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**Ref: Consultation on Ofgem's minded-to decision in respect of CMP444**

Thank you for the opportunity to respond to the consultation regarding Ofgem's minded to decision in respect of CMP444. Please find below E.ON's response.

**Executive Summary**

Whilst E.ON does not currently have any transmission connected generation in its UK portfolio we have responded to this consultation to show our support for Ofgem's minded-to position from the perspective of our customers. Whilst CMP444 does not have any direct impact on the Transmission Demand Residual (TDR), we believe that the decision to support or reject CMP444 does have ramifications for customers and their future bills which are forecasted to rise dramatically in the next year.

E.ON supports Ofgem's overall negative assessment of CMP444. However, we would urge Ofgem to stop trying to 'repair' the existing TNUoS methodology and rather focus on its wholesale replacement such that it better balances predictability and cost reflectivity as part of REMA's Reformed National Pricing Delivery Plan. We are concerned that CMP444 would encourage inefficient siting and that any cap and floor methodology undermines cost reflective charging and results in cross-subsidisation between groups. Such mechanisms can be used to serve non-cost reflective objectives such as customer protection, but this must be balanced against the market distortion that non-reflective charges can also create.

We agree with Ofgem's view that CMP444 does not support competition. While greater predictability in TNUoS will reduce investment risk and potentially facilitate market entry, adding more 'sticky tape' to an already complex scheme to achieve this may heighten perceptions of regulatory interference and hence risk. We believe that a root and branch review of TNUoS (as per the Reformed National Pricing Delivery Plan) is the only way to achieve the goal of predictability alongside cost reflectiveness. We agree that under the existing methodology, there is a definite trade-off between these two outcomes, hence why we are advocating for a wholesale replacement that is better suited to the electricity system of the future.

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Better cost reflective charging in conjunction with predictability should also act as an incentive to investment, especially for projects that will reduce spend on network reinforcement. Greater predictability will also aid suppliers in setting long term fixed priced tariffs whereas the recent 80% jump in the TDR has come as a significant shock to the supply industry. This should be Ofgem's priority.

CMP444 will also distort the market by introducing unforeseen changes for existing generators, possibly pushing some southern assets to early closure decisions when arguably they are most needed. Although reducing investor risk through greater predictability, CMP444 might encourage further investment in renewable generation that increases system constraint costs which will ultimately be borne by consumers and may prolong existing network constraints. Overall, we believe that this could see customers detriment in direct opposition to Ofgem's principal objective.

Yours faithfully

Matthew Cullen

**Q1. To what extent do you agree with our assessment (negative) of the impacts of CMP444 options on cost reflectivity? Please provide your detailed rationale.**

We agree with Ofgem's negative assessment of the impacts of CMP444 against the cost reflectivity objective. By its very nature, a cap and floor methodology for setting costs is not cost reflective and cross-subsidises the costs of one group (by lowering the highest costs to a cap) with the costs of another group (by raising the lowest costs to a floor) for no cost reflective reason. There are other rational reasons to introduce a cap and floor mechanism, but these are not for cost reflective reasons. When any cap and floor mechanism is introduced, it always has a clear purpose and objective that is nothing to do with cost reflectivity – either to stabilise revenue (such as for interconnectors) or protect a small group of customers from the extremes of a cost reflective charge (such as AAHEDC<sup>1</sup>). We cannot think of any instance where a cap and floor mechanism has been introduced in any industry to better reflect actual costs.

We do not believe that credits in a costing methodology is a sign of non-cost reflectivity. If a new embedded generator is built such that reinforcement to the transmission network is avoided, this cost saving should be recognised in the methodology. Credits are also necessary to retain the €2.50/MWh cap under the current methodology. Removing credits will necessitate GB repealing legislation which was introduced to ensure that British generators were not at a disadvantage compared to EU generators. Removing the €2.50/MWh cap could also mean a more even split of TNUoS costs across generation and demand which could support the reduction of the TDR. However, it is likely that generators would simply factor this increase in costs into the wholesale price thereby keeping the overall cost to customers the same.

**Q2. Do you agree with our assessment (neutral) of the impacts of CMP444 options against encouraging competition? Please provide your rationale. If you have data to support your assessment of the interactions between CMP444 options and competition in generation we would encourage you to share it with us alongside this consultation response, clearly marking any confidential data.**

We agree with Ofgem as to the lack of any evidence that the net impact of CMP444 on competition is either positive or negative. Making TNUoS a more predictable cost is laudable and would hopefully reduce barriers to entry by making investment cases less risky. However, we believe that Ofgem should focus on a wholesale replacement to TNUoS that better reflects the Net Zero/CP30 world in which we are now working. This could, if implemented swiftly, support investment and encourage competition. We need a charging methodology that can offer predictability whilst better reflecting the actual (and not relative) costs of maintaining and reinforcing the transmission network. Further 'quick fixes' will increase the perception of future regulatory interventions being more likely and

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<sup>1</sup> Assistance for Areas with High Electricity Distribution Costs

therefore increases regulatory uncertainty, damaging investor confidence and hence competition.

We do have some sympathy for the argument that generators (especially in the CfD and CM auctions) are currently competing on who is prepared to accept more TNUoS risk, a risk that cannot be managed by these generators. However, this needs to be balanced by the very real distortion to the market of applying caps and floors to TNUoS that existing generators would not have foreseen. Whilst regulation change is a risk that every investor takes, we believe that all regulation change needs to be to the benefit of the end customer, and we are not convinced that this is the case for CMP444.

It could be argued that the customer benefits from CMP444 by more renewable energy being built through the reduction in risk for investors. However, it is probable that without better cost reflective signals this additional renewable generation will be built in the north of the country. Under this assumption, customers will suffer from increased constraint costs as more redispatch is required to balance the system. TNUoS is not an operational signal, but it does have impacts on operational costs that need to be considered. CMP444 will only serve to support generation being built in areas that will exacerbate existing constraints and is likely to extend the period for which constraints persist.

**Q3. To what extent do you agree with our views on the interactions between cost-reflectivity and competition? Please provide evidence (qualitative or quantitative) supporting your answer.**

We are also in agreement that cost reflective, regionally different TNUoS charges are themselves not anti-competitive or distort the market. These costs should represent the cost of transporting power from the generator to the customer. With most customers in the south of the country, this means that generators in the north of the country should pay more. A comparable argument would suggest that gas fired generators shouldn't have to pay the price of gas to provide their power as this distorts the market compared to the price of electricity generated by nuclear for instance.

**Q4. To what extent do you agree with our assessment (neutral) of CMP444 options against developments in the TSOs business? Please provide your detailed reasoning.**

We do not see any evidence to suggest that the impact of CMP44 on considering developments in the TSO business is either positive or negative. Therefore, we agree that this impact should be assessed as neutral.

**Q5. To what extent do you agree with our assessment (neutral) of CMP444 options against compliance with regulation? Please provide your detailed reasoning.**

We do not see any evidence to suggest that the impact of CMP44 on compliance with British or EU regulation is either positive or negative. Therefore, we agree that this impact should be assessed as neutral.

**Q6. To what extent do you agree with our assessment (negative) of CMP444 options against administration efficiency? Please provide your detailed reasoning.**

As CMP444 requires the additional complexity of needing to find a cap and floor level that is a) as cost reflective as possible b) distorts the market as little as possible c) is regularly reassessed and d) has the agreement of most of the industry, we believe that CMP444 has a negative impact on the administration efficiency objective as per Ofgem's decision.

**Q7. To what extent do you agree with our assessment (negative) of CMP444 options against the objectives, taken collectively? Please provide your detailed reasoning and any evidence in support.**

Based solely on the five Applicable CUSC Charging Objectives covered above, we agree with Ofgem's decision that CMP444 has a collective negative impact.

**Q8. Do you consider that implementation of any of the proposals (if we assessed them to better facilitate achievement of the objectives) would have particular impacts relevant to our principal objective and/or wider statutory duties? Please provide your detailed reasoning and any evidence in support.**

Ofgem's principal objective (to protect the interests of existing and future consumers) would, to us, appear to be a trade-off between supporting GB to hit its Net Zero target and keeping bills affordable for customers. As set out in Q2, CMP444 could support the building of more renewable generation, but it is likely that this would be in areas that are suboptimal from the perspective of operating the network. This in turn would drive up balancing costs as more generation is constrained from delivering its power due to the limitations of the system. Whilst it can be argued that this is a short to medium term issue and would be solved by more network investment, we believe that the strain on customer finances is a more important issue to tackle. Because of the existence of this trade-off under the existing TNUoS methodology, we are advocating for a fundamental review of TNUoS that can deliver both predictable and cost-reflective charges.