

RWE npower



Professor Maxwell Irvine FRSE
The Royal Society of Edinburgh
22 – 26 George Street
Edinburgh
EH2 2PQ

Your ref
Our ref
Name Terry Ballard
Fax
E-Mail Terry.Ballard@rwenpower.com

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RSE Inquiry into Energy Issues for Scotland

Dear Professor Irvine,

Thank you for your letter dated 13th May 2005.

Please find attached a response on behalf of RWE npower. We are happy for the contents of our submission to be made publicly available.

Yours Sincerely

Terry Ballard
Economic Regulation

RWE npower

Trigonos
Windmill Hill Business
Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

T +44(0)1793/87 77 77
F +44(0)1793/89 25 25
I www.rwenpower.com

Registered office:
RWE Npower plc
Windmill Hill Business
Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

Registered in England
and Wales no. 3892782

SUBMISSION TO THE ROYAL SOCIETY OF EDINBURGH INQUIRY INTO ENERGY ISSUES FOR SCOTLAND

ON BEHALF OF RWEpower

Introduction

RWEpower is an integrated energy company owned by the RWE Group, a European multi-utility company based in Essen. It is the managing company of RWE's UK energy business employing approximately 10,000 people.

RWEpower and its sister company RWE Trading combines substantial generation activities with an established presence in the traded energy markets. We manage a flexible, low-cost portfolio of around 8,000MW oil, gas and coal-fired power stations based in the south of England and almost 2,000MW of co-generation (combined heat and power) plant making us one of the United Kingdom's leading generating companies. We also provide trading services to smaller, independent market participants.

The RWEpower retail business, called "npower", was formed largely from the purchase of supply businesses from the former Midlands Electricity, Yorkshire Electricity and Northern Electric. npower serves approximately 6 million customer accounts, making us also one of the United Kingdom's leading energy supply businesses.

RWEpower's renewable business develops and operates wind and hydro plant that produce sustainable and environmentally friendly electricity. This clean electricity provides an alternative to fossil fuels, as part of our commitment to the Government's targets for renewable energy production.

Npowerone, RWEpower's operation and engineering business, provides support and specialist services to other power plant owners and operators around the world, in addition to supporting our own generation assets.

The Development of Energy Markets

Since the privatisation of the gas and electricity industries in 1986 and 1990 respectively, the two energy markets have developed significantly. Whereas previously they would have been considered in terms of their national geographic boundaries, they have arguably joined the oil and coal markets in becoming global and at the very least European.

Experience from the UK suggests that the most effective method of ensuring that demand for electricity is met and security of supply maintained is to encourage market based solutions. RWEpower supports the benefits of liberalised markets for the production, trading and supply of energy in the UK and Europe and the removal of barriers to entry. This should be accompanied by clarity and stability of policy from Government and their Regulators with a minimum of market intervention and the avoidance of micro-management. For markets to be fully effective in delivering secure energy supplies at lowest cost, distortions must be removed and costs borne by those whose actions cause them. Transparent fully traded markets will deliver the lowest costs for customers and address the environmental challenges (particularly CO₂) that face the energy industry. RWEpower supported and played an active role in the introduction of the British Electricity Trading and Trading Arrangements (BETTA). This will enable Scotland to benefit from the GB-wide arrangements that have proved largely successful since their introduction in England and Wales in 2001.

It is clear that the UK faces challenges in the future with ageing generation assets and the declining supply of gas from the UKCS. Although these issues are exacerbated by the slow progress of liberalisation in European markets, we are confident that the market-based framework that currently operates within GB will provide the appropriate signals for investment. This has already been the case with a number of energy companies announcing their intention to both invest in new generation and construct gas importation and storage facilities.

Our view that market mechanisms will ultimately deliver security of supply leads us to the conclusion that Scotland should not aim to be self sufficient in energy in general or electricity in particular. Such a move would result in a sub-optimum solution and lead to customers incurring additional unwarranted costs.

Similarly we believe that it would be unrealistic to determine an optimum mix of generating technologies within a national portfolio. It is better to ensure that an informed decision can be made regarding any investment by removing obstacles and allowing like for like consideration of alternative investment options.

Scotland's Transmission and Distribution System

RWEpower believe that robust networks are required to transport energy to customers in the UK and to and from interconnected markets. As a vertically integrated company, predictable network charges are important to enable us to offer accurate charges to our customers. The methodologies used in the calculation of network charges should be clear and transparent and applied equitably to all market participants. If Government policy dictates that there is a requirement to subsidise particular classes of participants e.g. renewable generation or remotely connected customers, this should be done explicitly and outside the market framework.

It follows therefore that any pricing arrangements for use of transmission and distribution systems should ensure that the economic signals sent to market participants reflect the costs of their actions. For example, charges should accurately reflect the cost of transporting generation to the point where it is consumed. We therefore support the recent introduction of GB Charging Methodologies to the National Grid Company's Transmission Use of System charging arrangements. We see no reason for subsidising or smoothing of these charges to favour either particular technologies or regions.

In addition to the recent use of system changes, we believe that a further refinement for transmission losses is also required. At present losses on the transmission system are charged on a uniformed basis. This does not reflect physical losses and does not provide locational signals. We support the introduction of a scheme for locational losses that allocates the cost of losses to those who cause them.

RWEpower maintain that these refinements, together with a liberalised market regime are the best way to ensure security of supply.

There are limits to the application of a market-based framework to monopoly network systems. It is the responsibility of Ofgem to regulate the monopoly activities of the network owners and operators to ensure that a reliable system is available at economic cost.

Scotland, and the north west of Scotland in particular, is an area where considerable investment in wind powered generation is anticipated in order to achieve the Governments targets for carbon reduction. Ofgem have recognised that no allowance was made for this investment when the existing transmission price controls were set in 1999 and 2000 and have subsequently agreed allowances for an additional investment of up to £750m. This will ensure that the required investment is carried out in a timely manner and before the issue is given further consideration when new price controls are set for April 2007 and beyond. These measures will ensure that the UK transmission system remains robust despite the additional challenges.

Environmental and Social Issues

The UK Government has committed itself to a number of environmental targets particularly CO2 reduction, however the approach and mechanisms adopted to date has been piecemeal. A more coherent framework is required in order to deliver this policy. Agreement on environmental constraints is required for at least the next fifteen years. This, coupled with market-aligned policies will allow the delivery of the investment programme needed to deliver reductions in CO2. To date the electricity industry has been the primary focus of these policy initiatives. It is increasingly important that other sectors of industry also become fully engaged in achieving climate change measures.

The long-term stability of the Renewables Obligation (RO) mechanism is fundamental to maintaining investor confidence. This has been aided by recent extension of the Government target to 15.4% by 2015/6. This has allowed RWEpower to invest in significant renewable plant in Scotland. Here, as in the rest of GB, planning remains a significant challenge to delivering the new capacity to meet Government targets. We are particularly concerned about the ability of an increasingly influential minority to frustrate the planning process, despite strong evidence that the majority of public generally support new renewables projects. A stronger lead is required from those in a position of influence in promoting the 'hearts and minds' campaign for wind power.

Offshore wind is key to achieving the target growth rate in renewables capacity. Again Scotland is well placed to provide a significant proportion of GB renewable requirements through this technology.

The energy price faced by customers is driven by the underlying costs of commodities be they carbon, gas, coal or wind and the costs of production. Inevitably as the price of these commodities and/or technologies rises, so will the price of energy. Whilst we believe that the major cause of fuel poverty is that of a poorly constructed national housing stock, higher prices will further disadvantage poor and vulnerable customers. There are significant numbers of these customers located in Scotland. We recognise that our view that the market will ultimately deliver economic pricing signals is of little comfort in the short term to these customers. RWEpower supports the government target of removing vulnerable customers from fuel poverty by 2016 through a number of programmes and complying with our obligations under the Social Action Plan. Achieving the 2016 target will however require a significant improvement in the identification of vulnerable households and the directing of resources in a more effective way. This is an area where Government departments and Local Authorities have the necessary information and should provide a lead.

Conclusion

The energy market is no longer confined to national boundaries. It is at least European and must be considered in this context. UK experience has demonstrated that liberalised market-based solutions are the best means of ensuring that demand for electricity is met and security of supply maintained. In European markets progress towards liberalisation has been slow and should be accelerated. This will provide Scotland with greater security than aiming for self-sufficiency in energy in general and electricity in particular.

There have been capital expenditure adjustments to the price controls of the Transmission Owners to ensure that the anticipated growth in renewable generation in Scotland can be accommodated. This, combined with locational price signals will ensure that the transmission and distribution systems remain robust and that participants are allocated the true economic cost of their actions.

The extension of the Renewable Obligation mechanism will give greater confidence to investors in renewable generation, a large proportion of which will be situated in Scotland. It is important that planning issues are addressed and that wind power is championed.

Higher fuel prices exacerbate the problems of the fuel poor. RWEpower supports the target of removing vulnerable customers from fuel poverty by 2016. Government and Local Authorities can provide a lead by identifying vulnerable customers. This will ensure that resources are more accurately targeted.