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4th February 2004

Dear Chris

Ofgem Proposed Corporate Strategy : 2004 - 2007

I write in response to Ofgem's further consultation on the above. We welcome the further chance to contribute to the development of the Ofgem Corporate Strategy, and would commend you for the improved presentation in your latest booklet. We have commented previously on many of the issues raised. I set out below our key observations under the seven themes identified in your document.

Creating and sustaining competition

Distribution businesses play an important role in supporting the competitive supply and generation markets, not least through the non-discriminatory delivery and infrastructure services we provide. At United Utilities we are also keen to play a growing role in the competitive metering and connections markets. We have been innovative in both areas in offering new services to our customers, who are often also major players in the energy market. However, there is a danger that Ofgem can slow the rate of market development through a reluctance to cast off existing regulation, or by introducing unnecessary new controls. We hope that Ofgem will be more prepared to step back having created an environment in which competition should be able to flourish.

Regulating network monopolies

The Distribution price control review is of paramount importance to distributors and we particularly welcome the open and constructive process that Ofgem has implemented. The review provides a new opportunity to construct a coherent framework of incentives. We welcome the stress placed in the strategy document on the importance of investment, incentives, renewables and service standards for the future. In our view, it is as important for incentives to encourage appropriate behaviour as it is to promote cost efficiency. We hope that the price control review process will develop clear links between allowed income and the delivery of services that meet the needs of customers and Government. This must include recognition of the linkage between investment levels and supply quality, levels of risk and network resilience.

We believe that Ofgem should work with energywatch to identify customers' requirements and also consider whether there is a separate public interest that reflects Government social policy. We welcome the Ofgem research into willingness to pay but it is imperative that this is a robust piece of work that clearly indicates the preferences of customers. Once standards have been set, network operators can be incentivised to consistently meet those levels of performance. This is not an easy area, but recent events indicate that the public debate will continue until there is greater clarity over both standards and the means of measuring performance. The current work on future structures for distribution charges is running parallel with the DPCR, and we hope that potential conflicts will be removed and scope will remain for commercial innovation.

More generally the price control review must allow companies sufficient funds to operate. This means that revenue allowances must reflect the requirements of the capital markets from which we must draw investment finance. It also explains our concern for appropriate use of comparative analysis on company performance. We welcome the efforts that Ofgem are taking to ensure consistency of data, and expect that a more robust approach to revenue setting can result.

Helping protect security of supply

The Energy Policy Review raised the question of security of supply. Recent events, internationally and in the UK, have added to the prominence of this debate. To the extent that this is an issue of network resilience, it is important that public expectations are clarified in good time for the impact to be assessed within the near future. Network resilience demands greater attention and we would welcome any shift from short term to longer-term perspectives on asset performance and network management. We hope to contribute positively going forward to the debate on defining and measuring resilience.

As we have indicated previously, the focus of attention in this area should now be on trying to develop a mechanism that can monitor the resilience of networks on an ongoing basis. This would then provide a means of reassuring Government and consumers that severe events, such as storms, would have no more effect on supplies than was reasonable in the circumstances. The search for measures of resilience has not yet proved successful, but the growing public awareness of the issue should encourage us all to redouble our efforts to find a solution. As with IIP, we should aim to find an outcome-based approach that can then be 'priced' to reflect customers' willingness to pay, possibly amended to reflect any Government social policy guidance.

Helping protect the environment

The Energy Policy Review also reviewed targets and aspirations for a low carbon future. However the delivery mechanisms associated with these objectives appear inadequate. There is widespread doubt over the ability to meet the targets for 2010 on both renewable generation and CHP. For renewables, in particular, there are problems that extend beyond the Renewables Obligation market support mechanism (though this also has its problems). Potentially successful projects are also deterred by the difficulties of achieving planning consents and the problems relating to connection to networks that were not designed to take large energy inputs.

We have always argued that Ofgem can play a major role in advising Government of what is needed with regard to distributed generation and in suggesting detailed solutions to particular problems. This should include the difficulties faced by renewable generators, uncertainty over the long-term future of ROCs and the network related issues arising from both planning and connection difficulties.

We are pleased to see that Ofgem have begun to develop an incentive regime aimed at accelerating the connection of distributed generation, but remain concerned that the proposals to date still bear the hallmark of a regulator concerned to avoid additional cost. Our comments in the Structure of Distribution Charges consultation on GDUoS reflect our view. The immediate need is to achieve a step change in the rate of development. This is likely to require commitment to construct infrastructure able to accept increasing volumes of new generation. This inevitably involves some speculation. The risk needs to be shared with society, in recognition of the environmental benefits that are expected to emerge in the longer term.

A leading voice in Europe

We welcome Ofgem's intention to be active in Europe. In many of these areas, the UK has been at the forefront of establishing a regulatory framework and it is important that the needs of others within the EU do not inhibit the development of the regulatory framework within the UK.

Helping tackle fuel poverty

Whilst most issues in this area are the responsibility of suppliers, we accept the important role of distributors in some areas such as the priority services register and we continue to work constructively with Ofgem and energywatch on issues that we can have some input on.

Improving Ofgem's effectiveness and efficiency

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. We continue to believe that Ofgem should focus its attention on a smaller number of major items of work. In our view your current priorities should reflect the key challenges discussed above.

Furthermore, it may be worth making a couple of observations on Ofgem's ways of working. We believe there can be a tendency for projects to run on too long. Once an issue has been raised it is important that it is dealt with promptly, removing uncertainty for customers and companies alike. We can think of recent examples, such as the treatment of DUoS bad debts, where this has not been the case. As a general principle it would be helpful to see quicker decisions and more obvious precedents being set, with guiding principles clearly evident.

I hope you find these comments helpful. We would be pleased to discuss them further if this would be of assistance.

Yours sincerely

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Head of Electricity Regulation

Cc: Sir John Mogg