely to change in the coming decade. In particular, what impact will the

² The Capacity Market applies to Great Britain – Scotland, England and Wales. Northern Ireland is part of a single electricity market across the Republic of Ireland and Northern Ireland.

development of demand side response have? What could be done to improve developments in this area?

We advocate a prudent approach to procurement in the Capacity Market that factors in the possibility that demand could exceed expectations, and the contribution of wind output at times of peak demand could be relatively modest. It is important to recognise the uncertainty around peak demand when determining the level of capacity to be procured.

The exact contribution of demand side response to reducing peak demand is difficult to estimate. The attraction of the Capacity Market is it allows demand side response and generation to compete to provide capacity on the basis of price. Therefore, the amount of demand side response that ultimately comes forward will depend on its economic competitiveness with generation.

2.3 Transmission Network

A number of new transmission network projects are currently under construction or being planned. What role will these have in securing electricity supplies, and where should future investment be directed? What role might the distribution network, and a single European electricity market play in securing supplies?

The large transmission network projects currently in train will increase transmission capacity within Scotland and between Scotland and the wider GB market. These projects strengthen the case for GB wide security of supply solutions, as generation capacity in one part of GB can more easily serve demand in other parts of GB with an enhanced transmission network. An enhanced transmission network also facilitates GB wide competition for balancing services, which in turn should reduce the need for procurement of balancing services on a regional basis and help drive down costs.

We nonetheless recognise that transmission and distribution network upgrades create costs to consumers in their own right, and must therefore be subject to careful economic appraisal before they are sanctioned.

2. 4. Market Functioning

A number of significant changes to the electricity market have recently been finalised and are being put in place to ensure competition and cost reflective prices for consumers. Are policies such as the Capacity Mechanism under Electricity Market Reform adequate, and what other long-term signals might be necessary to ensure security of supply?

We support the GB-wide Capacity Market and believe it should be the single instrument for achieving security of supply. The auction process for procuring electricity supplies in the Capacity Market increases competition and will reduce costs to consumers.

However, once the Capacity Market starts delivering (from October 2018) it should be the single mechanism for ensuring sufficient electricity supplies. Balancing services such as STOR should not be expanded / modified to provide capacity, and SBR, which is designed to procure capacity in the short term, should be phased out as the capacity market comes into force, therefore leaving one transparent market for procuring capacity.

We believe long-term investment signals should continue to come from the availability of longer-term agreements in the Capacity Market. Agreements of up to 15 years are available to new capacity that meets the criteria set out in the Capacity Market Rules and Regulations.

2.5 Additional Matters

Any other matters concerning security of supply that you would like to bring to the Committee's attention.

The UK relies on North Sea oil and gas for approximately half of all oil and gas used in the UK and will continue to need around 70% of oil and gas until 2030. Offshore oil and gas production has fallen by almost two thirds since its peak 15 years ago and this trend is set to continue over the coming years, increasing the UK's reliance on imports.

A stable fiscal and regulatory regime is vital for ensuring continued investment in the North Sea. The 2015 Budget announced a number of positive measures, particularly the reduction in SCT. Also, the Government's implementation of Sir Ian Wood's recommendations for regulatory reform is welcome. But we need to build on these measures and look for further positive changes to PRT, Corporation Tax and the implementation of the investment allowance to help ensure continued development in the sector.