



Andy MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE

E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
West Midlands
CV4 8LG
eon-uk.com

Dan Meredith
024 7618 3115

20th February 2008

Ofgem Corporate Strategy & Plan 2008-2013

E.ON UK Response

We welcome the continuing consultation process for Ofgem's rolling 5 year strategy, and this opportunity to provide a response to the 2008-13 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 broadly supports the Government's current Energy Policy and its emphasis on creating a long-term market based framework for investment, its support for a wider range of low carbon investment options, and its avoidance of interventionist measures which undermine the operation of the market.

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.

We believe this investment will best 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

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

distributed generation in the long-term;

- Arguing for outcomes within the new EU regulatory structures that encourage the development of more competitive and integrated energy markets, support continuing industry investment, and avoid interventionist policies to achieve security of supply or other objectives.

Ofgem's Role:

Ofgem's role is more important than ever during this time of uncertainty and transition in the energy industry. The efficient and effective delivery of energy policy through regulation will have a direct impact on customers and the UK economy.

Given the industry landscape is rapidly changing, E.ON UK feels that Ofgem's emphasis, and allocation of limited resources, should now shift away from driving shorter-term cost reductions to focus increasingly on delivering the stable market framework that will help bring forward investment.

In particular, E.ON UK would like to see more stability in market rules and a longer-term vision for the role of network monopolies. Any modifications to trading rules in a market where competition is clearly working should only be introduced where the economic benefits to customers can be clearly demonstrated.

E.ON UK's comments on Ofgem's key themes and associated questions are presented below:

1. Creating and sustaining competition

1. *Does this theme remain valid?*
2. *Have we identified all the relevant issues within this theme?*
3. *Is Ofgem's approach to the challenges ahead the right one?*

E.ON UK believes this theme remains valid, and a key area in which Ofgem should outline its fundamental beliefs, as well as its strategy for future action.

E.ON supports Ofgem's view that competition is the best way to protect customers, and agrees Ofgem's role in monitoring competition remains useful. With energy prices likely to remain an important political and social matter, Ofgem must be more active in communicating their assessment of the market

and its benefits to the public.

Ofgem continues to influence trading arrangements significantly. E.ON would welcome Ofgem's views on the benefits of stability of trading rules against continuous modifications in search of a 'perfect' market.

With regards to smart meters, we would urge Ofgem to be open-minded about the most effective implementation route, recognising that competition in metering does add complexity to competition in supply. Government and Ofgem must also work to clarify the manner and timing of any smart meter roll out such that DNOs can assess the likely stranding effect on their legacy assets in time for the next price review. There may be other knock-on impacts and costs for DNOs due to smart metering introduction that also need to be identified and evaluated, and this should not be forgotten.

2. Regulating networks effectively

- 1. Does this theme remain valid?*
- 2. Have we identified all the relevant issues within this theme?*
- 3. Is Ofgem's approach to the challenges ahead the right one?*

E.ON believes this theme remains particularly valid, especially with the upcoming distribution price control and given the uncertainties around energy policy and global markets which are driving the price and lead times for plant, materials and resources.

E.ON are generally happy with Ofgem's approach to this theme, although more clarity is required in certain areas. Networks are long lived assets and hence distributors require consensus around a longer term vision and stable platform upon which to base these investment decisions. Terms such as "no higher than necessary" (para 2.2) need to be more precisely defined to help companies in their planning decisions.

For example, companies need to demonstrate that their investment choices give the best value to customers over the lifetime of the asset. However, given the uncertainty in energy policy, a hypothetical option (A) might be capable of immediate implementation, but this option will not support the connection of distributed generation in the future without significant further significant expenditure. Whereas a different option (B) may cost more in the short term, but

will be less expensive when viewed over the long term if the expected level of distributed generation materialises.

We would argue that it is not currently obvious whether option A (short term least cost) is preferable to option B in Ofgem's view, particularly given the uncertainty surrounding current and future energy policy. E.ON would welcome further clarity and discussion of this issue in future strategy and price control documents.

E.ON supports the continued use of incentive-based regulation to achieve Ofgem's objectives. This framework has worked well and investors value the stability and predictability of the regime. Our networks are facing increasing replacement requirements, driven predominantly by deterioration of asset condition due to age, but also load-related expansion and the requirements of distributed generation. In the latter case, preliminary indications are that in the medium term additional investment will be needed for generation to be accommodated in significant amounts on the network. Consequently, companies will continue to need incentives to invest, however we would encourage moves away from the "one size fits all" approach when considering incentives regimes in DR5.

Environmental sustainability is at the heart of the government's energy legislation. However, in order to factor this into the forthcoming distribution price control review, Ofgem needs to provide their view of the appropriate importance that should be given to the cost of carbon in cost-benefit assessments by companies when making long-term asset replacement decisions. Investing in the network is a long term commitment, and future connection trends for distributed generation are still very uncertain, driven predominantly by factors outside DNOs' control, particularly planning and other significant energy policy decisions.

E.ON are working hard to identify and remove potential commercial barriers created by charging regimes and physical barriers via innovation in network design and operation. However, some policy decisions (e.g. the depth of connection sharing regime and implied level of social subsidy for connecting generators) will remain with Government or Ofgem.

Moving to active distribution networks will be transitional over, at least, the next ten to twenty years. During this transition, technical and commercial risks need to be carefully managed, and will likely be at a local level. A key example is the degree to which a network operator can practically rely on an initially undiverse generation portfolio to support system security and thus defer reinforcement. Contractual responsibilities and liabilities are not immediately clear at present.

As described above, companies will increasingly need to decide whether to invest ahead of need to better accommodate distributed generation and reduce costs in the longer term, provided that a minimum level of generation eventually connects.

In essence, the opportunity cost to society of focusing on short term investment cost minimisation needs to be considered in developing longer term plans. Ofgem needs to work with companies over the next price control review to develop methods for sharing risk and reward between customers and companies based on an assessment of reasonable outcomes in terms of connection volumes, carbon reduction and carbon price. Clearly this view also needs to take account of the potential to discriminate between current and future customers, and the appropriate apportionment of risk/reward between them.

Regarding charging changes to better accommodate DE, we are frustrated that our work via Central Networks, with Scottish and Southern and Scottish Power, to produce a more cost-reflective methodology, including discussions with customers and Ofgem has not met with a more positive response. A large amount of resource has been invested in development to date following the guidance provided by Ofgem initially and following on from the joint DNO work under the Energy Networks Association's Commercial Operations Group (COG). Any change of direction at this stage could render much of this work redundant.

This work represents a common charging methodology covering almost half of the customers in Great Britain and involves actively looking at areas where we can ascribe the benefits from distributed energy into the charging structure, a process which has proven to be a far more complicated process than generally thought. To now move to a new common framework will both lead to additional cost and further significant delay in order to establish and then implement an industry approach.

We look forward to raising these issues further, and in more detail, with Ofgem during the course of the DR5 negotiations.

3. Helping to protect security of Britain's energy supplies

1. Does this theme remain valid?
2. Have we identified all the relevant issues within this theme?
3. Is Ofgem's approach to the challenges ahead the right one?

E.ON UK believes this theme remains valid, and a key area for Ofgem to better outline its ongoing strategy and beliefs.

We strongly support Ofgem's view that the competitive market is the most effective and efficient way of ensuring security of supply, but are disappointed to not see more of Ofgem's current thinking in this chapter.

E.ON agree that this country's planning regime is the major constraint on ensuring security of supply, and would like to see more visible support from Ofgem for the Government's planning reform proposals.

In addition, security of supply will be impacted by various other energy policy and regulatory issues, such as energy efficiency, demand-side management, distributed energy, etc. The wider issues of security of supply, entailing how customers perceive the issue is also important in this context (particularly, for example, customer views on non-interruptible supplies in relation to distributed energy, private networks, and microgeneration). E.ON believe that this strategy document is the correct place for Ofgem to open discussion on these wider issues, and engage industry on them.

E.ON welcomes the publication of the Energy Markets Outlook report by BERR in conjunction with Ofgem and looks forward to a continued dialogue with BERR and Ofgem on its future development..

4. A leading voice in Europe

1. Does this theme remain valid?
2. Have we identified all the relevant issues within this theme?
3. Is Ofgem's approach to the challenges ahead the right one?

This theme is very relevant given the recent publication of the Commission's green package, and the continuing discussion on the implementation of the 3rd liberalisation package.

We agree that Ofgem should continue to play an active, leading role in this area and we entirely share its objective of creating a more integrated, transparent and competitive energy market which will at the same time underpin the large volume of investment which is required.

E.ON supports the Regional Markets initiative and we are active in discussions at our trade associations. We believe the three workstreams (transparency, congestion management and balancing) are driving the UK-FR-IR market in the right direction, and that they should start to deliver results soon.

We support appropriate harmonisation of market design on those elements that are necessary to foster cross border trade and European integration. However, we do not believe that markets need to be identical in every last detail – provided there is sufficient transparency and a level playing field with reciprocal market access (which is not the case at present in all markets), traders will be happy to trade across borders.

This is a particular risk for well developed markets like GB which, although well functioning, may differ from the eventual European market design. Harmonisation beyond that needed to facilitate trade will lead to unnecessary costs which will ultimately be borne by customers.

The full functional separation of TSOs from competitive businesses is a vital part of European market development. However, we believe that there are a number of models which could deliver effective separation to give confidence in the impartiality of TSOs.

A robust governance model for the creation and maintenance of market codes is a vital element of the development of a well functioning European market. Market participants, including customers, traders, suppliers generators and networks businesses should be involved in the drafting of market codes, and this could be done through the establishment of a standing market panel, constituted in such a way that no one group could block or delay developments that were to the overall benefit of the market.

The GB market is still suffering from lack of interconnection to the continental markets. We believe that provision must exist for the construction of merchant interconnectors built by companies other than TSOs if this position is to change.

We support the drive for strong and independent regulators across the EU, and believe that market development and integration are hindered in countries where the regulator is subject to undue political influence.

5. Helping to achieve sustainable development

1. *Does this theme remain valid?*
2. *Have we identified all the relevant issues within this theme?*
3. *Is Ofgem's approach to the challenges ahead the right one?*

E.ON welcomes Ofgem's continued focus on supporting sustainable energy, and the varied achievements detailed in both the strategy document and Ofgem's Sustainable Development Report.

However, we feel it would be useful for Ofgem to set out its higher level approach to helping achieve sustainable development in the context of its principal objective of protecting the interests of consumers and the more demanding targets which the industry is facing in terms of delivering renewable energy and reductions in demand. Given the prospect of increasing levels of Government intervention to achieve climate change goals, we would welcome Ofgem's continued support for competitive market-led routes as the means of achieving them.

6. Helping to tackle fuel poverty

1. *Does this theme remain valid?*
2. *Have we identified all the relevant issues within this theme?*
3. *Is Ofgem's approach to the challenges ahead the right one?*
4. *Should Ofgem revisit the issue of debt blocking to facilitate the participation in the competitive market of customers who are in debt?*

We fully support Ofgem's position that, although there is much that the energy industry can do to alleviate fuel poverty, it is the overall responsibility of Government to tackle the wider issues of poverty and poor housing. Ofgem could do more to promote a wider understanding amongst stakeholders that energy and housing costs are linked issues, both in terms of potential government support and of customer choice.

On the subject of debt-blocking, E.ON believe that the outcome of the supply-licence review is still valid. Debt-blocking protects the majority of customers who pay their bills from the potential costs caused by a minority of customers who do not continue to pay their debts after a change of supplier, (or cause additional costs in establishing and maintaining payment arrangements).

The conclusion of the supply licence review was that the benefit to the majority from debt-blocking outweighs the disadvantage to those customers in debt who would continue to repay their debt. There has been no change in the market to suggest this is no longer robust. Indeed the difficulties in managing debt from short term lets have become clearer. E.ON therefore does not believe the issue should be revisited now.

However, this assessment will change with the implementation of smart meters. Suppliers would then be able to provide pay as you go terms at lower cost (and as the norm in rented property) and offer accurate monthly billing at a premium which reflects the credit risk. Quarterly billing could reasonably be a premium option. In these circumstances the balance of benefit between the two customer groups would change and it may be appropriate to end debt blocking.

Our recommendation is to review the situation again when the smart meter roll-out programme is underway and there is experience of 'pay as you go' operation of smart meters.

Ofgem needs to understand why there is a low take-up of the PPM debt assignment provisions, though as the option is clearly stated to customers on debt-objection letters it would seem to be a matter of customer choice. We recommend Ofgem include understanding this aspect of customer attitudes as part of the research programme on disadvantaged customers.

7. Better Regulation

1. *Does this theme remain valid?*
2. *Have we identified all the relevant issues within this theme?*
3. *Is Ofgem's approach to the challenges ahead the right one?*
4. *Are there any other activities that we should include in the Simplification Plan that we intend to publish in March?*
5. *Are there any areas of regulation that we should review to ensure that our approach is proportionate to the risk?*

E.ON strongly supports Ofgem's approach to seek alternatives to conventional regulation as the most efficient method of protecting customers in many

circumstances. This can be seen via current self regulation projects such as the Code of Practice for Accurate Bills and the Code of Practice for the Face-To-Face Marketing of Energy Supply, as well as the ESO.

However, better regulation also means better quality of standard regulation practices, and, as stated above, E.ON do not believe that the benefits of stability in market rules are being recognised or addressed currently.

When Ofgem are keen to introduce policy proposals, thorough and realistic impact assessments are important to ensure the outcome of any new policy is not too onerous on companies, as this would inevitably have a negative impact on all consumers.

Yours sincerely

Dan Meredith

Regulation and Government Affairs

Strategy & Energy Policy

office: **02476 183115**

mobex: **777-2563**

mobile: **07876 445181**

daniel.meredith@eon-uk.com

