

Andrew MacFaul
Head of Better Regulation
Ofgem
9 Millbank
London
SW1P 3GE

Direct line 01925 534504
Direct fax 01925 534571
paul.bircham@enwltd.co.uk

25 September 2008

Dear Andy

OFGEM'S FIVE YEAR STRATEGY 2009-14

I write in response to Lord Mogg's letter of 21 August. This is now an annual consultation which is helpful in examining the themes that remain consistent from one year to the next and thus drives greater consistency of approach. The work that continues on long-term electricity network scenarios is a welcome example of a longer-term perspective and will hopefully link in closely with the Distribution Price Control work. 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 Energy Bill. At this time last year, we were commenting that whilst wholesale energy prices were falling as new infrastructure came on-stream, it was important that Ofgem maintained strong pressure on the relevant parties to ensure that customers benefited from the changing circumstances and that customers' faith in the competitive market did not diminish. That scenario has changed considerably with the large rise in wholesale and retail prices during the last twelve months, coupled with the general economic downturn. In the current climate the need to maintain customers' faith in the competitive market is even more important and the Energy probe and other initiatives by Ofgem must deliver this objective on behalf of both customers and politicians. Equally, Ofgem must not accede to increasing calls to intervene in the market in ways that cause distortion or increase the uncertainty of regulatory treatment. We appreciate this is a difficult balance to achieve, but it is one that Ofgem and the industry as a whole need to maintain during this difficult economic period.

As we have indicated previously, 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. This strand of Ofgem's work must be linked with the theme relating to security of supply where efficient and timely investment is imperative. This has been brought into sharper focus with the storms and flooding during the last two summers, which are likely to be a recurring feature of the UK climate, possibly with increasing severity.

The industry (including its regulator) needs to collaborate to establish a longer term vision for asset replacement, taking account of both emerging technologies and the risk of service failure if too much reliance is placed on aged assets. We hope your initiative on long-term future electricity scenarios previously referred to can address this issue and we believe this initiative needs to deliver its initial findings early in the Distribution Price Control Review process.

The Distribution Price Control Review (DPCR5) should be built on established practice and it is important that all stakeholders can see consistent messages over the long-term on issues such as future network investment. As capital expenditure requirements continue to grow it is essential that investors continue to be attracted to the sector and the results of DPCR5 must send out important messages of regulatory consistency to potential investors. The growth in expenditure requirements necessitates that the DPCR5 process must also demonstrate more clearly what customers are getting for their money. The development of a clear regime of output measurement and incentivisation is an important deliverable for DPCR5.

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. The cost impact of the connection of a significant rise in Distributed Energy would be significant in the long-term. Whether UK energy policy will require and facilitate this is, however, still unclear. The option of a significant rise in new nuclear and off-shore wind generation remains an alternative way to reduce the carbon emissions of the UK generation fleet. Whilst the extent of change for Distributors remains uncertain we must seek to minimise abortive network investment. This requires DPCR5 to contain flexible mechanisms that encourage DNOs to react to a change in the energy generation mix in a timely fashion.

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 new Act 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 Distribution Price Control Review. We have also repeatedly argued that electricity security of supply issues and broader network resilience issues should be more prominent on Ofgem's agenda.

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. It is essential that investors continue to be attracted to the energy sector by the stability of the regulatory regime and the opportunity to secure reliable returns in a difficult economic climate. Ofgem may have to consider how the regulatory framework should evolve to address the current environment of high input price inflation and financial instability,

but should reserve discussion of any more radical change or a revolution in the regulatory approach for the RPI@20 project.

2.3. Structure of charges

Whilst under United Utilities ownership and since the establishment of ENW, we have been at the forefront of trying to deliver a charging methodology that would meet the needs of all our customers, both demand and generation. We would urge Ofgem to avoid the imposition of an ill-considered solution that does not have the full confidence of DNOs.

2.4. Metering and Connections

Striking the balance between competition and regulation is essential. 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. We have recently presented evidence to Ofgem from an independent report that we commissioned to establish the level of competition in connections with particular reference to the North-West of England. It is clear from the report that competition in connections has developed more rapidly and effectively in the North West than in other parts of the UK and this should be recognised by Ofgem in developing policy in this area.

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. The recently announced workstreams for the Industry Code Governance review and the RPI@20 project in particular should not be allowed to deflect resources away from the DPCR5 work.

The current consultation on pensions issues is potentially destabilising for pension scheme trustees and could result in a move to a shorter-term focus that increases costs for customers. Ofgem will find from this consultation that the existing pension principles are sound, robust and enable sufficient development of approach to address arising issues. The pension consultation should not be allowed to develop into another distracting workstream and a prompt re-iteration of confidence in the existing pensions principles is in customers' interests.

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

Yours sincerely,

Paul Bircham
Regulation Director
Electricity North West Limited