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4 March 2019

Dear Sir or Madam

Thank you for the opportunity to respond to the RIIO-2 sector methodology consultation. Please find below E.ON's response.

Executive Summary:

E.ON believes that:

- Affordability needs to be explicitly included in the three new output categories reflecting what consumers want and value from the networks. Whilst it can be argued that affordability is covered in other areas of the price control, it sets a 'customer-first' focus to include it explicitly in the output categories.
- Whole system thinking needs to focus on electricity systems only in the first instance to keep the process manageable and limit the number of parties involved to ensure that momentum is maintained. Whole system solutions that involve energy efficiency, transport and heat (such as insulation in electrically heated homes, smart charging for EVs and fuel switching for hybrid heat pumps) need to be included in 'electricity-only, whole system thinking', but the gas and road network companies do not need to be involved to gain the electricity benefits.
- Whole system incentives should be incorporated into existing incentives to avoid double payments (as most whole system solutions will aid other output delivery incentives). Also, there should be no separate pot for whole system thinking incentives but rather that innovation projects that incorporate whole system thinking will be prioritised.
- Whole system solutions will be best achieved by having a single party accountable for the balancing and operation of the networks across all voltage levels. That party would be responsible for identifying system needs and then tendering for solutions to solve them. The DNOs would be able to offer traditional network reinforcement as well as smart grid solutions whilst third parties would be able to offer flexibility solutions

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derived from Distributed Energy Resources (DER). The single party would then choose the most economically rational solution.

- E.ON believes National Grid Electricity System Operator (ESO) is the best option for this single party due to its current responsibilities for operating the GB transmission network. This single party governance structure is better suited to delivering whole system solutions as it avoids the complications caused by different drivers, cultures, systems and data that would be inherent in a multiple DSO structure. It also prevents conflicts of interest inherent in structures where the DNOs become DSOs i.e. where network owners would be responsible for procuring work to meet system needs whilst also offering grid (traditional and smart) solutions themselves. The Open Network Project has this option as one of its future worlds (World D).
- Under the 'single party accountable for all networks' model, whole system innovation should be limited to large scale projects that cannot be funded through a consortium of companies. These projects would need the approval of the ESO and a stakeholder panel.
- Price controls should be accurate and this should also feed into the current charging reviews (TCR and the Access and Forward-Looking Charge SCR). A full review of the 'correct' split between residual charges and forward-looking charges is needed, investigating the correct investment drivers. Ofgem can then allow customers to reduce their forward-looking charges (through load shifting, DER etc), but only where these actions help reduce overall network charges whilst not avoiding the sunk, residual charges. These changes should be delivered at the same time to ensure the DER market is not hampered by removing incentives before replacing them.
- The ESO price control process cycle should be shorter than the RIIO-1 cycle. This is because long cycles are only required for companies that have a heavy asset investment model that needs to reassure investors of a certain level of long term revenue. The ESO will be an asset light business where IT systems will constitute their largest investments. Typical depreciation timescales for these types of assets are much lower than for network owner assets (such as substations and pylons). Therefore, a two to three-year price control process cycle would appear to be the correct level.
- Incentives derived from ex ante targets evaluated after delivery will allow suppliers to factor in a range of outcomes to customers' bills that ex post criteria do not allow for, thereby giving customers more certainty in their bills. E.ON acknowledges that it will be difficult for Ofgem to set ex ante targets in a rapidly changing energy system, but the reduction of the price control process timescales for ESO to two years should mitigate these problems. E.ON's recommendation of a 'single accountable party across all voltage levels' and the definition of whole system being constrained to electricity only will also ensure the effectiveness of this option.

- A single ‘incentive pot’ for the ESO does not allow for it to be rewarded properly for over-delivery of a specific principle and does not promote transparency. An incentive for each principle would be a more open model.

Output categories questions - CSQ2: Do you agree with our proposed three new output categories?

1. E.ON welcomes Ofgem’s proposed consolidation of the six output categories under RIIO-1 to three. This enables network operators to be clearer about their focus as several of the RIIO-1 categories overlapped significantly e.g. customer satisfaction is primarily driven by availability for existing customers and by the process for connection for new customers¹. Whilst there is no explicit mention of a prioritisation between these categories, the concentric circle diagram and the statement *“These [categories] place the consumer experience at the heart of RIIO-2”*² does suggest that meeting the needs of consumers and network users is the primary aim of the RIIO-2 framework. E.ON is fully supportive of this focus on customers.
2. E.ON notes that Ofgem has considered including affordability as another key area, but has decided against explicitly including it as an output category, believing that it is better captured through other components of the framework (such as the assessment of efficient costs)³. However, E.ON believes that including affordability right at the front of the framework as a key output target shows customers the seriousness that Ofgem places on this output, meeting one of Ofgem’s principal objectives of promoting value for money. By hiding affordability away in the assessment of efficient costs, Ofgem is not making it easy for interested customers to see how it is ‘promoting value for money’. E.ON believes that this could be easily achieved by changing the definition of *“Meet the needs of consumers and network users”* to be *“Network companies must deliver a high quality, affordable and reliable service to all network users and consumers, including those in vulnerable situations”*.

Output categories questions - CSQ3: Are there any other outcomes currently not captured within the three output categories which we should consider including?

3. See answer to CSQ2

Output categories questions – CSQ4: Do you agree with our proposed overarching framework for license obligations, price control deliverables and output delivery incentives?

¹ UK Power Networks Business Plan (2015-2023) Annex 4: Customer Satisfaction Survey March 2014

² RIIO-2 Sector Specific Methodology Core Document Section 4.6

³ RIIO-2 Sector Specific Methodology Core Document Section 4.9

4. E.ON believes that the price control deliverables (PCDs) framework needs to link seamlessly with the charging methodology currently under consultation in the Targeted Charging Review (TCR) and the Access and Forward Looking Charge Significant Code Review. Upfront funded PCDs and uncertainty mechanisms within the PCD framework need to be clearly mapped to either residual or forward looking charges to allow customers to either invest in assets that will support the grid (and therefore reduce their forward looking charges) or pay their fair share of socialised sunk costs.

Output categories questions - CSQ5: Do you agree with our proposals to introduce dynamic and relative incentives, where appropriate? Are there any additional considerations not captured in our proposed framework which you think we should take into account?

5. E.ON agrees with the introduction of dynamic incentives as RIIO-1 has shown the speed with which the industry can change in terms of performance/thinking. E.ON is concerned with the effect relative incentives might have on cooperation within the sector and the sharing of best practice. By incentivising DNOs to compete against each other (as in relative incentives) will hamper the dissemination of best practice across the industry, which is currently good.

Enabling whole system solutions questions - CSQ8: Do you feel we have defined the problem correctly?

6. Section 5.8 of the Core document defines the problem as “How to enable greater levels of co-ordination between different parts of the energy system in investment planning and operational delivery so that the sum of costs across the system is minimised”
7. E.ON agrees with Ofgem’s hypothesis that there is a problem needing to be addressed by RIIO-2 and that without support from the price control framework (either through specific incentives or license conditions) progress towards whole system thinking will be slow. This can be seen in the low number of Network Innovation Competition (NIC) projects that have looked to develop linkages between DNOs and TOs and the low number of collaborative NIC projects (TEF⁴ being the exception).

Enabling whole system solutions questions - CSQ9: What views do you have on our proposed approach to adopt a narrow focus for whole systems in the RIIO-2 price control, as set out above?

⁴ Three projects submitted to the NIC (Transition submitted by SSEN & ENW, EFFS submitted by WPD and Fusion submitted by SPEN) that jointly support the transition from DNO to DSO

8. E.ON believes that there are broadly four options for focus on whole system thinking, each with their own pros and cons. They are:
 - a. Focus solely on electricity
 - b. Focus on electricity and gas
 - c. Focus on electricity, gas and heat (including energy efficiency)
 - d. Focus on electricity, gas, heat and transportation
9. E.ON believes that the linkages between water and waste are not strong enough for them to be considered as potential options.
10. Option 1 (focus solely on electricity) benefits from being the simplest option with the fewest number of parties that need to co-ordinate. It has also been the subject of the most amount of research in terms of financial benefit⁵ and had the most thought regarding how to deliver it (Open Networks Workstream 4). However, Option 1 limits the synergy savings and were it to be chosen, it might make adding other sectors in later more expensive.
11. Option 2 (focus on electricity and gas) benefits from the clear linkages between gas and electricity. As heat is decarbonised (possibly via electrification) there will be a large opportunity to optimise across fuels to reduce costs e.g. hybrid heat pumps that can switch to gas if the local electricity system is under stress. Obviously, this option involves more parties and will be more complex, but is likely to generate higher savings for customers (though to E.ON's knowledge there has not been any quantitative measure of this benefit). However, it is not clear that the gas network companies will be affected by any fuel switching as the gas network will not need further reinforcement or operational actions in these situations. Therefore, it is not clear that gas network companies need to be involved in any whole system development.
12. Option 3 (focus on electricity, gas and heat) considers using energy efficiency in long term planning as an alternative to reinforcement. This option will be especially relevant if heat decarbonises through electrification as localised peak electricity consumption could increase dramatically. By including energy efficiency, this peak could be reduced through large scale installation of good quality insulation. Energy efficiency has also been identified as a key area in the Clean Growth Strategy and the Network Innovation Allowance (NIA). Paying for customers to have insulation added at the same time as having electrical heating installed is logically the same as paying EV owners for smart charging rather than charging at their own discretion. Therefore E.ON believes that energy efficiency ought to be considered as part of the alternatives to traditional reinforcement, but this does not involve additional stakeholders needing to be consulted (and

⁵ Imperial College report

therefore slowing down the process). As with fuel switching in hybrid heat pumps and smart charging for EVs, the system operator should consider energy efficiency in electrically heated homes, but only as part of the standard tendering/auctioning process. There is no need to consider how energy efficiency supply chains are impacted.

13. Option 4 (focus on electricity, heat and transportation) is the most optimistic approach and in principle should deliver the largest benefit to customers. However, the complexity and numerous parties involved in this level of optimisation is likely to make this option unwieldy at best and undeliverable at worst. Ofgem must also consider that their remit may need to be extended to incorporate other industries (such as transportation, water and waste) into whole system thinking, especially if money from gas and electricity bills is being used to fund projects where non- gas and electricity license holders are receiving funds.

14. E.ON believes that Option 1 (focus solely on electricity) is the best option at this time due to the level of progress that has been made in this area already. By incorporating gas or transportation network companies as well it is likely to delay benefits until much further in the future. However, this should not prevent electricity network solutions such as fuel switching for hybrid heat pumps, smart charging for electric vehicles and energy efficiency for electrically heated homes. These solutions can be delivered without the involvement of gas or transportation networks. By designing the correct framework with transparent cost drivers linked to charges, then investment decisions across all solutions can be made in an efficient way.

Enabling whole system solutions questions - CSQ10: Where might there be benefits through adopting a broader scope for some mechanisms? Please provide evidence?

15. See answer to CSQ9

Enabling whole system solutions questions - CSQ11: Do you have reasons and evidence to support or reject any of the possible mechanisms outlined in this chapter? Do you have views on how they should be designed to protect the interests of consumers?

16. E.ON believes that the six potential options could all deliver better whole system thinking and coordination. However, whole system thinking and coordination will help network operators deliver on other outputs and therefore help network operators capture higher rewards from their Output Delivery Incentives (ODIs)⁶. To prevent double payments (and therefore keep costs down for customers), it is important that there are no incentives specifically rewarded

⁶ Especially if affordability is incorporated into the output categories (see CSQ2)

on delivery of whole system thinking alone, such as Option 3 (coordination and information sharing). As highlighted by Ofgem, coordination and information sharing could be incorporated into other aspects of the price control⁷ or into the license conditions⁸. E.ON believes that this is a better option for customers.

17. Option 2 (ensuring network innovation has a whole system focus) would incentivise innovative whole system thinking which might otherwise not have been pursued. E.ON does not believe that a separate funding pot is necessary for whole system thinking delivery (Option 6). E.ON believes a better route would be for Ofgem to make clear that funding requests that incorporate whole system benefits in the project will be prioritised. This should drive the desired behaviour.
18. A good example for how whole system thinking can be incorporated into other incentives is Option 1 (inclusion of whole system thinking in the Business Plan Incentive). Network operators who clearly lay out whole system thinking as part of their core business plan as well as suggesting additional whole system projects will score highly towards the overall business plan incentive of +2% totex. The weighting of good whole system thinking towards the overall business plan incentive will need to be carefully set to balance whole system thinking with other business plan criteria.
19. Option 4 (balancing financial incentives between traditional and whole systems behaviour) highlights an issue that having multiple parties involved in operating and planning the network presents. If a single independent party were accountable for operating and planning the entire network at all voltage levels then network operators would contract with that single party to deliver their system needs and therefore factor this cost into their price control deliverable without any unbalanced incentives. E.ON believes that National Grid ESO is best suited to this role due to its current balancing responsibilities. The Open Network project is also considering an ESO led option as part of its scenario analysis.⁹ It should be noted that this approach can be quickly delivered (and benefits realised) for a 'electricity only' whole system. Delivering a single party accountable for the operation of a whole system that includes gas will add significant delays (due to the required legal separation of the gas system operator (GSO) from National Grid and its subsequent combining with the ESO).
20. The option to add further reopeners to the price control specifically to deal with coordinated whole system projects (Option 5 – ensuring the framework is able to flex to meet whole system needs) would appear to make the RIIO-2 process

⁷ The Network Access Policy

⁸ Consultation on license conditions and guidance for network operators to support an efficient, coordinated and economical Whole System

⁹ "Open networks Future Worlds" 31 July 2018

even more complex and difficult to set and as such E.ON does not believe this is aligned with Ofgem's principles for RIIO-2.

Enabling whole system solutions questions - CSQ12: Which of the possible mechanisms we have outlined above could pose regulatory risk, such as additionality payments or incentivising the wrong behaviour?

21. As stated in CSQ11, any incentive that rewards whole system thinking alone will be at risk of generating additionality payments for network operators as whole system actions should help deliver on other ODIs which will also lead to reward payments. As such whole system thinking should be woven into the existing framework, making it easier for those network operators who look to adopt whole system thinking to hit existing ODIs i.e. the business plan incentive.

Enabling whole system solutions questions - CSQ13: Are there obstacles to transferring revenues between networks that disincentivise networks from using a coordinated solution (please give details and suggest any changes or solutions)?

22. As stated in CSQ11, E.ON believes that a single party should be made accountable for the operation and planning of the networks at all voltage levels. That party would be responsible for identifying system needs (existing and forecasted) and then tendering for solutions to solve them. The DNOs would be able to offer traditional network reinforcement as well as smart grid solutions (such as ENW's Class Project) for their own networks and for support of other networks whilst third parties would be able to offer flexibility solutions derived from DER. The single party would then choose the most economically rational solution. E.ON believes National Grid ESO is the best option for this single party due to its current responsibilities for operating the GB transmission network. Under this governance structure, there would be no need for transferring revenues between networks as NG ESO would direct the money to the correct party who is meeting the system need. This option also tackles the issue of conflicts of interest between flexibility provision and network ownership.

Enabling whole system solutions questions - CSQ14: Can you recommend approaches that would better balance financial incentives between networks to enable whole system solutions?

23. See answer to CSQ13

Enabling whole system solutions questions - CSQ15: Are there other mechanisms that we have not identified that we should consider? (please give details)

24. See answer to CSQ13

Enabling whole system solutions questions - CSQ16: Are there any additional framework -level whole system barriers or unlocked benefits, and if so, any price control mechanisms to address these?

25.E.ON believes that this consultation has captured all the themes that lead to barriers and unlocked benefits for whole system thinking.

Enabling whole system solutions questions - CSQ17: Are there any sector-specific whole system barriers or unlocked benefits, and if so, any sector-specific price control mechanisms to address these?

26.E.ON believes that this consultation has captured all the sector specific themes that lead to barriers and unlocked benefits for whole system thinking

Enabling whole system solutions questions - CSQ18: Which of the proposed mechanisms would be most suitable in circumstances where a broader definition of whole system is likely to deliver benefits to network consumers?

27.One of the key issues surrounding a broad definition of whole system thinking is that Ofgem (as the gas and electricity regulator) may not have a remit to cover all the changes to regulation that are needed to incorporate whole system thinking. For example, it is not clear that Ofgem can allow revenue from gas and electricity bills to fund trials where water or transportation companies will be the sole recipients of project funds (although under whole system thinking this should be the case). As an example, it is not clear whether a trial that funded research into hybrid vehicles being 'smart' and choosing which fuel they will use the next day should be paid for out of gas and electricity bills even if a successful trial would lead to lower electricity bills.

Physical security questions - CSQ36. Do you agree with maintaining the existing scope of costs that fall under Physical Security, ie costs associated with the PSUP works mandated by government? Please explain your reasons and suggest alternative definitions you believe should be considered.

28.E.ON is in agreement with maintaining the existing scope of costs that fall under Physical Security, especially allowing for a single reopener that can capture additional government legislation in this area.

Real price effects questions - CSQ43. Do you have any views on our proposed factors to consider in deciding on appropriate input price indices? Do you have any evidence justifying the need for RPEs and any initial views on appropriate price indices?

29.E.ON is not aware of any publicly available indices, but any RPE must be transparent and therefore be based on an index that is available to all parties

regardless of size i.e. a party should not have to purchase an index in order to forecast network costs.

Managing the risk of asset stranding questions - CSQ48. Do you have any views on our direction of travel with regard to anticipatory investment?

30.E.ON agrees that network companies should be required to prove customer benefits for all investment as part of the three overarching outcomes. This is especially true of highly anticipatory investments which we believe would be best delivered through a joint working group. E.ON also believes that higher hurdles via enhanced cost benefit analysis/alternative options ('least worst regrets') should be required to prove value to the customer before securing investment. It should also be transparent as to how to reflect anticipatory investment in the current charging methodology. E.ON believes that the most efficient approach would be to treat this as forward-looking wherever possible. In particular, should the anticipatory investment be directly attributable to the actions of users, then this needs to be included in a cost-reflective charge. This will allow customers to take action to reduce their exposure to the charge and potentially avoid the investment altogether. However, E.ON recognises that there may be some instances where this is not possible, for example investment in IT infrastructure.

Innovation questions - CSQ52 Do you agree with our proposals to encourage more innovation as BAU?

31.E.ON does agree that network operators should be encouraged to conduct low risk operational and maintenance innovation projects as BAU as these will have direct benefits to a network operator's ODIs. Therefore E.ON also agrees with the Ofgem proposal to capture and challenge this BAU innovation through the business plan incentive. Separate innovation funding should focus on higher risk projects, especially where that risk can be shared across multiple operators and third parties.

Innovation questions - CSQ54: Do you agree with our proposals to introduce a new network innovation funding pot, in place of the Network Innovation Competition, that will have a sharper focus on strategic energy system transition challenges?

32.As proposed in CSQ11, E.ON believes that whole system innovation should not be separately funded. Under E.ON's proposed 'single party accountable for operating the system at all voltage levels', both network owners and flexibility providers will be incentivised to find innovative system solutions through competition¹⁰, looking for ways to deliver on system needs as identified by NG ESO as cheaply as possible. The only exception to this could be innovative large-

¹⁰ Network owners considering innovation network solutions and flexibility providers focussing on non-network solutions

scale projects that the ESO believes could dramatically help the system, but which are too high risk for even a consortium of network owners and/or flexibility providers to fund. Therefore, the ESO together with network operators and/or flexibility providers could apply for funding to test new solutions. External stakeholders would decide upon such large-scale system projects with a prioritisation for projects that include multiple parties (including third parties) being involved.

Innovation questions - CSQ55: Do you have any views on our proposal for raising innovation funds?

33. Ofgem are currently consulting on the residual and forward-looking components of all transportation costs (TNUoS, DUoS and BSUoS) and E.ON has highlighted the need for the split between forward-looking charges and residual charges to be more cost reflective¹¹. Any innovation funding naturally should be funded out of the combination of forward looking charges. With E.ON's proposed governance structure where NG ESO is accountable for all operational and balancing issues, innovation can then be funded from a combination of all the forward looking components of the transportation charges.

Innovation questions - CSQ55: Have we set out an appropriate set of models for both late and early competition to explore further?

34. Referring to Figure 4 in the core document, E.ON believes that there is a conflict of interest by allowing network licensees to run competitions. As per our responses to CSQ11 and CSQ13, E.ON believes that the ESO is the best placed party to have a clear picture of system wide needs and to award tenders to DNOs and flexibility asset owners to meet these needs.

Innovation questions - CSQ70: Do you agree with the criteria we have set out for assessing who should run competitions? Based on these criteria, which institution do you consider best placed to run early or late competitions?

35. See answer to CSQ55

RIIO-2 Achieving a reasonable balance questions - CSQ100: Do you agree with our assessment of the measures we have identified to make the price control more accurate?

36. As stated in CSQ55, E.ON believes that the consultations that are considering the residual and forward looking components of the transportation charges should incorporate a wide review of whether the current balance is correct (based on drivers of actual costs). Once this split is correctly set, then the

¹¹ TCR – Minded to decision E.ON Response v4

charging methodologies set out in RIIO-2 can reflect these drivers. Only then can price controls be set accurately.

RIIO-2 Achieving a reasonable balance questions - CSQ101: Are there other measures we should take to improve the accuracy of the price control?

37. See answer to CSQ100

RIIO-2 Achieving a reasonable balance questions - CSQ102: Are there other steps we could take to simplify the price controls, without significantly affecting the accuracy of the control?

38. As stated in CSQ11, E.ON believes that price controls can be simplified by making one single party accountable for all planning and operational aspects of transportation at all voltage levels. This would mean that price controls would be even more accurate and simple in that only one price control would be needed to deal with all the operational and future looking cost aspects of running the network (the ESO price control). All the DNOs would then have much simpler price controls which would cover their sunk costs and which would be covered by the residual components of DUoS and TNUoS.

RIIO-2 Achieving a reasonable balance questions - CSQ103: Do you agree with our consideration of the risks facing these companies? Do you think the measures we are proposing will mitigate these risks? Does the expected level of return indicated by our proposals reflect this risk?

39. With E.ON's proposed 'single party accountable' proposition (see CSQ11), the risks for the network owners will become even lower than present (as there will be no operational/delivery risk). Therefore, the level of return that the network owners should be allowed to make from their monopolistic network assets should be reduced. Network owners will be able to make more returns via the sale of network services to NG ESO, but in a competitive market i.e. they will no longer be a monopoly, but will have to compete with flexibility providers that will dictate the level of return they can make.

40. The level of return that NG ESO can make will need to be carefully gauged in its price control as it will now be the monopoly system operator, but it will still be an asset light business coordinating system needs and system provision. It will still have delivery risk which it might choose to pass on to system provision providers through penalty payments.

RIIO-2 Achieving a reasonable balance questions - CSQ104: Have we achieved a reasonable balance with our proposals in seeking to achieve an accurate price control with return adjustment mechanisms only being used as a failsafe? Should

we instead have a simpler price control and put more reliance on return adjustment mechanisms?

41.E.ON believes the inclusion of Return Adjustment Mechanisms (RAMs) is a sensible option. It has been proven to work well in Northern Ireland where price controls make use of wholesale over/under recovery on a regular basis. This can give suppliers more confidence in the transmission and distribution price forecasts that are issued ahead of time which can be translated into more stable energy retail prices for long term tariffs.

RIIO-2 Achieving a reasonable balance questions - CSQ106: Have we got the right focus on the areas that are of most value to consumers?

42.E.ON believes that at a high level, the three overarching outcomes as defined in Core Document Section 4.6 **with the explicit inclusion of affordability** (see answer to CSQ2) captures the areas that are of most value to consumers with quality, reliability and affordability being the core attributes of any price control.

RIIO-2 Achieving a reasonable balance questions - CSQ107: Are we proposing a methodology that allows us to achieve a reasonable balance between the interests of different consumer groups, including between the generality of consumer and those groups that are poorly served/most vulnerable? Are we missing any group?

43.E.ON agrees with Ofgem that the redistribution of costs between energy consumers is for government and energy bills should not be used to cross subsidise benefits for vulnerable customers. E.ON has repeatedly called for social obligation costs to be taken out of energy bills and put into general taxation. However, E.ON does believe that distribution companies (as well as energy suppliers) have a special responsibility to vulnerable customers. In the light of decarbonisation targets, E.ON believes that the Fuel Poor Network Extension Scheme should be revised to become a joint scheme between gas and electricity distribution companies to find the best solution for vulnerable customer heating needs across the various gas and electrical heating technology alternatives.

RIIO-2 Achieving a reasonable balance questions - CSQ108: Are we proposing a methodology that allows us to achieve a reasonable balance between the interests of existing and future consumers?

44.E.ON believes that Ofgem have proposed a methodology that looks to consider the balance of existing and future consumers. The key issues will focus around anticipatory investment, especially for the decarbonisation of transport and heat. Therefore, it is fundamental that an agreed industry wide probabilistic cost benefit analysis and 'least worst regrets' assessment is developed and that joint working groups like the Electricity Networks Strategy Group (see Core

Document Section 7.37) are formed. This will ensure that bills for existing and future customers are consistently balanced across all networks.

ESQ1: Do you agree with our proposal to maintain the current roles and principles framework for RIIO-2?

45. Whilst E.ON believes that the ESO should retain its current roles and principles, we also think that the ESO, as part of principle 6 (coordinate effectively to ensure efficient whole system operation and optimal use of resources) should be made responsible for the operation of all networks across all voltage levels. As part of Ofgem's desire for whole system thinking to improve efficiency and reduce costs, it is difficult to see how multiple companies with different drivers, cultures, systems and data will be able to coordinate sufficiently to achieve the desired level of optimisation. E.ON believes that having a single party accountable for the balancing and operation of the entire network will ensure that the most nationally optimal solution is followed. By having full sight of all the options and constraints, National Grid ESO will be able to assign the correct cashflows to the correct parties without complications as highlighted in Section 5.34 of the core document.

46. As part of this suggested expanded role, the ESO should be allowed to recoup the additional cost associated with additional resources (systems and staff). This would need to be incorporated into the ESO's RIIO 2 business plan.

ESQ2: Do you agree with our proposals to keep the ESO's code administration, EMR delivery body, data administration, and revenue collection functions in place for RIIO-2? Do you believe that any of these functions (or any other functions) should be opened up to competition, either now or in the future?

47. E.ON believes that there are potential benefits to be gained from opening up the code administration elements of ESO's duties to competition. Other parties that already focus on code administration could offer a wider service provision, especially in terms of stakeholder engagement.

ESQ3: Do you consider the ESO is best-placed to run early and late competitions?

48. See answer to CSQ55

ESQ4: Do you agree with our proposal to move to a two-year business planning cycles price control process for the ESO? If not, please outline your preferred alternative, noting any key features (e.g. uncertainty mechanisms or re-openers) that should be included?

49. The rationale for a long-term business planning cycle is to give companies certainty in revenue. The only companies that need certainty in revenue are

those that are investing in business critical, long lifetime assets that expose the company to capital market investment requirements. E.ON believes that the ESO (either under its current role or under E.ON's preferred role as system operator across all networks) will not have an investment heavy requirement and where it will need to invest in systems/IT, these assets are much short lived than network assets. Therefore E.ON believes that the ESO does not need a price control process that is the same length as the transmission/distribution owners. Two years may be too low but the price control cycle should be no longer than three years (Typical depreciation timescales for these types of assets are much lower than for network owner assets such as substations and pylons).

ESOQ5: What stakeholder engagement mechanisms should be put in place for the ESO's business planning and ongoing scrutiny of its performance? Do you agree with our proposal to maintain and build upon, the role of the Performance Panel?

50. E.ON agrees with Ofgem's proposal to continue to convene a Performance Panel for the ESO and that the ESO should look to gain as broad a stakeholder feedback as is possible.

ESOQ6: Do you agree with our proposed approach of using evaluative, ex post incentive arrangements for the ESO?

51. E.ON believes that evaluative, ex post incentives (with ex ante limits) are best suited to a single player market. The inability to factor ex post incentives into customer bills is not such an issue where the total incentive is set ex ante i.e. £30m. However, E.ON does believe that certain key areas need to be explicitly highlighted such as the timely delivery of the SNaPS agenda and that ESO has done everything in its power to develop flexibility markets, open and transparent to all. E.ON's proposal for a single party accountable for balancing and operation of all the network across all voltage levels would fit into this incentive as the ESO would be solely accountable for this development.

ESOQ7: Do you agree that we should continue to apply a single 'pot' of incentives to the ESO and that this should be a symmetrical positive/negative amount? If not, why not?

52. The main issue with a single 'pot' of incentives is that it does not reward over-delivery of a specific incentive. By having an incentive that is averaged across the seven principles, it is not transparent where the ESO has performed well and where it has underperformed. A more transparent approach may be to have seven incentives (which can be weighted) and that ESO performance is measured in each area (with an associated incentive/penalty). This way stakeholder feedback can be more specific and targeted. However, this needs to be balanced against a simple incentive scheme which prevents double counting of rewards or penalties

General response to ETQ

53. As mentioned in CSQ4, E.ON believes it is vital that the electricity transmission operators clearly identify forward-looking costs explicitly in their business plans. By making these costs clear (and working towards making more of these costs forward-looking), TOs can set charging arrangements that inform the customers of actions they can take that both help reduce network costs as well as reduce their own bill. By reducing the percentage of the bill that is residual (and therefore that ought to be unavoidable and socialised across all customers), customers can be more in control of their bills whilst also helping the UK deliver on its carbon targets.