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Your ref

23 July 2007

Dear Mr Hull

Connecting the Islands of Scotland

Thank you for the opportunity to consider this potential change in the regulatory regime. Given the recent developments in regulatory policy and approach that have been stimulated by the debate and Government policy in relation to Offshore Transmission it is quite appropriate that Ofgem should raise the questions posed by your letter of 5 June. Furthermore, as your final proposals indicated, the possibility of changing the existing regulatory framework for transmission has been under consideration for some time.

It is important for Ofgem, when considering the mission of extending competition, to do so only where there is a strong case that such competition will reduce costs and improve service for customers, whose protection must always be recognised as Ofgem's principal objective. In this particular instance there seems to be evidence that the monopoly approach may not deliver the least cost solution and that there are viable alternative approaches.

We believe that Ofgem should explore the merits of options b) and c) as detailed in your 5 June letter. The key criteria that should be used in selecting a preferred approach must be the ability to deliver the required asset capability in a timely manner and at an efficient cost. The connection of offshore windfarms prior to the introduction of the new offshore transmission licensing regime demonstrates that a merchant approach, option b), is possible and that in the right circumstances investors are prepared to commit themselves without the comfort of a price control regime. The levels of interest and recent developments in relation to Offshore Transmission demonstrate that there is also an appetite for the type of model described in option c). In option c), as is likely to be the case in the new Offshore Transmission regime, it seems likely that GB consumers will benefit from taking some risks, particularly in relation to asset stranding, that will enable the development of a stable regulatory regime with lower costs.

As your letter points out, there have been a number of similar investments made where the commercial pressure to maximise the effective usage of assets leads to sensitively priced charges that encourage further connection and reduce stranding risk. We would therefore, support Ofgem's contention that it is sensible to allow any company which wishes to construct an island connection to signal its interest through some form of tender process. Appropriate ring-fencing provisions should be made such that SHETL should not be precluded from joining such a tender process should they wish to do so.

We recognize that there are considerable challenges to develop this part of the regulatory framework. We believe much of this work can be undertaken jointly with the development of the Offshore Transmission regime, but such joint running should not preclude the further exploration of merchant approaches. We look forward to contributing further to this debate and we will attend your planned workshop.

Yours sincerely,

Paul Bircham
Regulation Director

cc Colin Green by e-mail