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31 October 2014

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Dear Diego,

Rebuilding consumer confidence: Actions to improve the transparency of energy company profits

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc ("Drax Group") 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 is an electricity retailer and 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.

We only provide comments on question 4 of the consultation.

Question 4: Do you think the obligation to produce Consolidated Segmental Statements should continue to be targeted to large vertically integrated companies? If not, who do you think the obligation should apply to and why?

We agree with Ofgem that it would be premature to propose extending the scope of the obligation before the CMA has concluded its investigation. There is significant potential that the findings of the CMA will determine a level of financial transparency that can be considered healthy for the operation of the market. It would be counterproductive for Ofgem to prejudge potential recommendations from the CMA at this stage.

Nevertheless, in considering whether the scope of the obligation should be extended to companies other than the Big Six, it is important to consider further the original intent behind Ofgem's decision to establish a Consolidated Segmental Statement (CSS) obligation. It is correct to say that the original policy intent was to target the obligation at the larger energy companies that are vertically integrated. However, the need for a greater level of transparency was deemed necessary to give non-vertically integrated firms, and potential new entrants, confidence that they can compete on fair terms. Moreover, the lack of transparency made it difficult for current and potential market participants to assess the profitability of different business activities. There was also little (and in some cases no) visibility of transfer pricing practices resulting in concerns that anti-competitive cross-subsidisation may be occurring.

In Drax's case we are part of a vertically integrated group, Drax operating in the electricity generation market and Haven operating in the electricity supply market. The Annual Report and Accounts of Drax Group currently publishes separate financial performance data for Drax and Haven. The separate publication of this data is in accordance with internationally recognised accounting standards (discussed in more detail below) and well established, arms' length, transfer pricing rules. This allows competitors, both current and potential,

as well as commentators and regulators to assess the profitability of the different segments, electricity generation and electricity retail, we operate within.

Unlike the Big Six, the markets Drax and Haven operate in (electricity generation and, primarily, the I&C and, to a lesser extent, the SME segments of the electricity supply markets) are competitive, and have been generally considered as such by Ofgem. The opportunities to exploit anti-competitive behaviour or cross-subsidy in such competitive markets do not really exist, and there is therefore likely to be less justification for further mandatory transparency. This is not the case for the domestic retail sector where levels of public trust are low at present, and where competition is less established. This is likely to justify the continuation of the CSS obligation on the Big Six domestic retailers for the foreseeable future.

If, despite the arguments above, Ofgem still believes it might want to extend the CSS obligation to parties competing in competitive sectors of the market, then the costs of complying with such an obligation must also be weighed against some very limited (if any) benefits. For example, Drax estimates it would cost approximately [REDACTED] per year to comply with the CSS obligation. Such costs do not seem justified considering the level of transparency we already provide.

Being obligated to produce CSS may also result in differences between our regulatory and PLC accounts. As a UK listed PLC, the accounts published by the Drax Group comply with International Financial Accounting Standards (IFRS). These standards contain very clear guidance on the reporting of different business segments, based on the Cash Generating Units of the business and the flow of internal information provided to the Chief Operational Decision Maker. The segments reported by Drax Group currently separate the Generation from the Retail businesses, i.e. they separate Drax from Haven despite their vertical integration. In the event that separate CSS publication standards are introduced which differ from established IFRS, two different views of the generation and retail business may be presented. This would lead to unnecessary confusion for the users of such information and additional workload for the Drax business and Drax Group in explaining and reconciling the differences.

In conclusion, we agree that a final decision should not be taken until after the CMA publishes its findings. But in Drax's case obligating us to comply with the CSS obligation will have little or no benefit, is unlikely to materially increase transparency, but will certainly raise our regulatory compliance costs.

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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Regulation and Policy
Drax Power Limited