



## **Consultation on Ofgem's Five Year Strategy 2007-12**

### **Comments by E.ON UK**

We welcome the continuing consultation process for Ofgem's rolling 5 year strategy, and this opportunity to provide early input into the 2007-12 strategy. The commitment to full consultation is an important contribution to understanding how the Authority intends to interpret its statutory duties.

#### **Key industry challenges:**

E.ON UK welcomes the Government's Energy Review and the subsequent report. We very much appreciate the role Ofgem has played throughout this process in supporting a market based approach to addressing energy policy objectives and in resisting interventionist solutions.

Substantial industry investment will be required over the next five years and beyond in all areas of the electricity and gas supply chain in order to meet the policy objectives of radically reducing carbon emissions and maintaining security and diversity of the UK's fuel supplies, etc. We believe this investment will be delivered within a market based framework. Ofgem has an essential role to play in helping the industry deliver this investment efficiently by:

- ensuring regulation is transparent, predictable and focussed only on those areas where it can add value for the consumer, both at the UK and EU level;
- 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;
- arguing for outcomes within the new EU regulatory structures that encourage the development of competitive markets, support continuing industry investment, and avoid interventionist policies to achieve security of supply or other objectives.

#### **UK Regulation**

##### Competitive Markets

In our February 2006 response to Ofgem's Five Year Strategy and Plan 2006-11 we commented on a number of projects that we considered did not deliver consumer value and should be dropped. These included the 'enduring offtake arrangements in gas, further reviews of cash-

out arrangements and encouragement of fundamental changes to emergency arrangements despite extensive and controversial reform during Q4 2005. We asked for a greater emphasis on industry self regulation and formal industry procedures rather than Ofgem determining policy choices in advance of modification proposals being submitted by market participants. This remains our view.

### Network Regulation

#### Long Term Network Investment

The RPI-x price control regime has delivered significant benefits to consumers and enabled companies to benefit from efficiency incentives. Looking forward, the scope for continued cost reduction at a rate faster than that of the general economy is minimal. This is particularly true for companies undertaking significant investment programmes to replace ageing assets or upgrade the network for embedded generation or improved reliability. Whilst the ongoing cost of providing a service to consumers must be kept at efficient levels, the focus of price controls going forward will need to reflect an environment of increased investment and stimulate innovation and efficiency on the part of network companies.

Because of the scale of networks, change will not occur overnight. Therefore, efficiency incentives and allowances for investment will need to have characteristics that provide longer term certainty for those companies taking investment decisions. Consequently, the benefits to the electricity distribution sector of a long term strategy to allow for increased effective investment in the network are paramount. DR4 signalled a move to greater investment but it is important that the role and long term outputs of networks are agreed such these assets are replaced efficiently and effectively to achieve their objective whilst minimising the overall costs in the long term to the end consumer. At present there is little certainty for either distributors or stakeholders past the end of the present price control either in terms of investment or outputs and hence the need for longer term targets than at present.

### Innovation

An increasingly important role for Ofgem going forward will be helping to create market frameworks that encourage innovation by energy companies in response to policy challenges. Two areas stand out in particular:

#### *Distributed Energy (DE)*

Delivery of a simple and effective regulatory framework to facilitate microgeneration and other distributed energy sources, including the active networks capable they require, will be important in supporting the government's energy policy. E.ON UK support the commitment to ongoing work in this area. A framework to support DE (of all sizes) must be developed quickly and efficiently, with appropriate sustainable incentives to encourage network operators to facilitate the development of economically viable forms of DE, whilst reinforcing and replacing old areas of the network.

### *Advanced Metering*

'Smart metering' is attracting increasing interest across the industry, and, if approached correctly, has the potential to benefit customers, network operators, suppliers and energy services companies. We believe that the best solution is one that recognises the need to facilitate the evolution of a competitive, demand-led approach to stimulating innovation.

As we have recommended, we hope that Ofgem have chosen to remove obligations on distributors in order to incentivise competition and innovation. Should this not be the case, Ofgem should review the current price control arrangements placed on distributors in order to assess their impact on the development of competition and innovation, including the impact on the development of smart metering.

### Offshore transmission

E.ON UK has been playing an active part in the development of the offshore transmission regime, primarily as a developer but also as a potential TO. The decision to move to a regulated framework should in theory lower risk to developers, more properly reflect the longer lasting nature of the transmission assets and allow a more co-ordinated approach going forward. Whilst there is still a lot more work to do, we believe that there are some issues on which more clarity is needed on the approach that will be taken both in the short term (adoption of assets) and the long term (ensuring that the framework is flexible enough to adapt to changes in the future and does not create perverse incentives for inefficient investment in the longer term). We look forward to continuing to work with Ofgem and the DTI on these issues.

### **European Union Regulation**

E.ON UK supports the development of more harmonised regulatory frameworks across Europe to facilitate the development of a single competitive European market. As a Europe wide group, E.ON believes the creation of an efficiently functioning European market, without barriers to trade and investment, is strongly in its interest. The development of efficiently functioning regional markets is an important practical interim step.

In taking a lead in the development of regional markets, Ofgem should support sensible regulatory outcomes which create the conditions which allow competition to develop further but which are also practicable, avoid unnecessary regulatory risk, and do not disrupt investment. The focus should be on implementing effectively existing EU legislation. Ofgem should encourage the Commission to avoid interventionist approaches which seek to direct investment in generation or networks. While there may be a requirement for more harmonisation and coordination of regulation within the EU, this should focus on ensuring efficient cross-border trading and eliminating market or regulatory factors which distort the operation of competitive markets. Regulatory policy should avoid unnecessary duplication or

complexity of functions, and ensure proper consultation and regulatory impact assessment, consistent with the principles of better regulation adopted in the UK.

EU regulators should be examining how their domestic powers and remits can be aligned sufficiently to ensure independent economic regulation on a consistent base across the EU and remove the lack of strategic co-ordination which currently acts as a barrier to investment in cross border infrastructure.

The Commission's sectoral review has raised the issue of network unbundling and ownership separation. In the UK, rigorous implementation of legal unbundling has resulted both in licence conditions which prohibit distortion of the market and place a positive requirement on network operators to ensure that the market functions correctly. Some other markets are at earlier stages of development of liberalised market structures. We believe similar full implementation of existing legislation by other European Governments can achieve similar results, and we do not favour further legislation that could impose ownership unbundling on UK DNOs, or, for that matter, an unnecessarily specific approach to functional unbundling which would be an unnecessary and costly exercise from the UK consumer's standpoint. We hope that Ofgem will make the case for more robust implementation of existing rules.

**Ofgem Business Strategy:**

We welcome the progress Ofgem has made in meeting its internally imposed price control during 2005/06. We hope that the need to justify priorities under the price control will encourage a transparent and robust justification of projects against statutory objectives and the broader framework of Government energy policy. It should also discourage projects which, while theoretically attractive, may in practice create unnecessary implementation costs and complexities for the industry, for minimal benefit to the consumer.

We also welcome progress on the 'Better Regulation' agenda made by Ofgem through 2005. 'Project Paperless' has been a success as Ofgem documentation remains clear and accessible since the changes brought about last year. The 25% reduction in the total number of documents published compared to 2004/05 is appreciated. Ofgem should publish a simplification plan which will lead to further improvements over the next five years.

E.ON UK  
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