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**Ofgem Proposed Corporate Strategy & Plan
2009 - 2014**

E.ON UK Response

We welcome the continuing consultation process on Ofgem's rolling five year strategy, and this opportunity to provide a response to the 2009-14 strategy. The commitment to full consultation is an important contribution to understanding how the Authority intends to interpret its statutory duties.

Key industry challenges

Very substantial industry investment will be required over the next five years and indeed in the period to 2030 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 energy supplies. The Climate Change Committee's expects that decarbonisation of the power sector by 2030 will form the basis for decarbonisation of much of the remainder of the economy. This will require replacement of much of the UK's existing generation but the total level of capital investment needed has been significantly increased by the EU renewable targets given that the expected requirement for a large volume of wind generation which will only make a limited contribution to security of supply at winter peak.

Despite the significant Government interventions in the market to achieve renewables and other goals, we believe investment continues to be best delivered within a competitive, market based framework. Nevertheless, this framework may need to be adjusted to

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achieve this objective, in the wholesale market to incentivise the continuing investment in non-renewable generation in a market where there is a large volume of must-run intermittently operating renewable generation, which will substantially reduce the load factors of other capacity. In the retail market, in some circumstances, geographic franchises or street-by-street approaches may be needed to ensure the most efficient roll-out of certain technologies where this is dictated by the urgency of the timescales set.

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, and that there is no overlap or inconsistency between national and EU regulation;
- ensuring that monopoly regulation is structured to attract the investment required to maintain the networks that will support the operation of competitive markets, security of supply and more renewable and other 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 excessively interventionist policies to achieve security of supply or other objectives.

The industry is facing tough decisions as we strive to deliver clean, affordable and secure energy supplies. To assist with the challenges which we continue to face we would like to see Ofgem focus on pragmatic solutions to issues such as grid access, rather than turn to overly complex market mechanisms.

The Renewable Energy Directive and the subsequent work which is currently being undertaken on the UK's Renewable Energy Strategy, suggest that a significant proportion of renewable energy is expected to come from

the electricity sector, with the Government's illustrative estimates suggesting around 32% by 2020.

Accommodating this level of renewable capacity on the electricity network will require significant investment in transmission and distribution assets. Ofgem needs to focus on how timely, efficient and strategic investments can be made to networks ahead of user commitments, as this may be required to meet the UK's mandatory renewable target. It would be helpful if Ofgem could clarify how it intends to approach this issue.

A major challenge will be enabling the market to reach the stretching renewables targets whilst balancing the cost to consumers resulting from transmission upgrades and those resulting from constraining generation.

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

1. Creating and sustaining competition

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 that Ofgem has an important role in monitoring competition and in helping to ensure that markets are operating in a competitive manner. It needs to be sure that in regulating markets and in attempting to achieve other policy goals such as 'fair' pricing (which is not necessarily entirely consistent with the way competitive markets function), it does not in fact damage competition with adverse consequences for consumers. With energy prices likely to remain an important political and social matter, Ofgem could be more active in communicating its assessment of the market and its benefits to the public.

2. Regulating networks effectively

E.ON believes this theme remains particularly valid. As we said in our response to Ofgem's September 2008

letter, the next Distribution Price Control (DPCR5) will be a key priority for the network companies, the energy industry and consumers, given the central role of distribution networks in enabling delivery of the UK's energy policy goals.

E.ON is generally happy with Ofgem's approach to this theme, although more clarity is required in certain areas. Networks have historically succeeded in reducing costs and driving prices down for consumers by some 50% in real terms since privatisation. However, DPCR4 signals a need to invest in an ageing asset base which was predominantly installed in the 1950s and 1960s. The future is also looking far less certain as new technological innovations and future energy policy could lead to different customer usage and a more local generation portfolio than exists today. This will require networks to adopt a more proactive role in facilitating the connection of distributed generation and other low carbon technology, but contains significant uncertainties around the timescales and nature of these changes and ultimately the impact such changes will have on distribution networks.

The price control review will therefore need to cope with this uncertainty but also provide DNOs with the resources and capabilities to engage with customers and trial new technologies and ways of operating the network.

E.ON is very supportive of the work currently being undertaken to review the regulatory framework for networks, asking 'RPI-X@20' to examine the regulatory framework for distribution networks post 2015. However, if energy policy does accelerate as we believe then some of the debate being held in the context of RPI-X@20 will be required in DPCR5. We are concerned that "gaps" may therefore arise where important policy issues covered as part of the RPI-X@20 review are not covered in DPCR5. The RPI-X@20 review also needs to make sure that longer term issues that are not dealt with fully at DPCR5 (in particular enduring approaches

for pensions and investment ahead of need) are picked up.

E.ON very much welcomes Ofgem's intention to review the market and regulatory structure for independent gas transporters (IGTs) and independent electricity distribution network operators (IDNOs). But in our view a firmer commitment from Ofgem is needed to help resolve the issues that affect gas customers connected to IGT networks. These now number in excess of one million and suffer from inferior service and increased costs. Addressing these issues has been ignored by Ofgem for too long, and we would like to see a commitment from Ofgem to ensure these issues are resolved within the next two years.

3. Helping to achieve sustainable development

E.ON welcomes Ofgem's continued focus on supporting sustainable energy.

In the light of the higher priority given to sustainable development in GEMA's statutory duties under the 2008 Energy Act, Ofgem should 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.

4. Helping to protect the security of Britain's energy supplies

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

The Committee on Climate Change suggested that UK's electricity sector needs to be significantly decarbonised by 2030. The transition to such an objective while maintaining secure and diverse supplies as higher carbon or time-expired plant is closed will require careful management in policy terms to ensure that secure supplies are maintained throughout this period and that the investment requirements on the

industry are manageable. As discussed above, this goal has been made more challenging in capital investment terms by the scale of renewable plant which may be required to be built by 2020 which will need to be backed up by more conventional capacity. Ofgem has a valuable role here in helping the Government navigate this path but needs to be alert to potential changes in the market framework which may be needed to facilitate this investment. In addition, new renewable developments (especially offshore) will require significant investment in transmission and distribution networks.

5. A leading voice in Europe

This theme remains valid and we agree that Ofgem should continue to play an active role in this area. We share its objective of supporting the European Commission in its drive to achieve competitive and sustainable energy markets that operate in the interests of energy consumers. The focus should now be on implementing and ensuring the success of the third package and not on contemplating a further round of EU legislation.

E.ON supports Ofgem's work with CEER, ERGEG, the Commission and the new Agency for Co-operation of Energy Regulators (ACER) to ensure that European competition and regulatory policy benefits UK and wider EU energy consumers and that markets are only aligned to the degree that is needed to facilitate trade, so as to avoid unnecessary costs of harmonization which will ultimately be borne by customers.

6. Helping to tackle fuel poverty

We 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 and Ofgem needs to continue to advise the Government on developing fuel poverty programmes.

We believe that the most effective and sustainable way of tackling fuel poverty is through improved energy efficiency. The potential savings are greater, and are

sustained, and target those in lower quality housing and hence most vulnerable to rising prices.

The focus should be on the severely fuel poor; with less emphasis on responding to the increase in number of fuel poor customers arising from rising energy costs and more on the increase in severity of fuel poverty for customers who have been fuel poor for some time. In doing this it should be appreciated that the fuel poverty indicator is purely a statistical measure which is flawed at a time of rising prices. As energy prices rise, incomes need to increase tenfold to have no impact on an individual's fuel poverty indicator.

E.ON supports Ofgem's approach of monitoring the effects of the measures that are going to be implemented in 2009 to improve the market for vulnerable consumers and to take further action if necessary.

Smart meters provide accurate consumption data that will help consumers to change their behaviour and reduce carbon emissions and will also improve the accuracy of billing and avoid the need for visits by meter readers. E.ON shares the Government's view that smart meters should be rolled out to all residential customers over the next ten years.

On the subject of debt blocking, E.ON recently responded to Ofgem's Initial Findings Report, concluding that debt-blocking generally benefits the majority of customers, particularly those in higher credit risk groups who manage their budget to be able to pay their bills. Without debt-blocking suppliers would have higher costs, which in a competitive market would be passed on to customers with a similar risk profile, and possibly would not compete so vigorously in higher risk areas. Debt-blocking can also benefit customers who are blocked from transferring, avoiding an immediate need to repay debts.

The conclusion is that debt-blocking arrangements are to customers' overall benefit but should be reviewed when smart meters start to be installed.

We are disappointed therefore that Ofgem is consulting again before a smart meter programme has been agreed, although we welcome the suggestion made for increased transparency of tariff options to customers.

7. Better Regulation

E.ON strongly supports Ofgem's approach to seek opportunities to remove unnecessary burdens on businesses and to seek continuous improvement to its operational efficiency and effectiveness, thereby keeping its costs under control.

We would like to see the same Better Regulation principles applied by the European regulatory agency once it has been established. Additional regulation at a European level should only be introduced where needed, and should be appropriate to the risk posed, and costs identified and minimised. Decisions should be justifiable, and inconsistency with existing regulation must be avoided.

We believe that robust, timely consultation with stakeholders will deliver real benefits in terms of improved market design and regulation, and would ask that Ofgem, in its role in the European Agency, endeavour to ensure that European initiatives are subject to similar robust processes.

Xoserve - Project Nexus

In its Corporate Strategy there is no mention of assistance from Ofgem with regards to the replacement of the central systems in the gas industry. This crucial project could have considerable consequences for the successful functioning of the competitive retail markets. It is complicated by the price controlled funding arrangements and the interaction with the implementation of smart metering and would significantly benefit from Ofgem involvement.

Yours sincerely

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