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Corporate Affairs Division  
The Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

22 September 2009

Dear Andy,

**OFGEM FIVE YEAR STRATEGY 2010-2015**

I am writing in response to Lord Mogg's letter of 28 July 2009 inviting comments on the themes for Ofgem's Five Year Strategy 2010-2015. This response is submitted on behalf of the ScottishPower Group and ScottishPower Renewable Energy Ltd.

We see Ofgem as having a pivotal role over the next five years, working with Government and the industry to help make the vision for a low carbon energy future a reality, whilst maintaining security of supply and keeping an eye on costs. All three of these objectives are a necessary part of the consumer interest.

We believe Ofgem's first priority in responding to these challenges must be in approving the necessary network investment required to ensure security of supply in the coming years and that low carbon sources of generation can have full access to the GB market. In particular:

- A clear and straightforward approach is needed to funding the immediate recommendations of the Energy Networks Strategy Group (ENSG), and other enhancements needed to connect renewable and nuclear power stations. It is imperative that time is not lost in getting these enhancements financed.
- Distribution and, in due course, transmission price control settlements need to be at a level which incentivises the necessary investment to develop the networks and ensure they are in good condition.

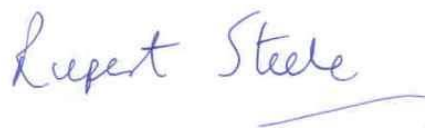
The second priority for Ofgem must be in reducing regulatory uncertainty, so as to attract generation investment to GB. The potential for changes to the GB regulatory and commercial framework over the life of a long-lived generation asset is significantly impacting the expected return from the asset and is acting as a disincentive for investment in GB compared to the rest of Europe. We believe Ofgem must act quickly to reduce this uncertainty and ensure long term security of supply.

In our opinion, the third priority should be in relation to smart metering. We believe that the implementation of smart metering should be used as an ideal, perhaps a unique, opportunity to simplify, rationalise and align the existing overly complex and disparate electricity and gas processes and governance. This could make it easier for customers to do business with their energy companies and improve the overall functioning of retail markets. We suggest that Ofgem and Government move quickly to establish a formal Programme Board, with industry involvement, responsible for agreeing the scope, timescales, resources and funding arrangements required to mobilise the central programme and the attendant governance arrangements.

Other areas of work we believe it will be important for Ofgem to focus on over the next five years include unbundling (where it will be important to process through and support the Article 9(9) derogations for the Scottish transmission businesses); management of the Government's environmental and social programmes and the attendant levies; ensuring the continued health of the market; and creating a level playing field in Europe.

I attach an Annex which provides our thoughts on the contents of your strategy in more detail. If you would like to discuss these issues, please do not hesitate to contact me using the details printed on the previous page.

Yours sincerely,

A handwritten signature in blue ink that reads "Rupert Steele". The signature is written in a cursive style and is positioned above a horizontal line.

**Rupert Steele**  
Director of Regulation

## ANNEX

### OFGEM'S FIVE YEAR STRATEGY 2010-2015

#### SCOTTISHPOWER INITIAL COMMENTS

##### Introduction

1. These comments are made on behalf of Scottish Power Limited and ScottishPower Renewable Energy Limited. Both companies are subsidiaries of Iberdrola SA and references to "ScottishPower" and "we" are to either or both companies as the context requires.
2. Scottish Power Limited is an energy business that provides electricity transmission and distribution services to more than 3 million customers, supplies 5.4 million electricity and gas services to homes and businesses across Great Britain (GB), and operates electricity generation, gas storage facilities and associated energy management activities in the UK.
3. ScottishPower Renewable Energy Limited is part of Iberdrola Renovables, which is 80% owned by Iberdrola SA. Iberdrola Renovables is the largest developer of renewables globally.
4. We welcome the opportunity to respond to your open letter regarding Ofgem's Five Year Strategy 2010-2015 and provide input into the development of Ofgem's future strategy, priorities and direction.

##### Short to Medium Term Challenges and Priority Areas

5. A rapid transition to a low carbon economy is essential to mitigate climate change at a global level. The UK government has set ambitious targets; a strong vision and leadership will be critical in ensuring these targets can be met and that the UK plays its part in meeting the overall climate challenge.
6. In the medium to long term, decarbonisation of the electricity mix is essential, particularly through new investment in large scale renewable generation, CCS and nuclear. It is also critical that the infrastructure needs of the country are fit for purpose. New and smarter networks will be needed to ensure that low carbon generation assets are connected up and performing to maximum efficiency; to ensure the connection and integration of distributed generation; and to accommodate potentially significant shifts in load as the transport industry becomes more dependent on electricity as a fuel source. Reform to the planning process, which is already underway, will be crucial in delivering the new generation and networks required at the necessary pace. Certainty in this area will be very important.
7. To deliver the vision and ambition set out in the UK Renewable Energy Strategy and the Government's Low Carbon Transition Plan, designed specifically to address these challenges, work needs to start now. We see Ofgem as having a pivotal role, working with Government and the Industry to help to make the vision for a low carbon energy future a reality.
8. As such, we believe it will be important for Ofgem to focus on the following areas of work in the coming five years:

- Network Investment and Connection in GB
- Generation Investment in GB
- Smart Metering
- Unbundling
- Ensuring the continued health of the market
- Environmental and Social Levies
- Creating a level playing field in Europe

9. The next section discusses each of these in more detail, providing our thoughts on how we believe Ofgem should respond in each area. We have also provided comments on the general concern over better regulation as well as changes to Ofgem's remit and structure.

## **Response Required From Ofgem**

### Network Investment and Connection in GB

10. Areas of the GB current network are often at full capacity and many share the view that the network is in urgent need of upgrading. We believe Ofgem's first priority must be approving the network investment required to ensure new and existing environmentally beneficial generation can have full access to the GB market and thus make a full contribution to the Government's carbon reduction targets. Crucial past network investment has been delayed in part by the time taken to achieve Ofgem approval; although other factors including planning approval also need to be addressed, it is imperative that essential investment is not delayed for financing reasons. In particular, a clear and straightforward approach is needed to funding the immediate recommendations of the Energy Networks Strategy Group (ENSG), and other enhancements needed to connect renewable and nuclear power stations.

11. We believe that Ofgem needs to become an important facilitator in the process by developing a balanced, supportive and forward-looking regulatory network investment framework that meets all stakeholders' ambition in meeting EU targets. In our opinion, the current price control arrangements have been and continue to be a successful mechanism for delivering optimal and cost-efficient investment for all forms of grid investment and are of fundamental importance to our energy future. However, increasing network investment will require the provision of significant amounts of finance from the investment market and should current circumstances persist, this will mean higher financing costs and more restrictive debt covenants. Prospective investors must therefore be re-assured that all efficient expenditure by network owners is recoverable and that the rewards available to them are commensurate with the risks they are faced with in transforming their networks. Given the potential scale of future grid investment beyond 2012, and the urgency to deliver this investment in a timely manner, we believe that there is a need to look at further incentives focussed on investment in potential major infrastructure projects that may be required in the future and that potentially remove the need for user commitment.

12. It will also be important to maximise the use of current grid capacity. Much work has been done in this area across the industry through the Transmission Access Review in particular. We have welcomed Ofgem's approval of the interim connect and manage regime enabling generation to connect earlier. Now that the Government has taken control of transmission access reform, Ofgem should support the industry's representations for a stable framework without the uncertainty of

auctions and with any additional temporary costs incurred before full network enhancement spread across the whole GB market as currently and not targeted at a group of generators. Renewable generation investment is supported by funding from across the GB market, and its benefits accrue to society as a whole, and thus we believe that (apart from any reasonable charges to the new generation itself) any additional costs arising as a result of this generation coming on earlier should also be funded from across the GB market.

13. In relation to renewables, we welcome Ofgem's initiatives to bring more generation on-stream but believe that changes to investment incentives and reform of transmission access arrangements to facilitate connection of all forms of renewable generation, particularly in remote locations, requires further consideration.

14. We understand that Ofgem favours competition for connection but we are not convinced that the approach currently taken for offshore delivers the best balance of price and risk for both developers and grid providers. We would ask that Ofgem in conjunction with the industry give further thought to the proposed regime focussing on the practicalities and on overcoming potential deliverability issues, given the urgency of the task ahead to meet the UK's renewable target.

15. TPCR5 will set the scene for transmission investment and service delivery up to 2018. We are currently working closely with Ofgem and other stakeholders to develop and implement robust and effective arrangements. We look forward to early dialogue in the development of the framework for TPCR5, including any implications arising out of RPI-X@20 project.

#### Generation Investment in GB

16. While the lower energy demand arising from the current recession is reducing the short term pressure on security of supply, we do believe that security will become an issue in the medium term as the generation mix changes in order to reduce carbon emissions. Generation investment decisions are long term and thus the issue of security of supply must continue to be addressed in periods of short term healthy plant margins to ensure economic reliability of energy supplies in the medium and longer term. To quote a phrase of the moment, we should aim to fix the roof while the sun is shining.

17. Ofgem has recognised the major challenges of climate change and security of supply. However, we believe Ofgem has underestimated the adverse impact that some key aspects of the current regulatory framework are having on the development of environmentally beneficial generation and the necessary investment in flexible back-up generation to support the increasing level of intermittent generation connecting to the network.

18. Ofgem should recognise the importance of reducing regulatory uncertainty to attract generation investment to GB, particularly given that companies have many other alternative options for investment in GB and internationally. While the fully competitive nature of the GB market could be attractive for generation investment compared to less competitive markets in Europe, the potential for changes to the GB regulatory and commercial framework over the life of a long-lived generation asset significantly impacts the expected return from the asset and acts as a disincentive for investment in GB compared to elsewhere in Europe.

19. Ofgem has instigated a number of initiatives which, if implemented, would have the effect of significantly increasing regulatory uncertainty. They include proposals for the industry to have a reduced influence in major rule changes and proposals to introduce auctions or similar mechanisms to govern transmission access. The major industry players who will provide the investment have made clear their concerns about these initiatives and Ofgem should recognise the adverse impact of seeking to force through changes not supported by the industry.

### Smart Metering

20. We believe that the implementation of smart metering should be used as an ideal, perhaps a unique, opportunity to simplify, rationalise and align the existing overly complex and disparate electricity and gas processes and governance thereby making it easier for customers to do business with their energy companies and improving the overall functioning of the retail markets. A clear vision from Government setting out the long-term objectives of the smart metering programme and its interaction with other key policies e.g. delivering the 2020 renewables targets, developing markets for ESCO's, zero carbon homes and electric vehicles, is required as a matter of urgency.

21. We suggest that Government and Ofgem move quickly to establish a formal Programme Board led by senior officials within Government and the Regulator. Membership should be drawn from representatives of key stakeholders who will have responsibility for the delivery of the smart metering programme e.g. Suppliers, Network Businesses and consumer representatives. The Programme Board should be responsible for agreeing the scope, timescales, resources and funding arrangements required to mobilise the central programme, and for setting up the attendant governance arrangements.

22. We are keen to avoid a smart metering solution that meets only the needs of energy suppliers, as we believe that the design decisions we take in the next 2-3 years on smart metering will define the operation of the electricity network for the next 20+ years. As such, the requirements of all industry parties for the development of future smart grids should be taken into account in the specification of the shared communications and data management infrastructure surrounding the roll out of smart meters. This will provide a sound platform for network businesses to develop smarter network management strategies, and for suppliers to provide a wide range of innovative products and services to end customers. It is vital therefore that the Programme board be established as quickly as possible and that consideration is given by them to the future potential of the optimum smart metering solution across the entire industry.

### Unbundling

23. A key task for Ofgem will be dealing with the application of the derogation under Article 9(9) of the electricity directive regarding the unbundling of transmission networks and supporting the UK's position with the European Commission. We are satisfied that the arrangements in place under BETTA and existing Ofgem regulation demonstrate more effective independence than the ITO model. Demonstrating this to the European Commission will be important as the current model has significant benefits for consumers, not least by enabling Ofgem to compare the approaches of the various transmission owners.

### Ensuring the continued health of the market

24. We continue to believe that Ofgem's priority must be to encourage and sustain a competitive energy supply market, which will ultimately provide the best service and prices for all customers, including those who are fuel poor or vulnerable. ScottishPower remains fully focussed on providing its customers with the best deals and excellent service and we believe that the best way that we can do this is within the context of a liberalised market.

25. The energy supply probe has provided valuable scrutiny of the retail market, along with Ofgem's quarterly wholesale / retail price reports. We have been working closely with Ofgem throughout the Energy Supply Probe to develop the proposed market remedies into Licence obligations that provide appropriate solutions for energy consumers while maintaining an appropriate balance with the flourishing of a competitive market. We appreciate the practical approach that Ofgem has taken through this process.

26. Managing and reducing debt remains a key priority for energy suppliers, particularly in the light of the worsening financial circumstances of recent years. It will be important to encourage strategies which assist in preventing the build-up of debt, the cost of which would otherwise be borne by other consumers. We look forward to working with Ofgem and Consumer Focus as their current review of debt and disconnection proceeds. We believe that it is essential that there is a fully joined up approach to this review.

27. We note Ofgem's concern, as detailed in your Strategy and Plan 2009-2014, that the challenge remains in getting the message across to those who need it most that energy suppliers have help on offer. We would ask that Ofgem clarifies its role and outlines its intentions in assisting energy suppliers in this task.

28. We think that the suggestion about recycling funds raised by auctioning carbon allowances to tackle fuel poverty is an interesting one and believe it would be worth Ofgem exploring this further, ensuring there is no risk of double counting between various schemes.

29. In relation to our social spend, it will be vital that Ofgem are fully engaged in the discussions around the proposed mandatory social price support post 2011 and how this will align with the continuation of the voluntary framework. There is also a role for Ofgem in pushing for a transparent, simplified policy design post 2011. We would ask that Ofgem consider consulting on the current social spend framework to help shape policy beyond 2011.

### Environmental and Social Levies

30. The energy industry is continually under pressure as a result of rising prices for consumers. Rising environmental and social levies to support renewables and energy efficiency and potentially Carbon Capture and Storage (CCS) in the future, as well as cross subsidy as a result of our social spend to support the fuel poor, all contribute towards the fact that energy prices are high. Whilst as a general point we believe taxation is fairer and less regressive than costs being levied on consumers' bills, we do see the benefit in certain instances of levies and cross subsidies in ensuring that these technologies are deployed at the required rate and that assistance is provided to the most vulnerable in society. However, we do believe that customers should be aware of costs that are being added to energy bills as a result of Government initiatives.

## Creating a Level Playing Field in Europe

34. We support Ofgem's leading role in Europe, seeking to influence Member States' implementation of important European legislation and regulation, and ensuring that UK customers, industries and power companies are not disadvantaged by differential application of European legislation. Harmonisation of key arrangements between GB and the rest of Europe will be necessary, especially as interconnection increases, 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 charges paid by generators, so as to ensure that power importers are not unduly advantaged over generators in GB.

### **Better Regulation**

35. Overall we firmly believe that better regulation through reducing regulatory uncertainty should be key to the entire regulatory framework in the UK and that Ofgem should adhere stringently to this principle in all areas of work. We would encourage Ofgem to continue to engage with stakeholders in an open way and to avoid policy surprises. We believe this way of working will be critical in order to develop a regulatory policy which supports investment and therefore assists the UK in meeting both the carbon reduction and renewable energy targets.

### **Changes to Ofgem's Structure**

36. In relation to the recent change to Ofgem's structure, announced on 8<sup>th</sup> September that it is to be organised in two groups, Ofgem E-Serve and Ofgem, we believe this is a sensible approach in the current environment.

### **Conclusion**

37. We are keen to continue to work with Ofgem to develop workable solutions which incentivise the necessary investment in the network and encourage sustainable generation, so as to ensure secure energy supplies as well as providing maximum benefit for the consumer as a result of a wholly functioning, competitive market. We look forward to the publication of Ofgem's draft Five Year Strategy 2010-2015 and to working with you again over the coming year.

ScottishPower  
22 September 2009