



ScottishPower

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Dear Chris

Ofgem's Proposed Corporate Strategy 2004-07

ScottishPower welcomes the publication of Ofgem's three year corporate strategy setting out the themes that represent the priorities for GEMA and Ofgem in the coming years. We welcome the fresh look being taken by Sir John Mogg and Alistair Buchanan recognising the new challenges faced while aiming for continuity and predictability in the way Ofgem discharges its statutory duties.

The relationship between GEMA, Ofgem and the industry it regulates has recently come under the spotlight in relation to decisions taken on transmission losses arrangements. One of the aims of the GEMA/Ofgem split was to increase accountability of regulation and to focus expertise. We are concerned that this aim has not been achieved and that it is extremely difficult for industry participants to get their concerns presented to GEMA and to establish to what extent GEMA determines strategy and major policy issues. We believe that more transparency of proceedings is necessary in relation to Ofgem and GEMA decision making.

We believe that one of Ofgem's key priorities over the next two years is fair and equitable GB transmission charging arrangements and that the current England & Wales transmission charging method is entirely unsuitable for extension to GB. It would have a discriminatory effect on generation from renewable sources, it reflects notional rather than actual costs and produces extreme charging rates highly sensitive to assumptions and decisions of market participants.

We welcome Ofgem's specific commitment to continue to withdraw from regulating the energy industry, where it believes this is in the best interests of customers, and look forward to Ofgem removing unnecessary licence conditions and making greater use of industry codes. This, together with the significant reduction in Ofgem's workload post 2005, when British Electricity Trading and Transmission Arrangements (BETTA) have been implemented and the distribution price control review has been completed should result in a significant reduction in Ofgem's costs. We look forward to this being reflected

in the draft Corporate Plan that will accompany the final Strategic Plan in March. While we recognise there will be new areas of work such as greater engagement in Europe and National Grid Transco's proposed sale of some gas distribution networks, the additional workload associated with these should be significantly less than that associated with the major areas from which Ofgem is withdrawing.

We support the seven identified themes which will drive Ofgem's strategy over the next three years and welcome the restoration of **improving Ofgem's efficiency and effectiveness** to a major theme. We believe that Ofgem's approach to market regulation is still over-active and a more focused approach should be adopted on a narrower range of issues.

We are generally supportive of the aims and objectives set out in the draft document, in particular the emphasis on facilitating electricity infrastructure investment to accommodate new renewable generation.

Creating and sustaining competition

Ofgem does recognise that retail prices will need to rise to meet the costs of transformation to a lower carbon and renewable based portfolio and of introducing new energy efficiency measures. The market will obviously require the regulatory signals from Ofgem to be clear in order to obtain certainty with regard to economic position. To that end, Ofgem should make it clear in its strategy that its regulatory objectives with respect to retail prices are adequately protected under competition law and that Ofgem intervention will be focussed on situations where there is prima facie evidence of non-competitive behaviour.

We are concerned that although Ofgem has recognised that competition is established in both the wholesale and retail markets, over 60% of Ofgem effort is still being allocated to competitive markets. Even without BETTA the level is still over 50%. Ofgem must let the market do its work and reduce effort and expenditure in this area following the implementation of BETTA.

We believe that a fair and equitable commercial and contractual framework for GB trading and transmission arrangements is vital and should include non-discriminatory GB transmission charging and losses arrangements which do not result in market participants facing volatile changes in their costs. Ofgem has an important role in setting up these GB arrangements and allowing the industry to develop the market.

It is important for Ofgem to ensure that its role in the development and governance of GB arrangements is supportive of the market. Ofgem should not use its governance role to impose conditions on the market which market participants do not support. Market participants are governed by competition law requirements and once a competitive market has been established there is no need for Ofgem to impose its views on the market. Indeed to do so discourages market entry to the long term detriment of competition and customers.

We do not see the need for Ofgem to keep the structure of the electricity and gas markets under constant review. While Ofgem needs to have resources available to address issues such as the NGT sale of gas distribution networks, such resources need not be full-time in this area and could be made available when required by delaying less important non-urgent work.

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We support the promotion of effective competition in connections and in metering. It is important that residual obligations on distribution network operators (DNOs) in these areas are reduced as appropriate to keep pace with such developments, and do not serve to distort competition. For example, the market for non-half-hourly meter operation services is marked by a considerable degree of competition, and a number of major suppliers have changed their meter operator or are considering doing so. In this situation, a continued requirement on those DNOs who were previously public electricity suppliers to provide meter operation services on request may discourage new entry. These obligations should therefore be reviewed. We also note that Ofgem intends to implement metering price controls for DNOs from 2005. This decision appears to have been taken in the absence of a review of metering competition. Such decisions should be informed by a market review, rather than being taken in advance.

The Energy Bill will extend NETA into Scotland through the BETTA project. In December 2001 Ofgem justified BETTA by saying that it had become increasingly important to establish competitive wholesale trading arrangements for existing and potential generators and suppliers wishing to compete in Scotland. However, in a recent public statement, Ofgem has created uncertainty for those same potential generators by advising that acquiring access is uncertain for those parties, particularly in Scotland, who have applied for access but have not yet been connected. It is vitally important for Ofgem to give assurance of access to the GB transmission network to those renewable generation projects who have already accepted offers for connection to the transmission network in Scotland, have signed connection agreements and are proceeding to develop their projects. Failure to do so will undermine confidence and diminish the prospects of realising many of the employment and investment benefits that were expected in Scotland as a result of the growth of renewable generation projects.

Enhancing competition in the electricity wholesale market is critically dependent on there being sufficient network capacity to support these markets and we must proceed in a planned fashion to meet the needs of users. We do not believe that reliance on market signals to deliver network investment is a realistic option.

Regulating network monopolies

We welcome the recognition that sufficient incentives are needed to facilitate investment in transmission and distribution networks to accommodate new renewable generation. It is important that any new regulatory framework in this area adequately addresses risks of undertaking infrastructure investment in advance of firm capacity requirements, while incentivising innovation in this area.

In electricity transmission, we broadly support the aim of improving information available to NGC on customer demand for additional network capacity. However, any initiatives in this area need to recognise the role of the Scottish transmission system owners, who will remain responsible for development of their respective networks.

Ofgem's proposals under incentives to invest appear to imply that future investment will need new incentives or it will not be efficient. They also imply that the investment which is needed now will be inefficient as new incentives cannot be developed in time. It is certainly true to say that investment is needed urgently but that is not to say it will

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inevitably be inefficient. There has been widespread criticism of the proposal to introduce the gas investment incentive scheme to electricity transmission. We do not believe it will deliver the outcomes required and we are firmly of the view that the necessary network enhancement can be completed efficiently and effectively under the current regulatory incentives.

As regards responsiveness to customers, we welcome the research taking place into customers' attitudes towards quality of supply and their willingness to pay for improvements in this area. It is important that any proposals for revised incentives relating to quality of supply are informed by robust evidence of customers' priorities and willingness to pay. In turn, companies need to be adequately funded to achieve expected improvements in performance.

Ofgem's proposals refer to the need for 'clearer' incentives for improved performance of distribution networks in the event of severe weather. We hope that the final document will acknowledge the existing very strong pressures on companies to respond quickly and effectively to network emergencies which comes from the Regulator, media, and Government as well as from Guaranteed Standards and the incentive mechanisms developed through the Information and Incentives Project.

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Helping protect security of Britain's energy supplies

We see securing Britain's gas and electricity supplies as an overriding theme for Ofgem setting the context for Ofgem's approach under the other themes. Ofgem has an important role to play in conjunction with the DTI in assessing supply security and publishing forward-looking indicators. We welcome Ofgem's undertaking to report on security of supply retrospectively twice a year, setting out levels of security achieved, relevant events and any lessons learned.

We believe that the current market arrangements may not be sufficient to avoid security of supply problems in the near future. We believe there is a need for a market mechanism to ensure sufficient capacity, based around capacity tickets or auctions. While the prospect of higher prices has resulted in some mothballed plant being brought back in to service it has still not encouraged any significant build of new conventional plant. We believe there is a need for an obligation to be put on the system operator to ensure a sufficient plant margin is maintained. This is a role for the system operator and not for Ofgem.

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It would be helpful if the final document acknowledged the impact that market design can have on security of supply. For example the proposed strategy implies that the problems experienced in California in 2000 stemmed mainly from market abuse. Most independent commentators, however, agree that restrictions on contracting in the wholesale market and the framework of price controls in place in California played a significant part in the supply problems experienced at that time.

We agree that the strategy towards network investment should look at incentives to invest quickly and efficiently and incentives to improve quality of supply. It should also take account of the need to renew an ageing asset base, and to ensure that customers' rising expectations of quality of supply are met economically.

A leading voice in Europe

We agree that European energy markets and EU regulatory policy will have an increasing influence on energy markets in GB. DTI represent the UK on the decision making Regulatory Committee and thus are the key body representing the UK in the new regulatory machinery being created at European level. Ofgem's role is on the advisory European Regulators Group for Electricity and Gas which has the aim of encouraging co-operation and co-ordination of national regulatory authorities in order to promote the development of the internal market for electricity and gas. DTI resources will continue to have a more direct input to European regulatory decisions than Ofgem and this must be recognised when determining how best to allocate UK resources for maximum impact. We are particularly concerned in areas where Ofgem's and DTI's views differ. Ofgem should not be advocating proposals in Europe which are contrary to DTI's views.

Helping protect the environment

While Ofgem has an important role in administering major Government environmental programmes it is important to recognise that in relation to environmental strategy Ofgem's role is a supporting one with the lead on policies being taken by the Government and bodies with direct environmental responsibilities.

We welcome the opportunity to take part in the recently announced pilot projects allowing us to offer domestic customers energy service packages linked to supply contracts that go beyond the normal 28-day limit.

Helping tackle fuel poverty

While Ofgem recognises the likelihood of significant increases in energy prices over the next few years and the adverse impact this could have on fuel poverty, it is Government that must take the key actions in this area if it is going to achieve its targets of eliminating fuel poverty among vulnerable households by 2010, and all households by 2016. Now that competition has been established in energy markets it will not be possible to offset the anticipated price increases from emissions trading and renewables through increased competitive pressures. New energy efficiency measures are also unlikely to be sufficient to offset these increases. Targeted Government initiatives, with support from Ofgem, energywatch and the industry, will be necessary for progress towards these targets to be achieved in the next three years.

Improving Ofgem's efficiency and effectiveness

We welcome the review currently being undertaken by Ofgem to ensure it is able to make the best use of its resources to deliver its strategy and to meet the new challenges it faces. However, we cannot agree with the statement that Ofgem's direct costs remain relatively small. As competition has become established in the electricity and gas markets, the cost of regulation has increased significantly, rather than reducing as was anticipated. The costs of Ofgem and energywatch are significantly greater than the costs of their predecessors, Offer, Ofgas and the Consumers' Committees. Over the years, when major projects, such as price reviews, the introduction of competition in 1998 or the introduction of NETA, have been completed the associated one-off costs appear to have been absorbed

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into general costs with no resultant overall cost reduction. This must not be repeated in 2005 when BETTA is introduced and the distribution price control review is completed.

One area in which we believe Ofgem could become more effective is in relation to media relations contacts with regulated companies. A more pro-active stance by Ofgem would reduce mis-understandings of which recent examples involving ScottishPower have been in relation to the benefits of BETTA and the level of competition in the Scottish market.

We look forward to the publication of the final Strategic Plan in March together with the draft Corporate Plan.

Yours sincerely

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