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02 May 2018

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Dear James,

RIIO-2 Framework - Consultation

Drax Group is a UK-based energy company with businesses spanning generation and retail. In recent years we have transformed Drax Power Station into the UK's single largest source of renewable power by upgrading its generation units to use compressed wood pellets in place of coal. Alongside our biomass and coal units, our acquisition of open cycle gas turbine (OCGT) development sites is intended to allow us to play an important role in supporting a flexible power system that can reliably support wind and solar power generation.

Our retail businesses, Haven Power and Opus Energy, are actively engaged in helping business customers with their energy needs, improving efficiency and switching to renewable products. Haven Power is the UK's 5th largest non-domestic electricity supplier by volume. Opus Energy is the UK's 6th largest non-domestic gas and electricity supplier by meter count with over 300,000 supply points.

We agree with the majority of proposals outlined in the consultation, and fully support Ofgem in developing the RIIO-2 Framework. We welcome the ongoing consultation with industry and the informative review of RIIO-1 conducted by Cambridge Economic Policy Associates (CEPA). We believe RIIO-2 can deliver benefits for network companies, network users and consumers. Our key points of feedback are:

- Given the transition to an independent Electricity System Operator (ESO), we would welcome the move to a separate price control for the ESO under an alternative mechanism to the Regulatory Asset Value (RAV) model.

- The move to a five-year price control with some allowances over a longer time period is welcomed and would better facilitate the energy transition. In particular, we think there will be efficiencies in setting allowances over a longer period of time, or a rolling period, for the ESO where they are contracting system support services.

- We support the proposals for consumer engagement in the formulation of the network companies' business plans. Should the ESO have a separate price control, it should have a similar consumer engagement strategy.
- RIIO-2 needs to be tougher on network businesses and ensure that network companies receive fair returns on the basis that they deliver appropriate forward looking signals to market and ensure good value for consumers.

Please find our response to the consultation questions in Appendix 1. Please feel free to contact me, should you wish to discuss any aspect of our response.

Yours faithfully,

Submitted via email

Paul Youngman
Regulation Manager

Appendix 1: Drax response to the consultation questions

Chapter 3 - Giving consumers a stronger voice

Question 1. How can we enhance these models and strengthen the role of stakeholders in providing input and challenge to company plans?

We welcome the proposals and the extra level of transparency, challenge and scrutiny that will be available to stakeholders. We believe the changes will deliver tangible benefits increasing stakeholder engagement and facilitating the development of robust business plans by the Transmission and Distribution Networks and the Electricity System Operator (ESO).

We support the introduction of the User Groups and Challenge Groups and agree with Ofgem that these should not be decision making bodies. That responsibility remains with Ofgem following consultation.

Additionally, the process could be enhanced in two ways. Firstly, a common set of terms of reference for each of the groups to ensure a consistent approach to the review and challenge of business plans across all network companies. Secondly, an ongoing requirement to publish the topics reviewed at stakeholder meetings, materials presented and meeting actions as the User meetings progress. Where the User Group recruits an independent chair, clear agreed criteria for the role should be established to ensure independence.

We also think it is prudent to hold Open Hearings on the business plans where there are areas of contention. Such an approach will ensure any proposals are sufficiently developed and justifiable, adding an additional level of review that currently does not exist. We would also welcome the inclusion of wider stakeholders in this process, although this should not act as a substitute for a formal consultation process.

We are advocates of the Electricity System Operator (ESO) having a separate price control and a separate ESO engagement group. It is our view that the ESO is central to the secure and efficient operation of the electricity system and the successful development of a whole system approach to network management. We feel it is justifiable that the ESO Business Plan User Group may enable wider participation and have more open hearings, given the centrality of its role in our energy system.

Chapter 4 – Responding to changes in how networks are used

Length of the price controls

Question 2. Do you agree with our preferred position to set the price control for a five-year period, but with the flexibility to set some allowances over a longer period, if companies can present a compelling justification, such as on innovation or efficiency grounds?

We agree with Ofgem's proposition that the price control should be set for a five-year period with the option for some allowances to be set over a shorter or longer period.

The pace of technological change and the continual evolution of the industry means it is challenging for Ofgem to predict allowances for network companies over a long period of time. We believe having the price control over a five-year period, rather than an eight-year period, reduces the risk of companies collecting excessive returns (due to allowances that are set too high) and provides more protection to consumers.

We would expect the option for allowances greater than five years to apply to a limited number of programmes where the return period for the programme is deliverable over a longer term, such as innovation projects or asset replacement programmes. We would also expect that these investments in assets or innovation projects be stringently tested to ensure that consumers receive value for money.

There is a compelling case that certain allowances for the ESO should be over a longer period of time. There could be additional consumer benefit if the ESO were to have a long-term procurement strategy. This would enable the ESO to forecast and secure (hedge) the necessary ancillary services required to operate the system safely and securely at the lowest cost to consumers. At present, we would argue that the short-term nature of the current framework, market signals and procurement practices place undue risk on consumers.

Should an extended Mid-Period Review be used over an eight-year price control period, it would make sense to widen the scope of the review beyond that currently set out in RIIO-1. It is important, however, to avoid the creation of two four-year price controls that may create greater investment uncertainty – it would be important to get the approach right at the start of RIIO-2 and simply seek to fine-tune initial assumptions at the Mid-Period review.

Whole System outcomes

Question 3. In what ways can the price control framework be an effective enabler or barrier to the delivery of whole system outcomes?

We believe aligning the transmission and distribution price controls would be an effective enabler to the delivery of whole system outcomes, especially given the DSO transition and the interactions with the ESO.

Question 4. Do you agree with our minded-to position to retain the current start dates for the electricity transmission and electricity distribution price controls, and not align them?

We believe there could be merit in aligning current start dates for Electricity Transmission, Distribution and the Electricity System Operator, unless significant issues or inefficiencies have been identified. In an ideal world the price controls would be aligned to better facilitate whole system outcomes across the energy system, maximising efficiencies through the interaction of price controls and delivering better value to consumers. We would support a mini transitional price control if Ofgem believe this is the best method of alignment and provides value to consumers.

Question 5. In defining the term 'whole system', what should we focus on for the RIIO-2 period, and what other areas should we consider in the longer-term?

In defining 'Whole System' for the RIIO-2 period, consideration should also be given to the mix of generation technologies and the new challenges this presents for Electricity Transmission and Distribution networks. The focus must be on ensuring a safe and reliable system for all users. The development of a mature, accessible market for the necessary system support services should provide the ESO with the tools they require, including the option to contract over longer-term periods for known service requirements.

Over the longer-term the definition of "Whole System" should include the whole energy system costs and benefits to consumers.

System Operator price controls

Question 6. Do you agree with our view that National Grid's electricity SO price control should be separated from its TO price control?

We agree the ESO should have a separate price control. Given the enhanced separation of the ESO and its changing role, we believe there is a need to drive a more unified package across the ESO's price control and the ESO's wider incentives.

Question 7. Do you agree that we should be considering alternative remuneration models for the electricity SO?

We believe it is right the Regulatory Asset Value (RAV) model is challenged. The ESO has a completely different asset base to the TO and isn't continually building new assets, as such, we think an alternative to the RAV model would be more appropriate. At this time we have no firm proposals or preference for which model should be developed further.

Question 8. Should we consider alternative remuneration models for the gas SO?

There could be a case for a separation of the Gas System Operator. If this was the case, for the same reasons specified in relation to the ESO, we also believe that alternative remuneration methods could be considered.

Network utilisation, stranding and investment risk

Question 9. What options, within the price control, should be considered further to help protect consumers against having to pay for costly assets that may not be needed in the future due to changing demand or technology, while ensuring companies meet the reasonable demands for network capacity in a changing energy system?

It is unlikely that we will see any form of significant asset stranding during the RIIO-2 period. There is significant uncertainty however around how networks may be utilised in the future and we note RIIO-GD1 took measures to address this, for example by front loading depreciation. There are clear linkages between government policy and technological advancements and how networks will be utilised in the future. To enable network companies to adapt, it will be vital to either utilise a shorter price control period or widen the scope of a Mid-Period Review, should an eight-year price control be retained. Coupled to this, large-scale Repex projects must be adequately justified within RIIO-2 business plans with the proposed RIIO-2 Challenge Group and Open Hearings clearly having a significant role in this process. Ofgem will also have an important role in reviewing any potential underspends should any proposed projects not materialise whilst also ensuring network investment has been delivered in a cost-effective manner.

End-use energy efficiency

Question 10. In light of future challenges such as the decarbonisation of heat, what should be the role of network companies, including SOs, in encouraging a reduction in energy use by consumers in order to reduce future investment in energy networks?

The SO and DSOs will have a key role in enabling parties to understand pinch points on network systems and enable efficient investment in the relevant network. Work is currently on-going in a number of areas to review the electricity network access arrangements and forward-looking charges, therefore we do not comment further on this issue here.

The RIIO-2 process should incentivise Network operators to drive the reduction of network cost and development through improving market signals and competition. This may result in changes to end-use demand and the adoption of new technology, but should not be the primary driver. The wider challenge for instance in realising the potential to decarbonise heat, should be addressed by wider policy decisions and measures. Network companies will play an important role in the development and implementation of these measures working with sector partners such as housing developers in relation to heat decarbonisation.

Chapter 5 - Driving innovation and efficiency

Innovation

Question 11. Do you agree with our proposal to retain dedicated innovation funding, limited to innovation projects which might not otherwise be delivered under the core RIIO-2 framework?

There should be no barriers to innovation and as such we see there is some merit in retaining dedicated innovation funding for innovation projects which might not otherwise be delivered under the core RIIO-2 framework. We would support more stringent qualification criteria to ensure that projects have identified real benefits for consumers without distorting the market and are not Business as Usual (BAU) activities.

Question 12. Do you agree with our three broad areas of reform: i) increased alignment of funds to support critical issues associated with the energy transition challenges ii) greater coordination with wider public sector innovation funding and support and iii) increased third party engagement (including potentially exploring direct access to RIIO innovation funding)?

Yes, we agree there needs to be clearer alignment of funding and would add that future innovation funding should not distort or foreclose the development of fair markets.

Question 13. What are the key issues we will need to consider in exploring these options for reform at the sector-specific methodology stage, including:

(i) What the critical issues may be in each sector and how we can mitigate the bias towards certain types of innovation through focusing on these issues?

(ii) How we can better coordinate any dedicated RIIO innovation funding with wider public sector funding and support (including Ofgem initiatives such as the Innovation Link and the Regulatory Sandbox)? RIIO-2 Framework Consultation March 2018

(iii) How we can enable increased third-party engagement and what could be the potential additional benefits and challenges of providing direct access to third parties in light of the future sources of transformative and disruptive innovation?

Please refer to our answer to Question 15.

Question 14. What form could the innovation funding take.

No comment.

Question 15. How can we further encourage the transition of innovation to BAU in the RIIO-2 period? How can we develop our approach to the monitoring and reporting of benefits arising from innovation?

Significant efficiencies and benefits to consumers can be delivered though innovation and we agree with Ofgem that innovation should be BAU for network companies. However, innovation takes time and should not be rushed, we would appreciate regular updates from network companies on the progress of innovation projects and the delivered benefits to consumers. Projects would benefit from Ofgem's steer and feedback to ensure they are making progress and meeting the necessary criteria.

Competition

Question 16. Do you agree with our proposal to extend the role of competition across the sectors (electricity and gas, transmission and distribution)?

We agree with the proposal to extend the role of competition across electricity and gas, transmission and distribution, a consistent approach would ensure efficiencies are maximised across all the networks. Effective competition in the development and management of the energy system can reduce connection times and drive better value for consumers.

Question 17. Do you consider there are any reasons why our new, separable and high value criteria might not be applicable across all four sectors?

As per our response to question 16, we believe efficiencies can be accessed by a consistent approach across all networks. We do not consider that there are any network specific reasons why the new, separable and high value criteria might not be applicable across all four sectors.

Question 18. What could the potential models be for early stage competitions (for design or technical solutions)?

We are eager to see the models proposed by Ofgem. Through not specific to this question we have engaged in the ENA open Networks projects and view favourably the Electricity System Operator as a centralised co-ordinator and procurer of services. In our view any decision to build Network assets needs to be contestable and open to competition including non-build solutions.

Chapter 6 – Simplifying the price controls

Approach to setting outputs

Question 19. What views do you have on our proposed approach to specifying outputs and setting incentives?

We agree with the CEPA report findings that care should be taken to ensure incentive rewards are not given for performance improvements linked to the RIIO process. We also generally agree with the focus on the output categories and understand that these are currently being revised with the Networks. We would like to see a more causal link between the output categories and focus areas such as improving competition, delivering consumer value and ensuring security of supply.

Approach to setting cost allowances

Question 20. What views do you have on our general approach to setting cost allowances?

The general approach to setting cost allowances including the focus on competition is welcome.

Question 21. What views do you have on our intention to index RPEs?

This seems appropriate and preferable to an upfront allowance figure. This should enable a greater degree of adjustment over the RIIO-2 period.

Question 22. What impact would resetting cost allowances based on actual cost performance (eg benchmarked to the average, upper quartile or best performer) during a price control have? Which cost categories might best suit this approach?

We welcome further explanation and detail of the methodology Ofgem proposes as it could help to mitigate any perception of Networks inflating allowances. We offer no other specific comments at this time.

Information-revealing devices

Question 23. Do you agree with our assessment of IQI?

Given the complicated nature of the information quality incentive (IQI) and the analysis provided by Ofgem in Figure 2, it's not clear if the IQI sufficiently influences companies to submit business plans that reflect the best estimate of their likely expenditure. We would agree with Ofgem's assessment that the IQI may be unduly costly for consumers and that a review is required.

Question 24. Do you agree with our assessment of fast-tracking?

It is not clear from the assessment that fast-tracking network companies' business plans for RIIO-1 delivered benefits for consumers, fast-tracked companies received greater financial benefits than was anticipated. However, we agree with Ofgem that there are certain benefits associated with keeping fast tracking for distribution companies who are all competing to submit the best business plans. On the basis that these same benefits aren't applicable at transmission since there is a lack of competition, we would support the removal of fast-tracking for the transmission sector.

Question 25. What are your views on the options we have described?

Whilst we appreciate it's difficult to determine what the benefit or cost to consumers would be under each of the options, it would also seem sensible not to have two incentive mechanisms running in parallel through IQI and the fast-track approach, effectively giving distribution companies two opportunities to increase returns. Acknowledging the difficulties Ofgem face through information asymmetry, in line with Ofgem's proposed 'option 3', one approach could be to build in the evaluation of IQI into the fast track criteria with the intention of simplifying the process and increasing transparency. Most importantly such an approach would avoid companies being rewarded twice for the same behaviour.

It is clear that fast-tracking for transmission is ineffective and costly for consumers, we support its removal. Given the complexity of the IQI the lack of evidence regarding its benefits, there's a strong case for its simplification, this would need to remain consistent across transmission and distribution.

Question 26. What factors should we take into account when assessing plans for example, under fast-tracking (option 2) or a single business plan incentive (option 3)?

Please see our answer to question 24.

Question 27. Do you have any views on the factors we should take into account when deciding how to differentiate efficiency incentives for companies if we do not use the IQI?

Please see our answer to question 25.

Question 28. Is an explicit upfront financial reward required to incentivise companies to submit high quality business plans, in addition to differential incentive rates or sharing factors?

We do not think it appropriate to have an upfront financial reward to produce a business plan.

Question 29. Do you have any views on our proposal to remove fast-tracking for transmission?

As per the rationale given above, and in the consultation, we support the proposal to remove fast-tracking from transmission.

Question 30. Do you have any views on how we propose to incentivise better business plans from transmission companies, including removing the prospect of an upfront financial or procedural reward and placing greater reliance on user and consumer engagement and scrutiny?

The increased stakeholder engagement in the development of transmission companies' business plans, along with the Challenge Groups, should provide sufficient scrutiny on the business plans of transmission companies. It is unclear how the fast-tracking of business plans and the Challenge Groups would be compatible, once fast-tracked there would no longer be scope for influencing the plan prior to Ofgem's formal review. We agree that the need for an upfront financial or procedural reward such as fast-tracking will not be necessary. Although, as noted previously, Ofgem is ultimately the decision-making body and responsible for approving the companies' business plans.

Annual reports/reporting

Question 31. How can we best improve the suite of annual reporting requirements to be as efficient and useful as possible?

Please see our answer to question 32.

Question 32. How can we make the annual reports easier for stakeholders to understand and more meaningful to use?

We agree with Ofgem that annual reports should tell the story of overall network performance and feel that RIIO-1 reports have not provided a clear articulation of network companies' performance. We would suggest the following:

- Maximum transparency between expenditure and outputs.
- The establishment of a stakeholder working group to collaboratively improve the visual representation of data comparing companies' reporting and performance.
- Illustration of the benefits that networks have delivered to consumers through RIIO-2.

Chapter 7 – Fair returns and financeability

Cost of debt

Question 33. What are your views on the policy objectives that we have defined with respect to the cost of debt?

The policy objectives that Ofgem have identified appear to be reasonable.

Question 34. Which option might help to ensure that the approach to updating the cost of debt methodology delivers best value to consumers and why?

We are not in a position to comment on the detail of the allowances for debt, though it would appear that option B may provide a more granular assessment of the actual cost during any price control period.

Cost of equity

Questions 35 and 36.

We have no comment to make at this time.

Financeability

Questions 37 to 39.

We have no comment to make at this time.

Corporation tax

Question 40.

We have no comment to make at this time.

Other finance issues

Question 41. Do you agree that we should move away from RPI for RIIO-2 (including for the indexation of the RAV if retained as a feature)?

We agree that the evidence in the CEPA report is compelling, there is less variation in the CPI index than the RPI currently used. We would like to understand in greater depth the likely impact on network charges that a change in the index would cause.

Questions 42 to 44.

We have no comment to make at this time.

Ensuring fair returns

Question 45. What are your views on each of the options to ensure fair returns we have described in this consultation?

Having reviewed the proposed options we are of the view that a discretionary adjustment approach as set out in 'option 2' would be preferable. The potential for an adjustment (which would be compatible with either a five- year price control or eight-year with widened Mid-Period Review) would require network companies to provide greater justification for genuine efficiency improvements and avoids the issue of companies delaying investment, e.g. where a tapered incentive rate is used. The discretionary adjustment approach also allows each company spend to be reviewed independently (acknowledging that other company performance can still be referenced for comparison), but most importantly avoids the issue of the performance of one company affecting that of others as seen in the 'anchoring' approach.

The timing of any potential adjustments will have an important role to play in delivering benefits to consumers. Reviewing performance will allow for the potential adjustment of allowances or targets where assumptions may have been incorrectly set at the start of the RIIO-2 period. The risk of an ex-post approach at the end of the price control should further incentivise companies to submit high quality business plans in preparation for RIIO-2 and provide sufficient evidence of spend and performance during the price control, thus improving transparency all round.

We appreciate the risk of a discretionary adjustment may to some degree increase regulatory uncertainty. This greater level of scrutiny however should be outweighed by the additional benefits for consumers through improved service provision and performance by network companies where underspends are justified or lower returns where underspends cannot be justified as a genuine efficiency improvement.

Question 46. Is RoRE a suitable metric to base return adjustments on? Are there other metrics that we should consider, and if so why?

We have no comment to make at this time.

Chapter 8 – Next Steps

Question 47. Do you have any views on the interlinkages and interactions outlined in this consultation and those that we will need to consider as we develop our sector-specific proposals?

The interlinkages identified appear appropriate and we have no specific comments to make.

Question 48. Do you have any views on the issues highlighted that we will consider as we develop our sector-specific proposals?
Question 49. Are there any sector-specific issues or policy areas that we should ensure we review and consider as we develop our sector-specific proposals?

The issues highlighted for each sector are appropriate for each sector. We are mindful that some activities networks undertake in a European context may be impacted or no longer applicable over the length of the price control period. We believe this may need addressing so that any efficiency savings are returned to customers.

Question 50. Do you have any views on our high-level proposals for timing of RIIO-2 implementation, and on our proposals for engagement going forward?

The proposed timings for consultations, decision points and final determination are useful. The clear timetable and engagement measures should enable stakeholders to have a more active input into the RIIO-2 process.