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Dear Jonathan,

RIIO-2 Response to open letter

Drax Group is a UK-based energy company with businesses spanning generation, retail and renewable heat. In recent years we have transformed Drax Power Station into the UK's single largest source of renewable power by upgrading three generation units to use compressed wood pellets in place of coal. Alongside our existing generation assets, our acquisition of three open cycle gas turbine (OCGT) development sites will allow us to build on the role we play in supporting a flexible power system that facilitates the deployment of wind and solar generation. Our retail businesses, Haven Power and Opus Energy, are actively engaged in helping businesses with their energy needs, improving efficiency and switching to renewable products. Finally, our renewable heat business, Billington Bioenergy, supplies compressed wood pellets to off-grid homes and businesses that would otherwise continue to use fossil fuels.

We welcome this opportunity to provide comments on Ofgem's open letter on the RIIO-2 framework. This response is submitted on behalf of Drax Group.

We agree with the general approach outlined in the open letter and fully support Ofgem's work to make improvements ahead of RIIO-2. We also commend Ofgem on opening engagement on the framework sufficiently in advance of the next price control review (PCR) period. In this letter we outline our support for the overall objective that Ofgem has identified and offer more specific commentary on each of the proposed principles. Our key observations are:

- Sufficient notice and transparency of changes to network charges is critical. Certainty in charging allows suppliers to reflect network tariffs accurately in prices offered to consumers, which may well be fixed with consumers for multiple years in advance.
- As the RIIO-2 framework is developed we expect to see network companies evidencing that their assets are efficiently managed. We also expect to see a greater role for the network companies in promoting competition. Both measures would help demonstrate that proposed investments provide value for money to end-users.
- We welcome the direction of travel in creating a more independent System Operator with its own price control. We also support continued vigilance by Ofgem to address potential conflicts of interest within distribution networks as they move towards a Distribution System Operator model, in particular where support through the price control may foreclose or distort competition.
- We would welcome Ofgem conducting a critical review of what worked well, and what did not (and why), in the determination and operation of RIIO-1.

Objectives of RIIO-2

RIIO-2 will ensure regulated network companies deliver the value for money services that consumers want and need

We agree with the overarching objective and broadly support the underlying principles that Ofgem has outlined. We also agree that networks need to deepen customer engagement and change the way they operate to enhance competition and meet the challenges of a changing energy system. The recently announced Targeted

Charging Review, and potential wider programme of charging reform, may help clarify the role that networks, as natural monopolies, have in facilitating the transition to a lower carbon future.

Giving consumers a stronger voice in setting outputs, shaping and assessing business plans

We do not believe the role of stakeholders in RIIO-1 was particularly clear or transparent so the renewed focus on networks engaging with consumers and other stakeholders is welcome. This engagement needs to deliver timely and effective conversations between network licensees and stakeholders. We also agree with Ofgem that stakeholder engagement may well need to be different for different network users. Ultimately the engagement must be as transparent and open as possible. As such, it may be beneficial for Ofgem to provide a clear expectation of network licensees and a timetable for them to begin developing their engagement plans. It may also be beneficial for Ofgem to consider the engagement strategies being adopted in other regulated sectors whether through the UK Regulatory Network (UKRN) or directly with specific Regulatory Authorities.

In addition, we do not believe the working groups established through the RIIO-1 process presented sufficient critical challenge, nor that the views of the few stakeholders that were able to meaningfully engage with the process were fully considered by the network companies or Ofgem. We would therefore recommend a comprehensive review of RIIO-1 with input from stakeholders to ensure improvements can be embedded in RIIO-2. The output frameworks and the annual reports provide excellent factual information on performance against the targets set in any given year, but they do not present an easily accessible narrative on value for money for consumers and stakeholders across the years.

Allowing regulated companies to earn returns that are fair and represent good value for consumers, properly reflecting the risks faced in these businesses, and prevailing financial market conditions

Clarity of network charges over time reduces the financial risk to suppliers and lowers costs for consumers. It is critical for suppliers to be able to accurately forecast network charges so that these can be reflected appropriately within their pricing to consumers. This accuracy is especially important when fixing prices for a year, or number of years, in response to consumer demand. Clarity and certainty of charging arrangements will also become increasingly important as non-traditional business models emerge and time-of-use tariffs become more prevalent.

Any changes to network charges should be appropriately signposted in advance with at least 15 months' formal notice given to suppliers. The transition between sequential price controls should also be aligned to ensure a smooth glide path to the new baseline.

In relation to the detailed questions on cost of capital, financeability and indexation, we feel it is important to conduct a critical review of the RIIO-1 determination and resulting outcomes in order to address any systemic issues. Any lessons learned or adjustment to the key metrics that underpin networks regulated returns can then be adopted in RIIO-2.

Incentivising companies to drive consumer value by shaping or proactively responding to changes in how networks are used and services are delivered

Specifically, on electricity networks we welcome the thoughts from Ofgem on the drivers for greater coordination and consideration of the whole energy system. It is clear that networks and the System Operator will need to ensure that there is fair competition on a level playing field as the diversity of users of the whole system increases. As regulated monopoly providers, it is critical that network companies can evidence their neutrality when reaching decisions and that any investment decisions are fully justified when compared to the viable alternatives.

With respect to incentives, network owners should not be able to earn exceptional returns for simply discharging their statutory duties and industry obligations. Financial incentives should be targeted at sustainable out-performance. We believe earning caps and sharing mechanisms should be adopted/retained in order to prevent exceptional returns, and those mechanisms should be complemented by financial penalties for poor performance thereby leveraging a powerful reputational effect.

We do see some merit in aligning electricity transmission and distribution price controls, and with the advent of an independent System Operator, potentially changing the length of price controls. While it is generally accepted that all businesses will have to change and adapt as the economy and technology changes, we do not believe that there is demonstrably greater uncertainty predicting the commercial future of network operators as there is for any other business. That said we do accept that over the course of eight years there is a need to build in sufficient mechanisms within the RIIO framework to ensure that appropriate levels of funding are maintained.

We also believe that innovation funds should be used for truly innovative or new approaches that are superior in nature to any existing commercial alternative. It is also important to ensure that innovation funding does not distort or foreclose commercial alternatives.

With respect to business planning and forecasting, we do not feel in a position to comment on the information presented by the networks to Ofgem during the RIIO-1 negotiations. A critical review of the RIIO-1 process as highlighted above could explore this issue further.

Simplifying the price controls by focusing on items of greatest value to consumers

We support the areas identified by Ofgem for improvement in business planning and transparency. Having clear comparable templates and consistency in presentation can facilitate informed stakeholder engagement. We would also support a critical review of the RIIO-1 process to further inform stakeholders' and consumers' participation.

We have supported System Operator independence, and recognise that a separate price control, potentially shorter than the Network Owner eight-year price control, is wholly appropriate given the distinct nature of a System Operator's core functions.

Please feel free to contact me, should you wish to discuss any aspect of this response.

Yours sincerely,

Submitted by email

Paul Youngman
Regulation Manager