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13 August 2014

Dear Kersti,

Consultation on CUSC Modification Proposal (CMP) 224

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. In March 2009, Drax acquired an electricity supply business, Haven Power Limited ("Haven"); Haven supplies small and medium (SME) sized business customers and larger Industrial and Commercial (I&C) customers; this provides an alternative route to market for some of Drax's power output.

The merits of CMP224 are entirely based on the future of EC Regulation 838/2010. There is a high degree of uncertainty with regards to how this might or might not change. Therefore, for the purpose of our response to this consultation we have assumed that the EC Regulation remains in its current form i.e. the allowable range for average transmission charges for GB generators is €0-€2.50/MWh. We provide our views to the three questions posed in the consultation below:

1. The interpretation of Paragraph 2(1) Annex Part B of the Regulation

We completely agree with your interpretation of the Regulation as well as the reasons you provide for agreeing with this interpretation. In addition, this interpretation is consistent with the legal opinion provided by National Grid's legal team.

2. The impact on consumers of transferring costs from generation to demand under the different proposals submitted to us; and
3. The impact on consumers of any additional risk that suppliers and/or generators face for options with a shorter lead time for setting the G:D split as compared to options with a longer lead time

Firstly, it is unjustified to say that the impact on consumers of both the Original and WACM1 are caused by the Modification itself. Rather the impact is a consequence of the EC Regulation which does not provide the ability to phase or delay, in some manner, changes to transmission charges that are required to comply with the Regulation. The only way this impact could have been mitigated is by proposing a change to the G:D split with sufficient notice at an earlier date than CMP224 was raised.

Secondly, it is important to differentiate between the impacts caused by CMP224 Original and WACM1 in the first charging year that the proposals are expected to become 'active' (i.e. 2015/16) and the impacts of the proposals in subsequent charging years. In the event of Authority approval of either the Original or WACM1 before April 2015, it is highly likely that little notice will be provided to market participants of the change to the G:D split and thus the change to TNUoS charges for 2015/16. As such, there will be an impact on consumers from a change in the G:D split from 2015/16 if the customer has not fixed all or part (for example the power element) of the retail price. If the customer has fully fixed the retail price the supplier will be impacted. However, this impact is unavoidable due to the need for the UK to ensure it complies with the EC Regulation. This impact is driven primarily by the lack of notice provided for the change to the G:D split, although the impact could be expected to be greater for WACM1 relative to the Original. This is due to the need to transfer a larger quantity of costs to demand (predicted to be £47m) in 2015/16 which comes as a result of employing a larger error margin in the WACM1 method.

However, for charging years beyond 2015/16 we expect the impact on consumers to be lower under WACM1 than the Original due to the use of a longer notice period in WACM1 (12 months rather than 2 months). This impact is lessened because generators and suppliers will have greater certainty of the transmission costs they are likely to face much further in advance. As a result, the risk premiums both generators and suppliers are likely to apply, in the wholesale and retail markets respectively, will be lower under WACM1 compared to the Original. These risk premiums will ultimately be borne by all consumers as generators and suppliers, regardless of size, will be equally uncertain of the future G:D split and thus of the transmission charges they will face. Risk premiums will be lower under WACM1 as forward wholesale prices will be able to adjust to more accurately reflect transmission charges ahead of trading. WACM1 will also allow for better budget setting by customers on pass-through arrangements.

We also note the following point in the consultation:

"bringing transmission charges for Great Britain generators more closely into line with those of their EU counterparts should reduce market distortions, resulting in more efficient trade between Great Britain and other EU member states. This should improve competition in the generation of electricity compared with the current arrangements. WACM1 would most closely align charges in Great Britain with those in other EU member states and, therefore, performs best in this respect as compared to the other proposals and the current arrangements."

We agree with this view and thus believe that the adoption of WACM1 relative to the Original will provide additional Single Market consumer benefits as a result of facilitating more efficient competition.

Overall, we are of the view that any additional short term costs of WACM1 relative to the Original, due to the use of a larger error margin, are outweighed by the lower long term costs as a result of applying longer notice periods, as well as greater consumer benefits as a result of facilitating more efficient trade throughout the Single Market. Therefore we consider that WACM1 both better achieves the relevant CUSC objectives and the Authority's principal objective and statutory duties relative to the Original. For the avoidance of doubt, we do not believe that either WACM2 or WACM3 better achieve the relevant CUSC objectives and the Authority's principal objective and statutory duties as these options are unlikely to be compliant with the EC Regulation as currently set.

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

Yours sincerely,

By email

Cem Suleyman
Regulation and Policy
Drax Power Limited