

## **Ofgem's three year strategy 2005-8 Comments by E.ON UK**

### **Key challenges**

1 We welcome this opportunity to comment on Ofgem's three year strategy. The commitment to full consultation throughout the strategy review process is an important contribution to understanding how the Authority intends to interpret its statutory duties.

2 Substantial industry investment will be required over the period 2005 to 2008 and beyond to meet the Government's targets for reducing carbon dioxide emissions and to maintain security and diversity of the UK's fuel supplies as the UK becomes more dependent on gas from external sources and as the environmental costs associated with coal-fired plant in operation rise. More investment will also be needed in networks to maintain reliability and to accommodate an increasing volume of distributed generation.

3 Ofgem has an essential role to play in helping the industry deliver this investment efficiently, consistent with its primary objective of protecting the interests of the consumer. Ofgem can best do this by:

- a) ensuring regulation is transparent, predictable and focussed only on those areas where it can add value for the consumer;
- b) ensuring that monopoly regulation is structured to attract the investment required to maintain the robust networks that will support the operation of competitive markets, security of supply and more renewable and other distributed generation;
- c) addressing remaining barriers to effective competition in Great Britain;
- d) arguing for sensible outcomes within the new EU regulatory structures and encouraging the Commission to avoid interventionist policies to achieve security of supply or other objectives;
- e) in its role as expert adviser to Government, encouraging the Government to adopt durable market-based mechanisms which will attract investment.

4 The following paragraphs identify the key issues in this context:

### **Competitive Markets**

5 Firstly Ofgem should continue to identify opportunities to withdraw from regulation of competitive markets, particularly where the additional regulatory burden on industry is likely to outweigh any remaining benefits to the consumer. A consultative review undertaken as part of Ofgem's 2005-06 work plan would help crystallise the issues for all stakeholders, and should encompass the scope for increased industry self governance in

wholesale markets. We look forward to Ofgem's forthcoming review of the supply licence.

6 We support Ofgem's efforts to encourage more transparency in and publication of more market data about the operation of the upstream gas market. This should improve market efficiency and confidence.

7 We are concerned that the combined effects of the EU ETS and the LCPD could lead to the early closure of significant coal-fired capacity. While these are matters for Government, we would welcome Ofgem's support in ensuring that Government policy implementation takes account of the role these plants can play in maintaining fuel diversity. This would be consistent with GEMA's new duty of carrying out its function in a manner best calculated to contribute to the achievement of sustainable development and its duty of achieving a diverse and viable energy supply.

8 Ofgem should continue to encourage cost-reflective locational charging arrangements for use of the transmission system under BETTA. Locational signals and transparent transmission charging are fundamental to the efficient and predictable operation of the market and to ensuring investment in networks and generation are efficiently located. This will help ensure the system costs of investment in renewables are transparent and properly understood.

9 Electricity and gas supply markets will need to change radically if the UK is to secure the levels of carbon savings it hopes to achieve from domestic energy efficiency measures. This will require the active engagement of customers and suppliers and the development of a market which is focussed on wider criteria than price. We welcomed Ofgem's agreement to a trial suspension of the 28-day rule to facilitate the development of an energy services market.

10 Retail costs and prices are likely to rise over time to reflect the impact of the Government's market interventions to achieve carbon reduction targets, and to provide adequate incentives for investment in generation and in distribution networks. It is important that suppliers are able to offset these effects through marketing energy efficiency services. We want to continue to work with Ofgem to establish how this can best be achieved.

11 We support Ofgem's continuing efforts to remove barriers to competition in the supply market and to ensure that the benefits of the market are open to all consumers. E.ON UK will continue to identify innovative ways of meeting the needs of low income or other vulnerable customers, working with the grain of the competitive market.

## **Network regulation**

12 A careful and considered approach to competition in connections and embedded networks is required. We support Ofgem's aim of establishing clear and robust frameworks for fair competition in connections and independent network operation. It is of fundamental

importance, however, that Ofgem ensures that both independently built connections and embedded networks are subject to the same constraints and standards as DNOs in terms of design, asset quality and service. Ofgem must continue to consult on competition in connections, taking full account of stakeholders' views, even if this means some delay in implementation of the scheme.

13 Ofgem and DNOs should work together through established forums to deliver robust output measures in advance of the specific consultation process leading to the next distribution price controls effective from April 2010. Whilst Ofgem's DR4 proposals recognise the need for investment to replace ageing assets, the process for setting and agreeing capital allowances remains more controversial than it needs to be, hampered by a relatively short-term view and the absence of reliable output measures. Replacement of ageing assets is a medium- to long-term need, and without work in the interim, the processes for the next price control will remain unnecessarily tortuous.

14 In deciding on output measures, Ofgem, with DTI and other industry stakeholders, will need to develop a longer-term strategy for energy networks. In particular, this should address what is required of networks in relation to:

- resilience to storms
- quality of supply
- distributed generation

15 For the DR4 period, Ofgem will be placing new incentives on DNOs to encourage them to connect distributed generation (DG) and new charging structures for DG will be implemented by DNOs. As the connected capacity of DG increases, it will start to impose new technical stresses on network assets and new pressures and requirements on the operational performance of DNOs, who will need to adopt more active operational roles to maintain supply security. Ofgem will need to maintain a watching brief on the development of DG, certainly in its early stages.

16 Temporary price controls have been proposed to facilitate fair competition in Meter Operations (MOP) and Meter Asset Provision (MAP) services and protect DNOs from asset stranding. In the early part of the DR4 period Ofgem will need to monitor the further development of competition for MOP services. This market is arguably already competitive and the proposed removal of DNO obligations by 2007 may need to be brought forward.

### **European Regulation**

17 We welcome Ofgem's engagement with the industry on European Union regulatory issues, and the leading role Ofgem is taking within ERGEG. Ofgem should continue to support sensible regulatory solutions which encourage efficient and competitive market structures but which are also practicable and of value within the UK market and avoid unnecessary additional costs on UK players. Investment can most effectively be encouraged within a stable regulatory environment and

Ofgem should continue to encourage the Commission to avoid interventionist approaches which seek to direct investment in generation or network investment in pre-conceived ways.

### **Regulatory Efficiency**

18 In conjunction with its self-imposition of a price control, Ofgem should look for ways to improve the efficiency of the regulatory process, taking into account indirect costs to business. We view the area of consultations as a key area for consideration, and believe that better use could be made of early, direct contact with industry. In other areas, regulatory activity could be more focussed on the specific questions which need to be addressed.

19 Earlier engagement with industry and other stakeholders on major issues could reduce the number and length of consultations documents and increase the effectiveness of the consultation procedure. More attention is needed to identify the key regulatory issues. For example, consideration of the regulatory issues arising from the gas DN sales process should focus on what is expedient and necessary to facilitate a sale. Ofgem's continued support for the sales should not be contingent on the introduction of NTS capacity auctions or line pack services.

20 The introduction of Regulatory Impact Assessments has the potential to ensure regulation identifies the key issues which benefit customers. However, it also has the potential to create an unnecessary new layer of bureaucracy and impede the regulatory process. We have submitted a response to Ofgem's recent consultation on this issue.

### **Administration of Renewables Obligation and Energy Efficiency Commitment**

21 Ofgem's role in administering the ROC and EEC mechanisms will have increasing importance as the sums involved in these schemes rise. It is important that processes are clear, transparent and predictable and that the administration of the schemes receives an appropriate senior managerial focus in Ofgem. Ofgem should review how it can most efficiently fulfil its obligations, and consider whether it should contract out the administration of the schemes to a third party within a clear framework set by DTI/Ofgem.

**E.ON UK**

September 2004