



RIIO-2 Framework Open Letter

E.ON Response

Executive Summary

- E.ON welcomes the opportunity to engage on the RIIO-2 framework at this early stage and look forward to further engagement throughout the rest of the process. The RIIO-2 has the potential to facilitate the delivery of an efficient, versatile and integrated network system that delivers value for customers. We therefore support Ofgem's overarching objective that "RIIO-2 will ensure regulated network companies deliver the value for money services that consumers want and need".
- E.ON agrees that consumers should help to shape the framework where possible, through effective engagement. However, it should be recognised that for many consumers, networks are remote from their thinking beyond the desire that "the lights come on when the switch is flicked". Therefore, careful consideration is required as to the best way of engaging stakeholders effectively, and where this is not possible, it is Ofgem's statutory duty to make decisions with the customers (current and future) best interests in mind. We believe that DNOs have a responsibility themselves to better understand customer needs and to educate and engage them to a greater extent than currently.
- More broadly, E.ON agrees that the RIIO-1 experience should be used to inform decisions about RIIO-2. We therefore believe it is imperative that Ofgem accelerate its analysis of recent performance of networks companies under the RIIO-1 framework in order to produce meaningful conclusions. The current analysis and learning is based upon only a single year of data - it is not statistically robust to extrapolate this for the entire 8 year framework period. In addition, whilst the networks have undergone significant development over the last few years, the pace of change and disruption to those networks is ever increasing. Therefore, it is vital that more recent years are assessed to understand the impact of some of these trends and changes.
- The rest of our response focuses on each of the key principles for the framework review, drawing out high level messages that can be developed in more detail as the process continues over the coming months.

Key Principles

Giving consumers a stronger voice in setting outputs, shaping and assessing business plans

1. E.ON agrees that a strong engagement with consumers will be important in developing the RIIO-2 framework and ensuring it meets the overarching principle. We have highlighted above that whilst some consumers are likely to be already engaged in this area as they see the direct

impact of network costs on their bills as well as the opportunities to provide services to the network operators themselves, for many consumers the networks are more distant aspects of electricity and gas. Furthermore, any customer engagement will need to take into account the increasing number of consumers that are becoming prosumers.

2. E.ON believes that it is right that Ofgem look to more ways, potentially learning from other industries, on how to engage a broader range of consumer in this topic. However, consideration must be given to the fact that networks are natural monopolies, and that for most existing users, there is little choice in terms of the network they can connect to. In addition, there is a significant information asymmetry. These facts may mean that it is difficult for consumers, assuming they can be engaged, to meaningfully challenge business plans and price controls and it may therefore fall to Ofgem to effectively represent these consumers.
3. With regards to the use of Outputs to determine the delivery of the framework, E.ON agrees that this approach provides flexibility for network owners to determine how best to deliver them, whilst also providing users with a clear measure of what is to be achieved. A key aspect going forward is to ensure that there is alignment between the outputs of the different frameworks such that there is consistency between the transmission and distribution networks to avoid conflicting outputs.
4. However, as we have already highlighted, E.ON does not believe that there is enough information available to properly assess whether the current output framework has been effective and therefore what changes would be beneficial for RIIO-2. We urge Ofgem to rapidly assess the information they have beyond the single year they have assessed.

Allowing regulated companies to earn returns that are fair and represent good value for consumers, properly reflecting the risks faced in these businesses and prevailing financial market conditions.

5. E.ON believes that Ofgem should carefully consider the returns that the regulated companies will earn under the RIIO-2 framework. At a high-level, returns should be aligned to the risks that network companies bear, based upon the risks being assigned to those who are best able to manage them. It seems sensible that in areas where returns are impacted by wider economic conditions that are outside of the network companies' control, then adjustments should be made to account for these. This reduces risk on network companies should economic conditions move against them and similarly avoids returns that are too large in more favourable circumstances.
6. It is also important that there is a degree of certainty in allowed revenues as this is a key aspect for both supply and generation businesses. Therefore, an appropriate balance is needed

between fixing aspects of the framework returns to provide certainty, and allowing adjustments to it to provide value for money and manage risk.

Incentivising companies to drive consumer value by shaping or proactively responding to changes in how networks are used and services are delivered.

7. E.ON believes that this principle will be vital to ensuring that an efficient and effective market for flexibility is facilitated in order to allow decisions to be made between network investment and procurement of flexible services in order to best manage the networks. It will be important to ensure that this is done on a whole systems basis as it may be most cost effective, for example, to solve a transmission constraint by procuring flexibility on a distribution network and would avoid situations whereby, for example, procurement of flexibility at a transmission level causes a distribution constraint. It will also be important to ensure that networks cannot abuse their monopoly position to the detriment of other solutions providers.
8. In order to ensure a whole systems approach; there will need to be a strong coordination between the network companies at a transmission and distribution level as well as the system operator (SO). E.ON believes that the SO should play a key part in determining the best approach for networks and would be best incentivised to do so under a completely separate framework from RIIO-2. This would also align to Ofgem's intention to legally separate the SO functions from the rest of National Grid. E.ON believes this would allow the right incentives to be placed upon both the networks companies and the SO in order to deliver a least costs system, utilising both local flexibility offerings as well as network investment.
9. With regards to managing uncertainty, it is important that Ofgem find an appropriate balance between giving users of the networks a level of certainty upon which investment decisions, such as those for flexible offerings, can be made whilst ensuring that there is an appropriate timescale for network companies to be incentivised to look for efficiency savings and innovate. One potential approach to encourage network companies to innovate would be to ring-fence such actions and associated outputs to ensure that the networks companies receive a share of an appropriate value for such innovation before it gets passed through entirely to users. Once again, a balance is needed between the greater adaptability this approach may give networks to innovate against the desire to keep the framework simple (as per principle 5).

Using the regulatory framework, or competition where appropriate, to drive innovation and efficiency

10. E.ON would suggest that effective cost assessment of business plans will be essential in ensuring that value for money for consumers is achieved. However, as Ofgem have recognised, there is a distinct information asymmetry which makes such challenge difficult. We have already raised our concerns about how to achieve this from end consumers, but the same issue remains even

for those within industry such as suppliers, generators and solutions providers and even within the direct challenge from Ofgem. A key aspect to make this process as robust as possible will be a detailed assessment of the RIIO-1 framework, beyond just the single year that has currently been assessed. It would be helpful if such an assessment could be included within the consultation process, both to allow comment and challenge, but also to help educate users to make that challenge more effective.

11. As described above, innovation and the development of efficient, flexible networks that are required now and in the future is of vital importance given the rate of change in the energy system. This means that approaches which seek to encourage innovation from network companies, over potentially shorter framework timescales should be investigated. This could be done through ring-fencing certain activities or outputs, but other approaches should also be consulted upon.
12. Ofgem also highlights the role of competition in ensuring better value for consumers. E.ON believes that in some areas this has been effective (e.g. OFTO regime). Furthermore we look forward to seeing whether competition for delivering new onshore investment will deliver savings for customers. Indirectly, competition between investment in networks and offerings of flexible services can also provide an important role in driving better value for consumers.

Simplifying the price controls by focusing on items of greatest value to consumers

13. E.ON would suggest that a principle of the framework being no more complex than it needs to be would be a good basis to use for RIIO-2. Inevitably, the framework for such a complex system will in itself need to have complexities, but where possible, these should be minimised. This would be of benefit to users, allowing them to better understand the system which drives a significant component of their costs and facilitating a more effective challenge for those users to ensure better value for consumers.
14. As highlighted above, one key aspect of this would be for the SO and network companies to have separate regulatory frameworks and incentive schemes to reflect the different roles that they fulfil within the current and future market. It would be important for Ofgem to consider how these schemes interact to ensure that they were not conflicting, but this could still allow a suitable degree of tension between the mechanisms to drive efficiency.