



United Utilities PLC
Dawson House
Great Sankey
Warrington WA5 3LW

Telephone 01925 237000
www.unitedutilities.com

Sean O'Hara
Head of Connections Policy
Office of Gas and Electricity Markets
9 Millbank
LONDON
SW1P 3GE

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

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Dear Sean

Regulation of IDNOs

I refer to your recent consultation paper and the workshop that we attended on 15 February. We are pleased to note that some of our comments to previous consultations last year have been reflected in these initial proposals. We have consistently argued for an approach that would place identical obligations on all parties that would be operating monopoly businesses. This would ensure that customers face the same level of protection regardless of who owns the network to which they are connected. However, there are still some issues that we would wish to comment on.

Charging arrangements

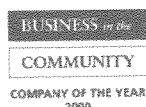
We have considered the various options described in the consultation paper. We prefer Option B (IDNO RPI-X regulation) but recognise the burden this may place on small IDNOs. We believe Option A should be the preferred option for IDNOs with less than 20,000 connections and Option B for IDNOs with more than 20,000. Our reasons for choosing these options are as follows:

Option A: Keep existing arrangements

- This satisfies the principle that it does not disadvantage consumers connected to an IDNO when compared to the incumbent DNO's network. It promotes competition between IDNOs, where the IDNO is connected at HV but supplies its consumers at LV. Other industry parties such as suppliers are not faced with more complex pricing structures, and the cost of implementation is less than the other methods.
- Option A may not be cost reflective of the IDNOs own costs, but it is cost reflective of the incumbent DNO's costs, which make up a significant element of the supplier's UoS charge.
- It provides consistency of charging for both IDNOs and DNOs across the industry.

Option B: RPI-X regulation based on IDNO's costs

- It produces cost reflective pricing.
- The same approach is applied to both IDNOs and DNOs.
- It provides a "level playing field" in terms of methodology for both IDNOs and DNOs.
- Provides the IDNO with greater certainty over charges.



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- It encourages the IDNO to operate efficiently.
- The drawback suggested in the consultation document was the regulatory burden the IDNO would have to carry. Our view is that all but the smallest of the IDNOs would be supported either by a DNO operating out of area or by a parent entity such as a construction company. Such licensee organisations can get the backing needed in terms of infrastructure and resources to manage these regulatory obligations.

Tiered Approach

Our suggested national threshold would be 20,000 connections, much lower than the 50,000 to 500,000 connections suggested in the document. This would enable IDNOs to commence operating under option B at a much earlier stage. The number of connections is only one indicator of the size of an IDNO, with electricity demand or units distributed and value of asset base being others. Networks, totalling over 20,000 connections, involving a significant proportion of commercial properties (with high electricity demand) may be considered to be relatively large.

Option A would operate for IDNOs with less than 20,000 and option B for IDNOs with more than 20,000 connections.

Start Date for the Review Period

Ofgem suggest 3 possible start dates – April 2005, September 2005 and April 2006.

As we are proposing options A and B, April 2005 should be the start point as it is consistent with the DNOs start point for DPCR4.

In terms of the other options, Ofgem were proposing September 2005 and April 2006 so as to minimise the impact of any price distortions that may occur at the start of DPCR4. Our view is that price corrections will continue to occur annually. Therefore any delay in the start date is unlikely to address Ofgem's specific concern.

Period of Price Control

The period of the price control should be consistent with DNOs i.e. 5 years.

Ofgem recommend that a review of arrangements would occur no sooner than year six i.e. 2011. We believe that a much sooner review is required, i.e. in year 2 or 3, particularly if the tiered approach with a threshold of 20,000 were to be implemented.

Aligning Gas and Electricity (Billing and Credit cover)

It was clear at the recent workshop that all DNOs were supporting the view that the IDNO should bill the supplier for the total distribution use of system associated with consumers directly connected to the IDNO network. The contractual relationship for UoS on an IDNO site is between the IDNO and the supplier, not with the DNO. The DNO should bill the IDNO for the upstream UoS up to the point of connection between the IDNO and the DNO. Such an approach is much simpler as the DNO does not require information about individual consumers (e.g. loadings, domestic/non-domestic, single rate/multi rate), but will raise one bill for units exiting the DNO network on the basis that the IDNO is a 'single consumer' on an agreed single tariff structure.

The new credit cover arrangement due for implementation in April 2005, should equally apply to IDNOs.

We cannot accept the argument put forward by the IDNOs that the DNO should carry some of the risk for upstream UoS if a supplier defaults. It is almost equivalent to suggesting that UU should have some liability for the debtors of its own goods and services providers. There is no point in developing a new system providing for IDNOs, if DNOs at certain points are expected to carry a liability for a contractual relationship between IDNO and supplier that the DNO is not a party to.

Boundary metering

It was clear at Ofgem's recent workshop that there was a clear division of opinion as to the necessity for boundary metering. We continue to believe that boundary metering is needed to accurately determine the level of DUoS and importantly, the accurate level of network losses. Whilst we appreciate that the requirement for metering in the case of low voltage connections from the existing LV network brings with it additional cost, your paper and the recent meeting offered no clarity as to how accurate DUoS charges would be arrived at if there is no metering at the boundary. We believe boundary metering is essential in most cases for transparency in charging for UoS and for the operation of the losses incentive scheme. Any cost benefit analysis to determine a de-minimis level of connections, up to which metering may not be required, must take into account the revenue implications of errors in the calculation of losses and associated incentive scheme rates.

Point of Isolation Equipment

UU's Electricity Specification for the connection of embedded distribution networks basically provides for connections to be on the same lines as those to an industrial or commercial customer. We do not normally duplicate isolation equipment.

Our current view is that, for a connection from United Utilities' LV network, the point of isolation will be within an industrial service module housed in a suitable roadside cabinet. Where a LV connection is made at a United Utilities substation, isolation of the IDNO's incoming cables would be provided on the United Utilities LV distribution fuseboard within the substation.

For an HV connection to an IDNO's single transformer, isolation of the IDNO's HV cable and transformer would be provided by the United Utilities HV circuit breaker within the substation. There may be certain circumstances e.g. where an IDNO has an HV ring circuit, where both parties may require independent points of isolation for operational purposes.

Quality of Service

We welcome the intention to introduce similar requirements on new entrants as apply to existing distributors and that the same guaranteed standard will apply to DNOs and IDNOs.

Financial Ring-Fencing

We responded previously that whilst welcoming new entrants, you should exercise caution before seeking to relax any of the ring-fencing provisions for new entrants. We note the proposals to maintain the current arrangements previously introduced and we support the proposed introduction to the IDNO licence of the amendments to the Indebtedness licence condition for DNOs. It is important

for the future that new entrants need to maintain the same financial rigour as existing distributors and the previous problems in generation and supply must act as a warning for the future. There is no 'distributor of last resort' to pick up the consequences of a failed business.

I hope our comments are of assistance to you.

Yours sincerely

Mike Boxall
Electricity Regulation Director