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Dear Gill

**Ofgem's Draft corporate strategy 2003-06**

I write in response to Callum McCarthy's letter of 22 November 2002 and your draft corporate plan for 2003-6.

We are pleased to have the opportunity to contribute further to the discussion on Ofgem's plans for the next three years. The process of dialogue on your work is very welcome. I will try to add to the observations in our letter of 21 August 2002, which responded to your previous letter on the formulation of the plan. I will structure our reply to follow the specific sections in the draft plan:

**1 Making competitive markets work successfully.**

From our perspective as an electricity distributor, we have consistently encouraged the development of competition in the electricity supply and generation markets and we note the positive effect this has had on customer prices. We supported the withdrawal of price regulation in the electricity supply market as soon as there was evidence that competition was effective. As a general principle, we believe that competition law should be used wherever possible to regulate markets.

**Wholesale and retail markets**

The demise of TXU Europe and the problems of British Energy clearly demonstrate that the wholesale and retail markets are not operating without difficulties. We fully accept that Ofgem has a role and must act where necessary "to safeguard consumers' interests, secure supplies and ensure competition works effectively". However it is also important that the obligations of all parties are appropriately defined and managed. Those providing the supporting infrastructure should also be able to protect themselves from the consequences of company failure, especially as they have so little ability to choose who their 'customers' are. There are times when it seems as though



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the focus of market reform looks only to the immediate needs of customers and the big players in the competitive generation and supply markets. However we would encourage you to ensure that under this heading you also address the concerns over credit cover for Distributors and others, the implications of developments in network access for DNOs and the wider question of market governance. During the debate over NETA we recommended that Distributor obligations under CUSC and BSC be stripped out into separate agreements where DNO's could have a stronger voice in governance than would be appropriate for many of the issues that these market wide documents cover. We suggest that these ideas are resurrected in your further work on the development of markets.

### Industry structures

Ofgem's success in creating a competitive metering market should be acknowledged, and the level of regulatory intervention in this area should be significantly reduced. The contracts recently won by United Utilities and Transco are evidence of increasing competition. The work of the various groups on metering chaired by Ofgem should be concluded as soon as possible. Innovation can best be encouraged by giving market participants the freedom to develop their own solutions, so long as this is not done in a way which distorts future competition.

In contrast Ofgem's work to develop competition in connections has not yet reached the stage where a true national market exists. We believe that work here should concentrate on the development of suitable adoption arrangements that will make it easy for the naturally competitive construction market to be separated from the long term ownership and management of network assets, which must continue to be a licensed activity.

We also think it would be appropriate to consider here the future of gas distribution. The existing project to separate price controls between LDZs must be extended in scope, as Richard Ramsay suggested at the workshop on 30 January, to make sure that the separately price controlled entities are capable of a sustained existence under separate ownership. If not, many of the opportunities for customer benefit from this project will be lost, and there will be no change to the structure of gas distribution in Great Britain.

## **2. Regulating monopoly businesses effectively**

### Developing regulation

The preparation for the next Distribution price control is now the key component of this area of Ofgem's work. The work during 2003/4 is critically important. We see three key elements that should be addressed through your plan:

- sufficient resources must be applied to tackle the extended scope of work implied by both the fundamental review of methodology and the challenge of network transformation
- a timetable must be established and committed to so that all parties can plan their work effectively

- maximum continuity must be maintained despite the senior staff changes that are anticipated in 2003. We recommend a more substantial role for the non-executive members of GEMA as a way of achieving this.

### Electricity

We welcome Ofgem's proposal to tie together the various strands of work relating to distribution businesses. In particular the timetable of work on both distributed generation and the structure of charges must be linked to wider price control deliberations. This may require the application of more resources over a relatively short period to ensure that a consistent and coherent set of proposals emerge for the next price control period. In this context it may help to defer any work on extending the concept of tradeable network access rights to distribution systems. Though this may eventually be valuable, it does not seem likely to us that it will be a priority before 2010. Another issue for the later part of your planning timeframe will be the need to create a level playing field between DNOs and private networks and the consequent issues of liability, performance and safety that must be resolved.

### Gas

We welcome the recent publication of the further consultation on price controls for Local distribution. We will be responding in due course to that consultation but we would urge Ofgem to not simply concentrate on the introduction of separate price controls, but to focus on wider issues. If genuinely separate regional network companies are to be created, then Ofgem must also examine issues such as system operation, safety and service performance if Transco do decide to sell off one or more of its regional networks. We welcome the comments of Richard Ramsay at the meeting of licensees on 30 January, that Ofgem were now considering whether to add non-price control issues into the work programme for LDZs. We would urge Ofgem to do that, and as stated at the meeting, the resource implications for both Ofgem and Transco must be addressed. This work needs to be aligned with the project on IGT pricing, so that all network operators face comparable regulatory obligations, and competition between them (to the extent this is possible) is fair.

## **3. Securing Britain's gas and electricity supplies**

There will be an increased interest in this issue when the Government publish their White Paper. We envisage debate over the security and reliability of energy supply in light of recent events in the market and a review of customers' expectations for service standards in the future. We recognise that any significant shift in requirements will need to be indicated by government rather than Ofgem, but we strongly believe that Ofgem should engage in the debate and be ready to advise Government on the statutory changes necessary to convert their policy objectives into reality.

## **4. Helping to tackle fuel poverty and meeting environmental objectives**

As with security of supply, we recognise the challenge to the Regulator and the industry in meeting social and environmental responsibilities. You are aware of our commitment in this area and in particular of John Roberts, our Chief Executive's engagement with issues relating to renewable generation and energy efficiency. Again

we see an important part of Ofgem's role as advising Government on the means to deliver its policy goals. Sufficient resource within Ofgem must be available during the period of debate after the publication of the Energy White Paper and the formulation of subsequent draft legislation.

## **5. Other issues**

We have commented before on Ofgem's tendency to take on too many tasks simultaneously. This not only causes resource problems for you but also makes it difficult for us to do justice to the many issues upon which we wish to comment and contribute. If Ofgem concentrate on a small number of core issues, it would allow resources currently being spent on less important issues to be diverted. Greater prioritisation is still required. We have also commented previously on the uneven publication of documents at certain points of the year. We found it frustrating again last year when, just before Christmas, we were faced with the publication of ten consultation documents, including the four documents relating to Betta, between 16<sup>th</sup> and 18<sup>th</sup> December 2002. As far as possible it would be helpful if consultations could be spread throughout the year, with most time allowed for those of greatest significance. In our view your current priorities should reflect the key challenges discussed above.

We also note that important elements of the Better Regulation Taskforce report including cost-benefit analysis of plans have yet to be implemented by Ofgem and the corporate plan would benefit from such improvements. We welcome the indication at the meeting on 30 January that from 1 April some consultation papers would include a regulatory impact assessment, with particular emphasis on environmental and security of supply issues.

I hope you find these comments helpful. Clearly, the delayed publication of the Energy White paper casts some uncertainty over the scope of work in the coming year. However we trust that Ofgem are fully engaged with government on this issue, and will be ready to respond to the activities that emerge. I would be happy to discuss any of our above comments with you at greater length.

Yours sincerely



**Mike Boxall**  
**Head of Electricity Regulation**