RWE npower

Hannah Nixon
Partner, Transmission
Office of Gas and Electricity Markets
2nd Floor
9 Millbank
London
SW1P 3GE

Your ref 5/10
Our ref
Name Charles Ruffell
Phone 01793 89 39 83
Fax 01793 89 29 81
E-Mail charles.ruffell@rwenpower.com

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Regulating energy networks for the future: RPI-X@20 Emerging Thinking January 2010

Dear Hannah,

We welcome the opportunity to respond to this Consultation. This response is provided on behalf of the RWE group of companies, including RWE npower, RWE Supply and Trading GmbH and RWE npower renewables, a fully owned subsidiary of RWE Innogy.

We agree that the energy industry will face significant future challenges meeting climate change and renewable energy targets and delivering security of supply cost effectively. The network businesses will have a key role in facilitating delivery of this sustainable energy sector and changes to the regulatory framework for energy networks may be needed to in the move to a low carbon economy.

Our main interest is in how the monopoly network businesses interact with the competitive energy sectors and whether the potential new regulatory framework set out in the *Emerging Thinking* consultation will affect this. We endorse Ofgem's conclusion that there should be no move to an alternative regulatory framework, as we consider that the RPI-X model can be adapted going forward. There are already examples of this approach, such as the capacity substitution incentives in gas and the OFTO arrangements for offshore electricity generation.

Ofgem is proposing changes that reflect the uncertainty about what network companies need to do to deliver a sustainable energy sector and are designed to change the mindset and focus of the network companies. The current input-based regulatory model will be replaced by an outcomes-led framework that will enable a series of high-level outputs to be specified. Each network company would then reflect the delivery of these outputs in its business plans which would be informed, in part, through enhanced stakeholder engagement. The package

RWE npower

Trigonos
Windmill Hill Business Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

T +44(0)1793/89 39 83
F +44(0)1793/89 29 81
I www.rwenpower.com

Registered office:
RWE Npower plc
Windmill Hill Business Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

Registered in England and Wales no. 3892782

of measures would include incentives on the networks to respond to and anticipate future needs and to deliver value for money over the longer term. Clearly, there is a need for Ofgem to determine an objective measure of longer-term efficiency under this augmented framework.

There appears to be an underlying assumption that more network infrastructure will be needed in the future. While we do not necessarily disagree, we would be concerned if the new regulatory framework resulted in less rigorous scrutiny of planning and delivery of outputs. Rather than undertake wholly anticipatory investment, the case for which may be poorly defined, our preference would be for this investment to be guided, at least in part, by user commitment. This will minimise stranding risk as assets will be constructed where users who are willing to commit, require them. To the extent that anticipatory investments are permitted, there needs to be an appropriate balance between risk and reward faced by the networks.

However, networks will need to undertake different roles as well, for example, active management of flows from entry at all levels both onshore and offshore and we consider that more needs to be done to incentivise demand-side participation. In our view, the document blurs the boundary between the provision of network services and energy services. While there may be collaboration in the development of energy services between networks and suppliers, we consider that it is critical that suppliers/shippers on the networks continue to have the enduring relationship with end-users and that the current delineation of roles and responsibilities between the monopoly and competitive parts of the market is maintained.

In principle, we can see the merit in longer term price controls, with a hybrid model with different incentive arrangements over different timescales likely to emerge. What is unclear is whether these arrangements meet Ofgem's stated objective of reducing complexity. Our view is that the regulatory arrangements are necessarily complicated and, given the levels of network investment predicted, are likely to remain so. Ofgem has a key role to play in undertaking detailed scrutiny and assessing the strength of any needs case associated with proposed investments.

Reforming the current regulatory framework to encourage more innovation and anticipatory investment will also require a definition of efficiency which covers a periods potentially longer than five years and embraces the total cost of developing and operating networks. This will be needed to reduce regulatory uncertainty and to help ensure that investment decisions are not undermined or delayed and that costs to consumers are minimised.

We hope these views are helpful and if you wish to discuss any aspect of them in further detail, please do not hesitate to contact me.

Yours sincerely,

By email so unsigned

Charles Ruffell
Economic Regulation