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Dear Andrew

### **Regulation of Electricity Distribution Licence Holders**

I write in response to your open letter of 31<sup>st</sup> May 2002. I am pleased to contribute to the discussion on the future regulation of distribution businesses. Our comments should be read in parallel with our response to your consultation on IGT charging. It is particularly encouraging to see that you also recognise the linkages between these issues and that you will therefore consider proposals that can apply to both gas and electricity markets.

### **General Principles**

During the discussions on the new licensing regime introduced under the Utilities Act 2000, we consistently argued for an approach that would place identical obligations on all parties, which would, in effect, be operating monopoly businesses.

At the time our arguments were not taken up. ‘Special conditions’ were identified that would only apply to the ex-PES distributors, and an exemption regime proposed that would also reduce the levels of customer protection available on networks with a limited number of connections.

We welcome the review of regulatory arrangements that you have initiated, and now feel able to add comments based on our experience of the gas transportation market which has seen a similar lack of regulation of new entrants, causing problems that are addressed in your paper on IGT pricing.

### **Charging Arrangements**

Once constructed, a distribution network is an effective monopoly. We believe it is essential for all customers to be afforded the protection available from price controls. The lack of adequate control on prices in the gas market has created the headroom for transportation businesses to provide ‘cashbacks’ to developers, which are ultimately funded by higher prices



to consumers for delivered gas. A system of price control could have prevented this by forcing such payments to be made from shareholders' funds, not customers'.

We believe that competition is more likely to be effective in the construction of connection assets than in the subsequent ownership of small local networks, and that regulatory arrangements should therefore encourage the former. This is likely to mean, especially in the new housing sector, that multi-utility contracts become common place. This increases the importance of suitable adoption arrangements as a means of transferring ownership of connections once constructed. We believe all distribution and transportation licences should include an obligation to adopt, where the licensee can specify reasonable requirements for new assets, (including inspection arrangements during construction), and publish adoption terms that include payments related to future tariff income.

Such a model would support the competitive connections market whilst still allowing the constructor or the developer to take out a distribution/transportation licence if they believed that there were further profit opportunities from doing so.

### **Quality of Service**

The arguments on quality of supply are the same as those on charging. Customers need to be sure that their network provider is focussed on delivering value for money. It seems equally appropriate to apply guaranteed and overall standards of service and IIP-style performance incentives to new licensees. We accept that there may be initial difficulties in setting targets and welcome your proposal to begin data collection as soon as possible. It is also worth noting that the process to set new price caps may be easier if Ofgem is able to specify allowed income and service levels simultaneously.

One further point to consider is the presentation of Quality of Supply information. We have, for the last two years, prepared, on a voluntary basis, a short form Quality of Supply Report. This is welcomed by our local Energywatch office and customers, who find it easier to understand than the full technical report. It may be helpful if new entrants were also encouraged to report in this way.

### **Financial Ring-fencing**

The financial security of network businesses is particularly important as there is no 'distributor of last resort' to pick up the consequences of a failed business. We therefore agree that Ofgem must be as concerned over the financial stability of a new licensee as they are of the existing licensed distributors. We would urge you to exercise caution before relaxing the requirements of any of the conditions (43-47) that you discuss.

### **Regulatory Accounts**

We agree that standardised regulatory accounting is an important feature of price controlled businesses and we support the extension of a Licensee obligation to this effect to all licensed network businesses. Putting such an obligation in place from the outset should help secure standardised reporting, and will provide Ofgem with data to assist in the formulation of appropriate price caps.

## Conclusion

We welcome your consultation, which, taken together with the review of IGT charging, should allow Ofgem to develop a more appropriate framework for alternative provision of local network assets. We believe that competition in connections is more likely to deliver real value to customers and should be encouraged through an obligation on network operators to adopt assets (subject to appropriate terms). Where other parties wish to own assets they should face identical obligations to those of the existing licensees. In such an environment the companies able to provide the best service (in terms of quality and price) should thrive.

It is unfortunate that you were unable to join our meeting on 25<sup>th</sup> June when we had the opportunity to discuss our views with your colleagues. I would be happy to meet you for a further discussion if you would find it useful.

Yours sincerely

A handwritten signature in black ink that reads "Mike Boxall". The signature is written in a cursive, slightly slanted style.

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