



**ScottishPower**

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Dear Andy

### **Ofgem's five year strategy 2006-11**

We are writing on behalf of ScottishPower in response to Sir John Mogg's invitation to contribute to the development of Ofgem's five year strategy for 2006-2011. We welcome this opportunity to give our views on the key challenges the industry faces, the actions Ofgem should take and the priority areas of work that Ofgem should tackle. We recognise the positive steps taken by Sir John Mogg and Alistair Buchanan in reviewing Ofgem's strategy and in working to an RPI-3 cost reduction target and looking to streamline and improve the consultation process.

We believe that all seven major themes set out in Ofgem's 2005-2010 corporate strategy and plan remain valid and are likely to do so for the next five years. Retention of these themes will benefit the industry in terms of regulatory continuity and predictability of working within a stable overall regulatory framework.

#### **1. Key challenges for the industry in the short to medium term**

The key challenge remains ensuring consistency between the Government's broader energy and environmental objectives and the price control regime, which promotes cost efficiency and energy price reduction, without distorting competition in the mature electricity and gas wholesale and retail markets and while also maintaining reliable supplies of gas and electricity.

Continuing fuel price and wholesale price volatility increases the challenges facing the industry. Customers cannot be immune to the volatilities of the market and a market framework that encourages fuel diversity is key.

Measures based on emissions reductions are vital and fuel security is also a key issue which in certain circumstances may have CO<sub>2</sub> implications. Renewable energy and energy efficiency are fundamental areas for expansion and energy efficiency is a critical part of tackling fuel poverty, particularly at times of increasing wholesale and retail prices.

A robust regime to deliver electricity infrastructure investment to support on-shore and off-shore renewable generation is vitally important. This must incorporate an incentives framework which will encourage efficient investment, recognise relevant system security considerations and allow price controlled companies to earn an adequate return.

The period following BETTA go-live has involved significant challenges for companies in Scotland, as they learn to work with the new arrangements for transmission charging and for system operation and planning. In distribution, significant new incentive arrangements covering embedded generation, quality of supply and losses were implemented in 2005. It is important that these changes are given time to settle down before further changes in these areas are considered.

It is essential that network users and customers realise the benefits from the sale of gas distribution network businesses. The sale has proceeded on the basis of significant benefits to customers from future price reviews and it is essential that these claimed benefits are indeed realised.

The implementation of current and new EU legislation for electricity and gas represents a further challenge for Ofgem and the industry. Fair and equitable implementation across Member States is key to UK companies and their ability to compete in the emerging European market.

## **2. Actions the Authority should take to respond to these challenges**

It is important that Ofgem in all of its work, including Regulatory Impact Assessments, fully adheres to the principles of better regulation, namely proportionality, accountability, consistency, transparency and targeting, and recognises the fundamental requirements for measures to be proportionate and applied in a non-discriminatory manner.

Regulation has been successful thus far in promoting competitive energy prices, securing efficiency gains and assisting in early market developments in renewables and energy efficiency. We are supportive of open and transparent markets for energy and also for emissions trading. Regulation will, however, require to be developed and refined in order to continue to deliver the diverse demands of energy policy addressing such needs as fuel poverty, renewable technology development, and fuel security. We fully support Ofgem's initiative to review the gas and electricity supply licence provisions.

Now that BETTA has been successfully implemented and security of supply is considered on a GB basis it is vital that environmental measures, which significantly affect the cost of maintaining and operating generation plant, are implemented consistently throughout GB in order to avoid electricity market distortion. Separate bodies are responsible for implementing environmental legislation in England & Wales and Scotland and it is key for Ofgem, with its overall GB market remit, to ensure consistency and for any transfer or trade of emissions allowances to operate on a GB basis.

The Renewables Obligation is a well supported policy using a market mechanism to deliver a national strategic goal. Tinkering with the Renewables Obligation would undermine investor confidence and increase the cost of meeting renewables targets. Other measures, outside the Renewables Obligation are required to support emerging technologies such as capital grants for demonstration wave power projects.

Transmission costs and liabilities have emerged as a major barrier to Round 2 off-shore developments, particularly the liability that developers must carry for on-shore reinforcement costs. Treating these reinforcements as baseline investments (as for earlier on-shore investment in Scotland) would provide a solution. Early resolution is required to meet next year's construction window.

If energy efficiency is to achieve its target levels then barriers to successful implementation in a competitive market must continue to be tackled. Energy services contracts and sound customer relationships are essential if these targets are to be met since energy efficiency products and services need a long term framework within which to evolve. The Energy Efficiency Commitment has been used to provide valuable support for the fuel poor. However, the extent to which future Energy Efficiency Commitment measures can provide additional relief is limited. We are keen to work with Ofgem, Government and others to develop the most effective measures to address fuel poverty.

We agree that Ofgem should work to influence Member States' implementation of important European legislation and regulation to ensure there is effective access to continental gas and electricity markets. Ofgem must work closely with the DTI to ensure that UK customers, industries and power companies are not disadvantaged by differential application of European legislation. Harmonisation of arrangements between GB and the rest of Europe is important to ensure a level playing field in a competitive market. Important in this regard is the harmonisation of transmission charging arrangements and in particular the proportion of transmission charges to be paid by generators.

We welcome Ofgem's improved transparency, including the publication of reports of the Authority's monthly meetings, and its aim to reduce the indirect costs imposed on companies through reducing the number of consultations and making publications more concise.

We believe Ofgem should not be diverted from its priorities by administrative work which could be carried out by industry bodies. Much of the work Ofgem currently carries out in relation to Renewables Obligation Certificates and Levy Exemption Certificates could be carried out by industry bodies such as the Non-Fossil Fuel Purchasing Agency allowing Ofgem to concentrate on its core tasks.

### **3. Priority areas of work**

We support the themes for driving Ofgem's work over the next five years as set out in the 2005-2010 corporate strategy and plan and see these continuing to set the framework for 2006-2011. Ofgem should continue to promote effective competition through replacing traditional regulation with a greater reliance on competition powers. We believe that securing Britain's gas and electricity supplies should be a priority in the short term.

With environmental measures having an increased impact on the UK gas and electricity markets there is a clear need for closer integration of energy and environmental policy and regulation. Wherever possible environmental and strategic goals should be achieved through market mechanisms.

Ofgem has recognised that retail prices will need to rise to meet the costs of transformation to a lower carbon economy. Ofgem intervention should therefore be focused on situations where there is clear prima facie evidence of anti-competitive behaviour.

Ofgem should continue to encourage the early development of more competitive energy markets across Europe with the focus on the implementation of existing directives and regulations. In contrast to the gas and electricity markets in GB many European markets retain significant barriers to entry. European wholesale gas prices are having an increasing influence on UK gas and electricity retail prices and trade in CO<sub>2</sub> across Europe under the EU ETS is anticipated to increase the impact of European markets on GB prices.

Yours sincerely

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