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23 May 2014

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Dear Maxine,

**Proposal to make a Market Investigation Reference in respect of the supply and acquisition of energy in Great Britain**

Drax Power Limited (“Drax”) is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. The 4000MW station consists of 6 separate units which together produce around 7-8% of UK generation, mainly fuelled by coal. However, Drax is currently embarking on an ambitious project to convert at least half of this capacity to 100% biomass, with the first unit converted in 2013, and the next one expected in 2015. In 2009, Drax acquired an electricity supply business, Haven Power Limited (“Haven”). Haven supplies an increasing number of small and medium (SME) sized business customers and larger Industrial and Commercial (I&C) customers; this provides additional competition and choice into those sectors as well as an alternative route to market for some of Drax’s power output, ROCs and LECs.

In the event that Ofgem (formally ‘the Authority’) decides to make a Market Investigation Reference (MIR) to the Competition and Markets Authority (CMA), we broadly agree with the scope Ofgem has proposed for the MIR in the Draft Terms of Reference. In particular, we agree that the supply of energy to domestic customers (including microbusinesses) should be the main focus of the MIR. The supply of energy to I&C and large SME customers is already highly competitive, as confirmed by the State of the Market Assessment, so should not be the focus of the MIR. Moreover, we also agree that the electricity generation sector should not be the focus of the MIR. This sector is also characterised by a high degree of competition as evidenced by the relatively low market concentration observed and Ofgem’s Return on Capital Employed (ROCE) analysis of the Big Six electricity generation businesses<sup>1</sup>. However, we recognise that it may be necessary for the CMA to examine some aspects of the wholesale market in order to better understand the operation of the retail market and to review the effects of vertical integration. As set out below, we also believe that the CMA could usefully examine the operation of the markets for Renewable Obligation Certificates (ROCs) and Levy Exemption Certificates (LECs).

We consider that the main focus of the CMA investigation should be on the high in-area domestic market shares enjoyed by incumbent energy suppliers; in some cases these market shares approach 70% for single fuel customers. The hedge provided by this “sticky” customer base is unique to the domestic supply sector and new entrants are unable to access/replicate this competitive advantage. In addition, consideration should be given to the effectiveness of regulatory interventions introduced by the Authority in recent years to address this issue. In particular the restrictions placed on product differentiation under the Retail Market Review reforms, and the

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<sup>1</sup> We note that the WACC adopted for the analysis (7% pre-tax nominal) is too low a rate of return for a market based generation business, particularly those operating on a stand-alone, merchant basis. However, even when adopting this low value, Ofgem’s conclusion is that the Big Six generation businesses achieved this rate of return and no more.

resulting impact on competition, should be subject to close scrutiny. If any competition concerns exist, we believe it is most likely to emanate from both the above mentioned issues.

With regards to vertical integration, we do not consider that vertical integration, of itself, will necessarily have an adverse effect on competition. In fact vertical integration can deliver efficiencies which reduce overall costs for consumers. However, problems associated with vertical integration may arise where it is employed in sectors characterised by high market concentration. But of course this further demonstrates that the focus of the MIR should be on market segments which exhibit high market concentration.

However, there may be a case for the CMA to undertake a detailed examination of the pros and cons of this business model, which may then finally allay any concerns stakeholders may have. It is important that the examination recognise that not all types of vertical integration are alike. For example, vertical integration may or may not involve the use of a trading business, transfer pricing etc. We look forward to contributing to this CBA of vertical integration and trust it will be undertaken in a transparent and inclusive manner.

Finally, we believe Ofgem should widen the scope of its draft Terms of Reference to include an examination of some of the issues associated with the operation of the ROC and LEC markets and the impact this has on independent renewable generators. These generators have to sell their ROCs and LECs to suppliers to achieve the market value from their renewable generation. However, this market is dominated by the Big Six suppliers, who have no actual obligation to buy the certificates and are therefore able to exert significant monopsony power. This highly concentrated market is undermining the functioning of the renewable power market, and a review by the CMA would be appropriate.

If you would like to discuss any of the views expressed in this response, please feel free to contact me.

Yours sincerely,

By email

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