



# ScottishPower

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27 September 2006

Dear Andy

## **Ofgem's Five Year Strategy 2007-12**

I am writing on behalf of ScottishPower in response to Sir John Mogg's invitation to contribute to the development of Ofgem's five year strategy.

I 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. Many of the strategic challenges identified in our contribution to this exercise last year remain valid today, and I am pleased to reiterate these challenges below and bring them up to date with our current views.

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

In our view the key challenges facing the industry are:

- (a) Ensuring a balance between the energy demands of the nation and the need to protect the environment for future generations.
- (b) Providing energy security for the nation. This includes securing access to sufficient raw materials and enough generation capacity to comfortably meet demand, as well as safeguarding the availability of both finance and skilled engineering resources to deliver investment in generation and infrastructure assets.
- (c) Managing high and volatile energy costs and their impacts on customers.
- (d) Ensuring that regulation, where needed, is performed as efficiently as possible – and striking the right balance between regulation and market based competition.
- (e) Influencing the evolution of energy markets in Europe so that they help rather than hinder the UK's energy needs and goals.

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

Against each of these challenges, there is much work to do. We highlight below some key areas of focus. You will be aware that we are working with yourselves and others on many of these issues through a variety of programmes.

a) **Energy and Environment** – It is critical that Ofgem seeks to align its regulation with the aims of energy policy development. The UK's policy drive for renewable generation is a good example. Regulation of electricity distribution and transmission businesses should support the development of a rich renewable resource for the nation and to connect it to the network. That means ensuring the needs for investment are fully considered and recognised in price controls (such as the ongoing TPCR4 process) rather than focussing on shorter term cost efficiency goals. While the TIRG and DG schemes are a start, there are flaws in the current system especially for the deep reinforcement required in remote areas that are rich in renewable resource but extremely sparse in terms of existing infrastructure that need to be addressed. On the generation side, Ofgem will also be aware of the potential changes facing the Renewables Obligation through the DTI's review. The Renewables Obligation is a well supported policy using a market mechanism to deliver a national strategic goal. Tinkering with the Renewables Obligation will undermine investor confidence and increase the cost of meeting renewables targets. We would encourage Ofgem to help guard against damaging changes to the Renewables Obligation as the consultation unfolds.

On CO<sub>2</sub> emissions there is also much policy work ongoing to define the role and structure of Carbon markets for the future. While this work is in the hands of DEFRA, we would also ask Ofgem to continue to underline the fact that equitable implementation of emissions reductions measures across GB and also throughout Europe is vital to ensure no distortion of competition in generation and supply.

b) **Energy Security** – The Government's Energy Review reaffirmed the commitment to competitive markets at the same time as making a strong case for renewed levels of investment in infrastructure and generation assets if we are to ensure security, reliability, and diversity of supply in the future. Ofgem has an important role to play in facilitating the delivery of this investment by encouraging the availability of both finance and skilled engineering resources. Ofgem should continue to strongly encourage the development and provision of energy security *through markets*. We agree with Ofgem's view that competitive markets have delivered significant new capacity both for gas and electricity in the UK. The current investment activity over both gas infrastructure and CCGT, nuclear and renewable generation is testimony to that. It is critical in this that market participants interact on fair and level playing fields. This means that regional imbalances need to be ironed out. Europe is the major key concern in this area (which we address below) but there are also regional issues within the UK. Since the implementation of BETTA -generators remote from the major load centre in the south east are facing the prospect of increased costs from proposals for zonal transmission losses on top of the high locational transmission charges imposed last year. The industry is overwhelmingly opposed to the introduction of zonal transmission losses. Ofgem should not use its powers to overrule the industry decision rejecting zonal losses which would result in significant windfall

gains and losses for some generators with very small and uncertain overall benefits. The industry has extensive governance procedures for its major codes and agreements and Ofgem should only use its powers to overrule industry decisions in exceptional circumstances.

- c) ***Volatile Energy Prices*** - Our electricity and gas wholesale and retail markets are being tested by continuing fuel price and wholesale price volatility. Despite the significant rises customers have seen over the last two years they have not been fully exposed to the volatility in fuel and wholesale prices experienced by generators and suppliers. It will take some time for the market to settle down and for a 'normal' relationship between retail, wholesale and fuel prices to be restored. During the recent period of volatility and rising prices in the GB market there has been no requirement for Ofgem to intervene in the market and Ofgem has been able to restrict its involvement to a monitoring role. The GB wholesale and retail markets have remained fully competitive during this difficult period and there is every indication that they will remain so as the market hopefully becomes less volatile and wholesale and retail prices stabilise. Ofgem should resist any pressure to intervene in the market as it stabilises toward full competition.

Against the current climate of rising prices there are also the twin issues of customer debt and fuel poverty. Debt prevention and management is a key strategic priority and an ongoing challenge for all energy suppliers. We believe that there would be value in Ofgem working to educate customers on how to avoid debt, help with energy budgeting and reduce demand. Factors that would be relevant here would be the importance of regular, accurate meter reads, advantages of certain discounted payment arrangements (e.g. Direct Debit) and the continued driver for increased energy efficiency.

- d) ***Efficient regulation*** – We welcome the opportunity presented by the DTI Energy Better Regulation project to improve regulation. We note that the DTI have shared our comments with you in respect to the detailed regulation and policy oversight and look forward to Ofgem's response to the points raised to be included in the revised five year strategy, notably in relation to regulatory simplification and the avoiding of overlap with existing regulations.

Ofgem should ensure that its thinking in this area is directed towards: a) refocusing Ofgem's priorities on true value added areas, and; b) ensuring the structural inefficiency between government and regulatory departments is not missed. For example, this could include an update review of the Guaranteed and Overall Standards of Performance Regulations. The mechanistic and prescriptive nature of the standards and their associated reporting burden are increasingly inappropriate in a competitive market, and it is questionable whether any consumer detriment would result from their removal. In moving to a lighter regulation model Ofgem should consider carefully the role for Self Regulation. We'd propose that hosting an industry seminar on self-regulation covering e.g. what they expect, experience so far, future work. This would seem particularly relevant at present given the current proposals being considered under the Supply Licence Review and Ofgem's commitment to withdraw from regulation where appropriate.

e) **Europe** - 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. Ofgem should increase the intensity of its work to influence Member States' implementation of important European legislation and regulation to ensure there is effective access to continental gas and electricity markets and continue to 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. We also believe that strong advocacy of the UK model in Europe would be helpful – in particular demonstrating the case that ownership unbundling of transmission is not a requirement for a healthily functioning energy market.

### 3. Priority areas of work

There is much to do, however as laid out in a cover note to this letter we believe that the key priority areas for Ofgem for the next 5 year period are:

- Ensuring that its activities reinforce the governments Energy policy direction – particularly around the regulation of our energy networks.
- Re-balancing of regulation for the UK's electricity and gas markets – and potentially streamlining activities in some areas and reduce levels of intervention?
- Seizing the opportunities presented by “Better regulation” to redesign the interfaces between government and regulatory departments.
- Redoubling efforts to drive market opening and liberalisation in Europe.

Yours sincerely



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