



SCOTTISH EXECUTIVE

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Dear Sir John,

OFGEM'S THREE YEAR STRATEGY 2004-07

Thank you for your letter of 1 September 2003. I apologise for the delay in replying.

I am pleased to have this opportunity to welcome you and Alistair Buchanan to your new posts. As you will be aware, the energy industries have a rich history in Scotland and the expertise and experience that this sector holds, allied to our vast natural resources, mean that Scotland is likely to continue to make an essential contribution to the UK's energy needs in the future.

This is clearly a key moment for energy policy. The recent UK Energy White Paper sets out the long term strategy for our energy future including, significantly, an emphasis on increased sustainability in energy generation and consumption. It will be of crucial importance that all parties work together to achieve the ambitious objectives set to achieve this goal. Indeed, as part of the Executive's contribution towards meeting the targets for renewable energy set out in the White Paper, on 25 March we announced a new target for renewable generation in Scotland of 40% by 2020. Of course, as you acknowledge, the strategic challenges that the authority faces at this time will also have a major bearing on the development of this new sustainable energy policy.

It is important that the regulatory framework for electricity generation, trading and transmission should recognise the increasing importance of renewable energy. The framework should be sensitive to the development of renewable electricity and, in particular, to the needs of the small renewable generators who will provide an increasingly significant contribution to our future energy needs.


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In addition to this general consideration, there are certain specific areas in which it will be of critical importance to recognise the implications of the move towards renewable energy. A greater emphasis on renewables poses new challenges to our existing energy infrastructure. There will be considerable changes to existing geographical patterns of generation with the retirement of major thermal generators and an evolution towards sources of renewable energy, which are likely to be situated in the remoter areas of the country. Grid constraints are already a feature in many of these areas. A substantial upgrading of the electricity transmission and distribution network in Scotland will be essential if the UK is to realise its renewables objectives. It will be of critical importance that the regulatory regime governing network upgrades is administered in a way that stimulates and encourages the investment required to undertake this upgrading.

Of course, the location of such significant energy sources in peripheral areas also poses new challenges to the methodology used for transmission charging. The very nature of renewable energy means that the distance from source to market will increase. We believe that the licence conditions set by the regulator should result in a charging methodology that encourages optimum value, by taking all the necessary economic and environmental costs into account. Therefore, we are keen that the new arrangements for transmission charging, currently being developed through the British Trading and Transmission Arrangements (BETTA), should not penalise generation in these peripheral areas in which much of our renewable energy resource is found.

I am grateful for the opportunity to comment on Ofgem's future strategy. I and my colleagues look forward to working with you in order to achieve our key objectives. If you wish to discuss these comments further you should contact Neil Stewart, Head of our Energy Policy Unit, by e-mail (Neil.A.Stewart@scotland.gsi.gov.uk) or by telephone (0141 242 5894).

Yours sincerely,


JOHN ELVIDGE