



SCOTTISHPOWER

Nick Horler
Chief Executive

Lord John Mogg, KCMG
Chairman
Ofgem
9 Millbank
London
SW1P 3GE

NH/AAK

21 December 2009

Dear John,

Electricity Distribution Price Control Review Final Proposals – December 2009

Following on from the call you have had with the Chairman of Iberdrola, I write to confirm that ScottishPower is minded to accept the Electricity Distribution Price Control Review Final Proposals published by Ofgem on 7 December 2009 on behalf of SP Manweb plc and SP Distribution Ltd, subject to their full, correct and complete translation into a coherent set of licence condition modifications and regulatory instructions.

In coming to this decision the ScottishPower Board undertook a very intense review of the overall DPCR5 package. It will not surprise you that we had a very robust debate surrounding the headline rate of return, which has been reduced below its 20-year average at a period of unprecedented economic and environmental challenge. I would emphasise that despite our acceptance of the overall package, we do not agree with the level of reduction in the weighted average cost of capital, particularly when contrasted against the level of risk and uncertainty surrounding the global energy sector, and we believe that ultimately this decision will discourage the vital investment that the United Kingdom's infrastructure requires.

ScottishPower's acceptance is based on a full assessment of the package and has ultimately focused on the following areas:

- Ofgem have addressed our serious concerns surrounding the losses incentive mechanism by adjusting our targets for DPCR5 to a realistic level and removed the revenue unit volume driver which we believe had little or no correlation with our costs
- Ofgem have committed to allow full recovery of the SPD and SPM proportion of our company pension scheme deficits and acknowledged the legislative protection provided to pre-privatisation employees
- We believe that there is the scope to improve the base rate of return by earning additional revenues through operational efficiency and incentives and that by fully implementing Iberdrola's global model for excellence, we will be able to achieve the level of return that our investors demand.

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I would also like to mention some of the feedback I received from our Board and our investors regarding the overall DPCR5 process. Given the level of expenditure that the company will be required to fund in the next five years we found it extremely frustrating that there was no clear sight of Ofgem's position on key items such as the cost of capital and pensions, and in particular the scale of the reduction in WACC Ofgem had in mind, until the final proposals of this price control review. We hope that this will not be the case in future and as we look forward to the next Transmission Price Control Review.

Putting these issues to one side, we will now look forward to closing the chapter on DPC4 and I would hope that ScottishPower and Ofgem can both look ahead to delivering a successful outcome for all network customers and companies over the next five years.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nick', written in a cursive style.

Nick Horler
Chief Executive