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Friday 17th September 2004

Dear Kyran,

RE: CAP047: 'Introduction of a competitive process for the provision of mandatory frequency response'

Thank you for the opportunity offered to E.ON UK to consider the issues contained within the 'CAP047' Impact Assessment. E.ON UK has consistently supported CAP047 Alternative 'A'. We believe that the introduction of this amendment will facilitate effective competition, create a transparent market and promote efficiency. As such, whilst recognising the indication within the IA shall not prejudice the final decision, we welcome Ofgem's initial preference for Alternative 'A'.

We share the concerns of Ofgem (5.27, Pg45) that failure to amend the current cost-based frequency response arrangements could potentially, in the long term, affect NGC's ability to balance the transmission system. Whilst we consider that both Alternatives 'A' and 'B' would provide tangible benefits in terms of efficient investment signals, competition and transparency compared to the status quo, we are confident that the latter option delivers significantly smaller

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benefits compared to Alternative 'A'. We remain unconvinced as to the validity of NGC's arguments against the implementation of Alternative 'A'. We note NGC's concerns regarding short term increases in procurement costs. However, we concur with Ofgem's assessment, that increases are likely to be significantly less than NGC's estimates. Furthermore, the effect of enhanced competition over the longer term is likely to result in the reduction of procurement costs with obvious benefits for consumers. We are unsure as to why a limit should be placed on the well documented ongoing benefits of Alternative 'A' for relatively negligible short term cost savings suggested under Alternative 'B'.

We firmly believe that, as the definitive feature of Alternative 'B', price capping would only have a detrimental effect upon competition. The proposal for two years of price capping will introduce distortion to the market signals. Distortion will arise where the actual price of frequency response is above the proposed caps. Consequently this will hinder decision making in terms of levels of efficient investment necessary for safeguarding security of supply. Further, there are no guarantees that the caps would be completely removed after two years. If the price caps were to be retained beyond the initial two year period, longer term distortion of market signals (along with the associated risks) should be expected.

In conclusion we agree with Ofgem that Alternative amendment 'A' would deliver more competitive and transparent mandatory frequency response arrangements. We believe that in comparison with 'B', Alternative 'A' would better facilitate;

- Improved transparency.
- Efficient investment signals for the provision of Mandatory Frequency Response and the associated benefits for security of supply.
- A realistic opportunity to reduce longer term procurement costs, leading to consumer benefits.
- Enhanced market liquidity by increasing levels of participation.

If you would like to discuss any of the issues raised within this response please don't hesitate to contact me.

Yours sincerely

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