



United Utilities PLC
Dawson House
Great Sankey
Warrington WA5 3LW

Telephone 01925 237000
www.unitedutilities.com

Mr Jonas Törnquist
Head of Electricity Transmission Policy
Networks Division
Ofgem
9 Millbank
London SW1P 3GE

Direct Line 01925 237096
mike.boxall@uuplc.co.uk

25th May, 2004

Dear Mr Törnquist

Transmission Investment for Renewable Generation

We welcome your latest consultation on the funding of transmission reinforcement for renewable generation. We share your concerns about the need for imminent decisions if the infrastructure is to be in place to meet the government's targets and aspirations. In particular we agree that it is inappropriate to trust to the existing price control mechanisms until the next review and then hope to address these issues at that time.

I would also like to draw your attention, as we did in your first consultation on this issue last October, to the similarities between these issues and UU's situation in Cumbria. The physical requirements for new 132kV circuitry in Cumbria are subject to identical drivers as in Scotland, albeit the quantity of applications in Scotland has brought these issues to a head sooner. We believe that many of the observations you make about Scotland apply, or will apply, directly to Cumbria. I am sure you would agree that the distinction between transmission and distribution in this case is merely one of semantics.

We generally agree with the views expressed by Ofgem in this document and the arguments by which you justify them, and particularly in relation to the need to create a funding mechanism that is an addition to the existing price controls. In particular we agree that it would be inappropriate to re-open price controls.

We also support your views on the need to provide lump sum funding based on your assessment of the necessary investment. We note that this is an extension of existing investment treatment, giving significant incentives on the licensee to deliver an efficient solution. It is worth pointing out that the licensee's ability to outperform under this arrangement is less than with the totality of a normal price control, as there is no diversity of investment and of construction risk. We therefore believe that such an investment requires a higher cost of capital than the diversified investment of the price control.

We believe that the matter of outputs is simply catered for in this case. You, and your consultants, will agree the broad level of reinforcement required which can be expressed



fairly simply in terms of new circuitry of appropriate capacity between new or existing major substations. There will be little ambiguity about whether such assets have been constructed as envisaged. The real outcome is new capacity. The capacity is implicitly agreed in the overall agreement to fund the assets: however it is the operation of the transmission System Operator incentives (post BETTA) that will ensure the capacity is efficiently utilised.

We agree with your assertion in 4.23 that there is more certainty in transmission than distribution in general, given the large land area of renewable development that transmission reinforcements open up. We agree that the lump sum mechanism you propose is appropriate. We also believe that this is an appropriate solution for similar strategic reinforcements on the 132kV system in England, ie Cumbria. We would therefore expect to agree such an approach in Cumbria when the time is right. We took some trouble in our response to the March DPCR consultation, sent to David Gray on 21 April, to explain our concerns about the proposed hybrid incentive scheme to bring forward necessary strategic investments, as opposed to the investments associate with individual schemes. We believe that our analysis therein is in harmony with your own in this regard.

Finally in answer to those questions in Chapter 7 where we believe we have something significant to say:

- We agree that licensees should be allowed revenue to fund the projected investments, starting in 2004/5.
- Formal agreement of outputs is not necessary, save at high level, as the lump sum treatment and SO incentive will ensure efficient investment and operation.
- The cost of capital should be marginally higher than for the main price control, given the lack of diversity in the investment.
- We agree that there is little other option for Ofgem than to employ expert consultants to agree the necessary scope of investments.
- We believe that there are other important dimensions overlooked in trying to do a simple cost benefit analysis regarding the costs of constraints if reinforcement is not done, versus the financing costs of the investment. Our principal concern is that whilst renewable plant is constrained, other fossil fuel plant is running to provide the energy, and contributing to the CO₂ emissions that the renewables policy is supposed to be reducing. We believe that the RIA for these proposals should include the environmental disbenefits of constraining renewable generators. In responding to the March Distribution Price Control consultation, we went to some lengths to explain our views on the RIAs that Ofgem is now producing. Given that you will now be contemplating the RIA to accompany your July proposals, we would be grateful if you would consider our points in the formulation of that RIA. We sent our comments to Nienke Hendricks on 5 May.
- We do not believe that it is appropriate or practicable to try to force certain generators to enter long term contracts. Rather, there should be a framework where once investment has been made to further the government's objectives, any stranded costs that arise should be spread over a wider consumer base in the UK as possible. Costs in TNUoS charges are well placed to achieve this.
- We believe that there should be no different approach in relation to network access and rights for generators connected to reinforced network than for any other part of the network.
- We do not have a ready answer to the question of how to engineer equitable charging arrangements between distribution or grid connected generation for use of the

transmission system. We continue to believe that a realistic threshold should be set for licensing (or a régime that calls for the equality of commercial treatment) such that all generators above a de-minimis size become caught by the balancing mechanism. Clearly, though, this goes against the DTI's wish to remove licensing requirements from generators sub 100MW. An alternative would be to apply some level of BSUoS charges to embedded generators over a certain size through their contracts with Suppliers, but it is hard to see how this could be achieved with changes to the Supply licenses and possibly even primary legislation.

We hope you find these comments useful. Please do not hesitate to contact me if you think I can be of any further help.

Yours sincerely

Mike Boxall
Head of Electricity Regulation