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Dear Andy

OFGEM'S FIVE YEAR STRATEGY 2008-13

I write in response to Sir John Mogg's letter of 6 August. It is helpful that you have identified themes which remain consistent from one year to the next and that your plans are intended to extend over a five year period. We did comment last year that this intention is less evident in practice as there continues to be a strong emphasis on the first year. However, the work proposed on long-term electricity network scenarios is a welcome example of a longer-term perspective. This has been brought into sharper focus by the recent flooding and the request from the Energy Minister for the industry to provide a report on the resilience of electricity substations to flooding.

We are pleased to provide the following comments:

1 Key challenges facing the industry in the short to medium term.

The question of security of supply formed an important element of the Energy Policy Review and the forthcoming Energy Bill. Whilst wholesale energy prices are falling as new infrastructure comes on-stream, it is important in the short-term that Ofgem maintains strong pressure on the relevant parties to ensure that customers benefit from the changing circumstances and that customers' faith in the competitive market does not diminish.

The Energy Bill will also reflect the increasing pressure to move to a lower carbon economy. The impact of such significant changes is highlighted throughout the rest of our response. We are aware that Ofgem are already debating whether the statutory duties placed on GEMA under the Electricity Act (as amended) are consistent with what is required to address these environmental issues. It is important that Ofgem clearly indicate how those duties will interact with their role in facilitating progress towards the government objectives in this area.

We have previously argued that a greater recognition needs to be given to investment planning in your timetable. The gradual replacement of energy network assets needs to be planned over a substantial period and it is important that managing investment is not limited to five-year price control windows. The industry needs to collaborate to establish a longer-term vision for asset replacement, taking account of both emerging

technologies and the risk of service failure. We hope your initiative on long-term future electricity scenarios can address this issue and we believe this initiative needs to deliver its initial findings at the start of the next Distribution Price Control Review process.

A further challenge in the short to medium term is the next Distribution Price Control Review. Our response to your recent scoping letter for the review addressed in detail issues of process and policy and we trust that our comments will be carefully considered.

2 What action is needed from Ofgem?

Ofgem's key role is to ensure that markets are working effectively to deliver outcomes that meet both consumer requirements and broader Government policy objectives. We see a number of areas for actions during the coming years under the headings below:

2.1 Energy Bill

The forthcoming Bill will reflect on the ongoing work on the review of Distributed Generation. If Government targets are to be met, the need to ensure that the growth of distributed generation is effectively managed is paramount. These issues must be reflected in the next Distribution Price Control Review. We have also repeatedly argued that electricity security of supply issues should be more prominent on Ofgem's agenda and broader network resilience issues. As indicated above, the recent flooding and the request from the Energy Minister has brought this into sharper focus.

2.2 Distribution price control review (DPCR5)

We indicated last year that a consistent approach should emerge from the transmission and gas distribution reviews so that the next Distribution Price Control Review can be built on established practice. As indicated in our recent response to your DPCR5 letter referred to above, companies are already making plans for DPCR5 and it is important that Distributors can see in the current reviews appropriate messages for the future on issues such as future network investment. It is essential that investors continue to be attracted to the energy sector by the returns that can be expected and the results of the current gas review will send out important messages to potential investors. It is also worth noting that facilitating a low carbon economy will be a dominant new topic for the review impacting on issues such as the revenue driver, losses, DG and smart meters. We would also urge Ofgem to ensure the right balance is achieved between streamlining the number of DPCR5 consultations and the need to ensure there is a thorough and transparent debate. In particular, we would ask Ofgem to reinstate the September update into the proposed DPCR5 timetable.

2.3 Exploring the future role of distributors

We have always had the view that the distribution companies should be seen as providers of infrastructure to support competitive supply and generation markets. It therefore follows that this role should not be restricted to owning and operating distribution networks. DNOs already provide other services such as the Master Registration Service and the Data Transfer Network, without which the competitive

retail market would be unable to function. We also see a continuing role for DNOs in revenue protection and urgent metering services, but acknowledge that there are greater development opportunities likely to arise from the Government's low carbon agenda. DNOs do offer a vehicle to provide unbranded and consistent services to all suppliers (or other market participants).

It is also consistent with this view (of DNOs as a key part of the energy markets) that we should expect to be challenged to contribute to the wider objectives on carbon reduction.

2.4 Metering and Connections

Striking the balance between competition and regulation is essential and we hope that, in these areas where competition has been fostered in recent years, Ofgem will be able to reduce the obligations on licensees. We welcomed the removal of the DNO obligations in respect of metering services in April 2007 and in connections we hope the focus will remain on making the existing market for contestable services more effective across the whole country. In our view, this will deliver greater benefits to customers than trying to extend the scope of competition before the current market is operating effectively.

3 **Priorities**

Our consistent theme in response to previous consultations on strategy has been to try and focus on a smaller number of key projects. Neither the industry, nor its regulator, has the resources to tackle too many projects simultaneously, and to do so increases the risk of unintended interactions.

I hope you find these comments helpful. I would be pleased to join in further discussion on the issues raised.

Yours sincerely

Paul Bircham
Electricity Regulation Director

cc: Sir John Mogg