

SCOTTISHPOWER

CE 4507

Nick Horler
Chief Executive

Alistair Buchanan CBE
Chief Executive
Office of Gas and Electricity Markets
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London
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NH/AAK

1 September 2009

Dear Alistair,

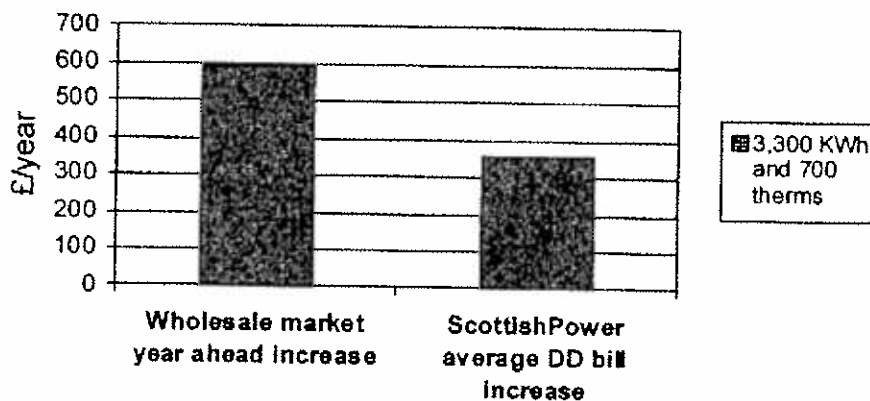
PRICING OF HOUSEHOLD ENERGY

Thank you for your letter of 4 August 2009.

We agree that it is important that there is a good understanding, ahead of the winter, of how cost changes, including falling wholesale costs, are likely to bear on energy bills.

Data published by Ofgem suggests that most market participants buy their requirements up to 18 months ahead, although as you would expect in a competitive market, there are variations. This meant that suppliers were able to shield their customers from a large part of the wholesale price rise in late 2007 to mid 2008 because a significant part of their requirements were purchased earlier when prices were lower. This is illustrated by the graph below comparing the increase in wholesale costs between July 2007 and September 2008 with the increase in retail tariffs:

Typical dual fuel customer



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Since that period, suppliers have made price reductions, but this factor also means that suppliers continue to have in their portfolios significant amounts of energy bought during early to mid 2008, when prices were very high and then perceived to be continuing to rise. It will take until the end of 2010 for this effect to fully work through the system. Forward gas prices remain at high levels – the current low prices for immediate delivery caused by a glut of LNG do not seem to be reflected in longer term prices.

In the meantime, there have been significant new costs arising from Government obligations and the need to pay for essential investment in the distribution networks. We estimate that these will increase ScottishPower's costs by a further £65m per year from April 2010, equivalent to an average of £26 a year for a typical dual fuel customer.

Finally, in order that we can invest to play our part in maintaining Britain's security of supply, we have to look at the end to end profitability of the business.

Taking these factors together, there are no immediate signals that would indicate a fall in retail prices for this winter, and risks of an increase next year. However, this is a competitive market and ScottishPower is committed to giving its customers a good deal and high quality service, so our decisions will depend in part on what others do.

I would be happy for you to publish this response on your website.

Yours sincerely,



Nick Horler
Chief Executive