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Transmission and Governance
Ofgem
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Dear Dena,

Impact Assessment: Locational BSUoS Charging Methodology - GB ECM-18

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. Drax welcomes this opportunity to respond to Ofgem's Impact Assessment consultation regarding National Grid's proposal to introduce a Locational BSUoS charging methodology.

Whilst the analysis presented by National Grid suggests that the overall cost of constraints would be reduced as a result of implementing a Locational BSUoS charging regime, there are a number of substantial issues that National Grid's proposal would introduce in areas such as transparency of costs, wholesale market competition, and both generation and transmission network investment. Drax believes that such issues outweigh the benefits of National Grid's Locational BSUoS proposal.

Predictability and Transparency

The Locational BSUoS proposal calculates charges on an ex post basis, meaning there would be huge uncertainty regarding the charges a generator would be subject to for a given settlement period. Ex post charging will be particularly difficult to predict and will involve complex calculations in order to forecast the costs associated with a given settlement period. This implies that users would be subject to an unhedgeable risk, which may lead to market prices being subject to additional risk premiums (in turn, having an adverse impact on consumers).

Whilst National Grid could provide forecast data for Locational BSUoS charges on an ex ante basis, such costs be difficult to model accurately. Further to this, details of forecast charges would need to be made available to users in timescales that match trading decisions; it is worth noting that the forecasting of constraint costs would be more difficult and less accurate when calculating cost predictions over longer periods of time. Both ex ante forecasts and ex post charging calculations would need to be transparent and open to scrutiny; this is an area that is not sufficiently addressed by the proposal.

Competition and Discrimination

It is important to appropriately weigh the distortion to competition that a Locational BSUoS charging regime would introduce. As noted in Ofgem's consultation document, not all generators behind a derogated boundary would be able to modify their behaviour on a half-hourly basis; for example, wind plant will seek to generate when their fuel is available and nuclear plant will seek to generate at baseload due to their fixed costs and inherent inflexibility. However, such plant may be required to contribute a considerable proportion of locational constraint costs as a result of the proposal, especially in the case of inflexible baseload nuclear generation behind the Cheviot boundary.

Whilst new users have a choice on where to connect and whether to be affected by Locational BSUoS, existing users have no choice regarding the decisions of others to connect in a given location and effectively cause the derogation of a boundary. This makes the Locational BSUoS model unmanageable and unhedgeable for existing projects; for clarification, existing projects are (a) those that are connected to the system now, (b) new generators that begin construction prior to a boundary becoming derogated (either via Connect & Management or Invest & Connect arrangements) and (c) potential new generators that have placed investment into a project that has not yet begun construction.

Furthermore, the proposal would be detrimental to competition between similar generation plants located on each side of a derogated boundary or located in differing areas within a set of nested boundaries. The difference in marginal cost between the two would not just be the difference between the Locational BSUoS charging element of their costs, but also the risk (and any associated risk premium) that would have to be factored into costs due to the ex post nature of the charging regime.

Investment

The electricity industry is currently undergoing unprecedented change as the UK aims to become a low-carbon economy; such change will require equally unprecedented investment in infrastructure in order to achieve the Government's environmental targets in an economic and efficient manner. Drax believes that it is important to ensure that the incentive for National Grid to build new infrastructure, when it is economic to do so, is maintained.

A question remains regarding how a Locational BSUoS scheme would affect National Grid's investment in transmission infrastructure. By placing the incentive on generators to reduce their output behind a derogated boundary, rather than on the System Operator to effectively manage constraints, Transmission Owners may receive a diminished signal in terms of where and when to prioritise investment. It would be detrimental to the future development of the market if Locational BSUoS effectively became an alternative to the timely construction of new infrastructure.

It is Drax's view that derogated boundaries should be temporary in nature and that a suitable and effective incentive on Transmission Owners to invest in transmission infrastructure (including strategic investment) must be maintained. Drax still seeks reassurance that the Locational BSUoS proposal would not be seen by National Grid as a potential alternative to timely transmission infrastructure investment.

A further consideration is the way in which signals are provided to investors and the impact of such signals on security of supply. The Locational BSUoS proposal would provide an additional signal to investors as to where to build new generation assets, where not to build new generation assets and where to close older generation assets across the transmission network. However, the signals do not take into account the effects of early plant closure in a given area where such plant may be required to provide balancing and stability services to the System Operator. As the signals do not take into account the types of generation plant that remain economic after the application of locational constraint charges, early closure could lead to a less diverse generation mix behind a derogated boundary, effectively exacerbating balancing related issues rather than alleviating them.

Transmission Access Review

As significant work is already underway as a result of the Secretary of State's intervention into grid access reform, Drax believes that it is inappropriate to continue to pursue National Grid's charging proposal at this time. Drax believes that there should be a holistic approach to transmission access and charging proposals, rather than a duplication of work across multiple processes that is disjointed and resource intensive for market participants.

Since the publication of this Impact Assessment consultation, DECC has continued to consider a range of proposals for grid access reform (including options for locational constraints charging) and has recently announced its intention to conduct a final consultation on the implementation of a Socialised Connect & Manage regime. DECC have made this decision after taking into account analysis provided by Redpoint Energy.

It would seem inappropriate to introduce a locational constraint charging methodology that would contradict the outcome of the Secretary of State's intervention into grid access reform. It would also be inefficient (in terms of cost and time) to implement National Grid's Locational BSUoS proposal if it were only to be effective until the Secretary of State's intervention was complete; for example, National Grid's proposal could be implemented in April 2010, yet replaced two months later by the charging arrangements contained within the enduring transmission access regime when implemented in June 2010. As such, it may be more appropriate to ask National Grid to withdraw the proposal whilst the Secretary of State and DECC complete their intervention and communicate the exact details of the chosen enduring transmission access model.

Given the concerns highlighted above, Drax does not believe that the Locational BSUoS proposals complement the changing nature of the transmission network, nor are they appropriate in promoting a competitive wholesale electricity market.

We look forward to viewing both Ofgem's and industry participants' responses to this consultation. In the meantime, if you would like to discuss any of the views expressed in this response, please feel free to contact me.

Yours sincerely,

By email

Stuart Cotten

Regulation
Drax Power Limited