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Dear Sir,

E.ON welcomes the opportunity to comment on Ofgem's corporate strategy for 2010-2015. We are encouraged by Ofgem's commitment to consult on their future direction and priorities on a regular basis, and we see this as a key component in building rapport between the regulator and industry.

Please find our response enclosed and if you have any queries please do not hesitate to contact me.

Yours faithfully

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Response to Ofgem Five Year Strategy 2010-2015 - Initial comments by E.ON

E.ON welcomes the continuing consultation process for Ofgem's rolling 5 year strategy, and this opportunity to provide a response to the 2010-15 strategy. The commitment to full consultation is an important contribution to understanding how the Authority intends to interpret its statutory duties.

We believe that the priorities for Ofgem over the next five years are as follows:

- Given the Government's proposals to amend Ofgem's duties, there is a risk that regulated companies will become less clear about how Ofgem will regulate the market, as regulation shifts away from promoting competition to more subjective goals such as 'fairness' and rebalances the interests of present and future consumers in respect of the costs of meeting climate change goals. Ofgem will need to provide clearer guidance to companies about how it proposes to carry out its functions within this revised regime;
- Notwithstanding the recession, the industry faces a major and prolonged period of investment in new generation assets both to meet security of supply and climate change goals. Ofgem must promote a stable and predictable regulatory environment in which efficient investment can be rewarded by the market;
- Ofgem should continue to manage network regulation to enable some strategic transmission investment to allow the timely connection of consented generation assets onto the grid;
- Regulation should support the investment needed in ageing distribution assets to ensure security of supply and to enable networks to play an important role in facilitating low carbon investments (including through smart grids), whilst maintaining and improving efficiency levels;

- Ofgem should take a leading role in facilitating the change of industry processes that will occur due to the introduction of smart metering, and implement a new regime of retail industry code governance;
- Ofgem should take a more assertive role in the xoserve project and lead its operation; as to date it has been left to the gas transporters and their agents to deliver;
- The introduction of the Feed-in-Tariff (FIT) and Renewable Heat Incentive (RHI) will require significant administrative activity from Ofgem. Our preference would be for Ofgem to take on the role of the administrator of payments under such a system;
- Delivery of energy efficiency measures to consumers will have to radically change in the future if the UK is to meet its targets in this area. Ofgem should be involved in debates revolving around any new regime and build upon the experience that it has acquired administering the EEC and CERT schemes;
- We encourage Ofgem, in areas where they do have responsibility, to assist vulnerable customers and the fuel poor by monitoring the effectiveness of the probe remedies in protecting such customers, and to make sure that the evaluation for the sunset clause on undue discrimination in 2012 is comprehensive.

The Key Industry Challenges:

Investment to meet Low Carbon and Security of Supply Goals and Regulatory Intervention

1. The UK Low Carbon Transition Plan is reliant on major investment in generation capacity, smart metering, energy efficiency and renewable technologies to deliver the UK's climate change goals. The industry also faces a huge investment challenge in order to replace assets closing as a result of the Large Combustion Plants Directive in

2015 and the Industrial Emissions Directive beyond that, in addition to nuclear plant closures. Investors need to be confident that competitive energy market structures will continue to function in a reasonably stable manner and that the regulatory framework is predictable in its effect. This is particularly relevant in a generation market dominated by large volumes of wind generation where a number of analyses have shown that prices may have to rise to very high levels to support the capacity needed to maintain security of supply during the relatively infrequent periods of very low wind generation. If this is not delivered energy markets will find it much more difficult to support the required investment which may lead to pressure for more interventionist means of delivering new investment. The future direction of regulatory interventions that have or may arise from the probe into energy markets, including proposed market power licence conditions and wholesale market liquidity remedies are clearly areas of concern in this regard.

The Grid Network

2. The UK has a target to deliver 15% of final energy consumption from renewable energy sources by 2020. A key challenge for Ofgem in this regard is the promotion of new generation capacity, particularly renewables, and the network infrastructure required to accommodate it; whilst ensuring that the costs incurred as a consequence for customers are no higher than necessary.
3. Ofgem should work with government and licensees to enable strategic investment in the transmission network to help ensure the timely connection of consented generation assets. Similarly, the transmission charging regime should be implemented as quickly as is feasible to ensure that new renewable generation assets are connected to the grid in a timely manner.

4. Ofgem should build upon the valuable work of the Electricity Networks Strategy Group (ENSG) to promote strategic investment in networks in order to reduce lead times for new infrastructure. They should also ensure that the arrangements for charging for access remain cost reflective and that incentives to locate generation in appropriate parts of the country are maintained. Full engagement with the industry and other stakeholders when considering such issues is necessary.
5. We urge Ofgem to push ahead with the introduction of the enduring regime for the new offshore transmission operator regime. This will provide greater confidence to the investor community and be consistent with supporting delivery of the 2020 renewables target in which offshore wind plays a significant role. Strategic investment in offshore transmission is also necessary in ensuring a timely, well-developed offshore network; this will provide longer term benefits and lower cost for consumers.

Disrtibution Price Control Review (DR5) & Distribution Network Operators DNOs

6. The regulatory framework in DR5 must provide the resources and investment to play a more proactive role in supporting implementation of lower carbon solutions (e.g. wind farm developers, Combined Heat & Power (CHP) schemes, micro-generation and heat etc). The framework should also allow DNOs the ability to recover investment incurred in trialling and adopting new and efficient network solutions to accommodate these and future changes.
7. DNOs need to invest in the network to ensure security of supply, they also need to invest in developing new technology to meet the government's low carbon targets and educating future engineers to maintain and develop the network. Furthermore, the next few years will see considerable development of UK infrastructure (in telecoms,

rail, utility and airports, for example) and DNOs must remain competitive and able to accommodate increasing price pressures as the recession unwinds.

8. DNOs need a reasonable rate of return to attract the necessary investment that they require. Ofgem must bear in mind that, for companies like E.ON, funds for investment are competing with other infrastructure projects, not only in the UK but across Europe.
9. The Authority should also ensure that DNOs have sufficient funds to invest as required and work closely with DNOs through the price control process. They should also work with industry members to ensure the proposed Low Carbon Network Fund provides a real chance of recovering costs for DNOs.

Industry Codes

10. Although we do not consider there to be fundamental flaws with the current industry code governance processes, we accept that, with the right checks and balances, a new Ofgem led major policy review (MPR) process could offer benefits in terms of more transparent and efficient decision making. Smart metering is one such area where a MPR process could be applied, similarly, its application is much needed to improve oversight of independent gas transporter (IGT) arrangements and the settlement systems managed by xoserve, both of which hinder supply competition in gas.
11. We urge Ofgem to address the issues regarding consumers on Independent Gas Transmission networks. There have been many long-standing concerns in this market sector which should be resolved by the robust regulation of the IGT.
12. The problems associated with poor processes,

lack of appropriate and robust governance, and unclear communication channels regarding new connections have led to high costs for suppliers and consumers from managing the connections process. Ofgem's activity to date has concentrated on ensuring that developers receive the financial benefits of connection competition as opposed to the increased costs that the consumers who move into new homes experience. We urge Ofgem to focus more on the end-to-end process of connections and to place lesser emphasis on competition in connections.

13. Many fundamental changes to market rules originate from discussions between Ofgem and the relevant regulated network business. These discussions often deal with matters that are actually more relevant to network users and their customers than the network businesses themselves; and a significant number of disputes, challenges and regulatory difficulties have arisen in the past where policies are agreed with the network business in this way. Examples of this have included the enduring gas off-take arrangements agreed as a condition of the sale of gas distribution networks, gas transfer and substitution arrangements, and more recently certain electricity transmission access proposals.
14. If the MPR process were to make these discussions more inclusive many problems, false-starts and misunderstandings could be avoided. Such a process would also be much enhanced if the relevant network business felt able to express their views without fear that their failure to promote an Ofgem originated rule change might weaken negotiations on the latest price controls.
15. Nevertheless we still remain somewhat concerned that the MPR process could be used to drive change for change's sake (rather than change motivated by a more principled, evidence based response); or implement overly complex mechanisms that have little support from the industry, customers and other relevant stakeholders.

16. Areas where we think Ofgem's use of a MPR would be highly detrimental include; mandatory day-ahead power auctions, market power related rules and auctions for transmission access in electricity, as well as shorter balancing periods and introduction of entry/exit flexibility capacity arrangements in gas.

Smart Metering

17. The introduction of smart metering will facilitate the wholesale change of the retail markets, and governance of industry processes will need to adjust accordingly. Ofgem should take a leading role in facilitating this change and implement the creation of a new regime of retail industry code governance. Ofgem should also ensure that they are sufficiently resourced to administer this change.
18. Likewise, the implementation of smart metering should allow for new and innovative methods for the detection of theft. Ofgem should use their long awaited consultation on this issue to concentrate on the development of initiatives for the future smart metering space that will help to eradicate theft going forward. Experience from other industries should be used (e.g. banking and insurance) to ensure different and more effective techniques can be developed, such as modelling techniques, to detect patterns of theft occurrence.

Xoserve

19. The replacement of the central gas systems (Project Nexus) potentially offers considerable benefits for the retail gas market as well as significant risk. Ofgem should assert a far more active role in this project and lead its delivery; as to date it has been left to the gas

Transporters and their agent to deliver.

20. Ofgem should use the opportunity of the next price control to fully implement the 'user pays' arrangement and move xoserve's cost to a pass through arrangement where they report to the industry. The current mechanism of funding central gas systems via the price control mechanism of gas transporters has proven to be ineffectual at delivering a robust, cost-effective service and has driven inappropriate behaviour by gas transporters that has not worked in the interests of the supply industry or gas consumers.

Feed-In-Tariff and Renewable Heat Incentive (FIT & RHI)

21. The introduction of the FIT and RHI will require significant administrative activity from Ofgem. Pro-actively leading on the delivery of these projects and ensuring that the existing competitive retail markets continue should be a priority. These systems, when they do come into force, must be administered in a thoroughly robust way.
22. We feel the administration of payments in this new system would be better dealt with by one party and this could be a role undertaken by Ofgem. It would increase simplicity in the eyes of the customer and ensure the audit trail of payments is more transparent.

Energy Efficiency

23. Delivery of energy efficiency measures to consumers will have to change radically in the future if the UK is to meet its targets in this area. Ofgem should be involved in debates revolving around any new regime and build upon the experience that it has acquired administering the EEC and CERT schemes.

24. Ofgem, alongside Government and utility companies, should engage in keeping customers satisfied and informed on the financial benefits of investing in energy efficiency and behavioural change.

Fuel Poverty

25. We encourage Ofgem (in areas where they do have responsibility) to support vulnerable customers by monitoring the effectiveness of the probe remedies in protecting such customers, and to make sure that the evaluation in 2012 (for the sunset clause on undue discrimination) is thorough.
26. We also urge Ofgem to contribute to the policy debate. In particular, on the impact of the cost of policies on consumers and how to minimise the impact on the most vulnerable fuel poor through the more effective targeting of policies. Ofgem should also act as a facilitator for smaller scale initiatives, such as those that arose from the fuel poverty summit.