11 October 2017

James Norman
New Transmission Investment
Ofgem
9 Millbank
London SW1P 3GE

Dear James,

ENERGY NETWORKS ASSOCIATION RESPONSE TO HINKLEY-SEABANK CONSULTATION ON FINAL NEEDS CASE AND POTENTIAL DELIVERY MODELS

Energy Networks Association (ENA) represents the "wires and pipes" transmission and distribution network operators for gas and electricity in the UK and Ireland. As private companies providing a public service, our members are responsible for the critical national infrastructure that delivers these vital services into customers' homes and businesses. This letter is on behalf of our electricity distribution and electricity transmission members[1].

Introduction

ENA members welcome the opportunity to respond to this consultation on the final needs case for the Hinkley-Seabank (HSB) project and potential delivery models.

Within our response we have sought to set out the collective views of our electricity network members. Our response therefore sets out a number of key common principles and points on which there is broad agreement between our members and responds to a number of the specific questions posed within the consultation.

ENA members are proud of their role as private companies providing a public service. Regular satisfaction surveys conducted by Ofgem with a range of customers show consistent satisfaction of more than 80% in the services provided by network companies, putting networks above any energy supply company, higher than many high-street retailers and amongst the very best performers in the UK Customer Satisfaction Index.

1 These are Electricity North West Limited, Northern Powergrid, Scottish Power Energy Networks, UK Power Networks, Scottish & Southern Electricity Networks, Western Power Distribution, National Grid.

Needs case

Our members welcome Ofgem's conclusions of its assessment of the economic and technical needs case for this important project to connect the new Hinkley Point C nuclear power station in Somerset that is being constructed by EDF. They also welcome Ofgem's recognition that the connection of the new power station will bring significant environmental and energy security benefits to consumers, as well as provide a stimulus for local and regional employment, skills & training, the development of UK industrial capability and substantial overseas inward investment.

Aspects of the project that Ofgem is seeking further justification

Flood risk: Given that the new transmission line will span a location which is recognised as having a relatively high flood risk it seems reasonable that provision is made for this risk. We would encourage Ofgem to enable such provision to be made, consistent with the principles of good risk management, thereby ensuring a fair and equitable allocation and provision for flood risk consistent with delivering an efficient solution in the interests of current and future consumers.

'T'-pylon: We are concerned that the methods applied to the economic evaluation of the T-pylon solution do not seem to take into account and assign to the project the value delivered by their introduction and use. For example, the contribution made to timely securing of planning consents, which in part, is due to mitigation of visual impact that comes with their use. As a principle Ofgem should support and encourage the introduction of innovative approaches, including the development and take up of new technologies such as the T-pylon.

Notwithstanding our comments on the need to recognise the wider benefits that result from use of the T-pylon, it is commonly accepted that the cost of new technologies can be expected to fall over time with greater take-up. We therefore support an approach that removes barriers to the introduction of the T-pylon allowing the value of this world leading technology to be unlocked and laying the foundations for delivering future and increasing benefits to existing and future consumers.

Potential Delivery Models

As a principle our members are supportive of considering various different approaches where this may help to identify those approaches that will deliver clear benefits to consumers. However, the approaches that are considered also need to be practical possibilities, and our members note that the delay to the primary legislation needed to properly implement the CATO regime means it is an unlikely option due to the uncertainly and serious delay it could impose on the commissioning and operation of the Hinkley Point C power station.

As context for our observations on the two alternative competitive delivery models described in the consultation (see below), we note that the CATO regime has been carefully developed over several years with much consideration and cross-industry input working closely with Ofgem. Even so there are still a number of aspects of the CATO regime that need further development.

Our members therefore have a general concern that compared to the CATO or status quo Strategic Wider Works (SWW) framework, these hurriedly developed alternative competitive models will at best deliver a comparative sub-optimal outcome. Generally, given the very limited information provided on the alternative models it is difficult to assess whether they could deliver the claimed benefits. That being the case it is difficult to see how Ofgem can make those assertions. This leads us to conclude that the introduction of an undeveloped and untested alternative model at this stage of the HSB project would introduce a variety of risks that may result in delay and/or increased costs to the project and consumers.

Special Purpose Vehicle (SPV) model

In light of our previous comments we see little or no evidence to support the SPV as a credible option. It is not clear how risks would be allocated between National Grid (NG) and the SPV and what impact the risks allocated to NG will have on its business and financing of its wider investment. For example, whilst allocating risk from HSB to NG might in theory enable a lower WACC to be bid, on the face of it reducing the cost of the project, markets are likely to factor the risks held by NG into the cost of capital, resulting in no overall net benefit to consumers. Issues such as increased interfaces and co-ordination complexity also need to be considered. Overall, the consultation document offers no evidence as to how the SPV approach will deliver greater value for consumers than the status quo.

Competition Proxy model

Whilst the Competition Proxy model would seem to be a more credible option than the SPV, it too appears to carry a good deal of risk and uncertainty. The lack of detail makes it difficult to assess. The proposed approach to benchmarking costs using information from OFTO and interconnector regimes seems to be inherently flawed for the suggested purpose given the very different financial and regulatory characteristics of offshore connections, interconnectors and onshore transmission. We would urge caution to assuming that the HSB project has the same investment profile to an OFTO as the two have very different characteristics, for example, in the case of offshore the assets have already been built and commissioned by the developer before a tender takes place. This means that an OFTO bidder does not need to make any allowance for construction risk or delay, potentially making these projects attractive to investors favouring low risk/low yield investments.

Other than the suggested locking-in of the current lower cost of debt, were it achievable, it is difficult to see what material benefits this model would deliver over and above the status quo approach. The SWW is a tried and tested approach that investors are familiar with and have confidence in as it incorporates the price control mechanisms that drive efficiency from financing through to delivery of the construction and operation. The price control parameters under which the majority of the HSB project would be delivered are yet to be set so it is difficult see how any assessment of the competition proxy approach could be done with an appropriate counterfactual ahead of the conclusion of the RIIO-2 process.

DNO costs

From a DNO perspective, we would like to highlight that in addition to the enabling work being undertaken by the DNO (WPD), such as undergrounding or 400kV crossings, part of the NG scheme involves the construction of some significant new 132kV distribution business assets. These works are integral to the NG Strategic Wider Works project and it is efficient for NG or their subcontractor to construct the assets as part of the overall integrated project programme. However once the 132kV assets have been constructed they will be an integral part of WPD's distribution system.

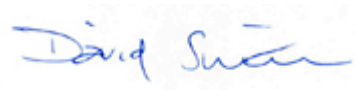
Within the DNO competitive model, DNOs adopt assets built by a third party, and are able to specify material and construction standards to ensure that the assets are built to the required standards. Whichever model is adopted for HSB or other similar projects, DNOs would wish to ensure that if the efficient project delivery involves third party building significant distribution business assets such as 132kV lines, cables, or switchgear, the DNO is able to specify material and construction standards, and an adoption agreement for the transfer of the assets to DNO ownership for the ongoing operation and maintenance.

Conclusion

Whilst ENA members welcome proposals that are in the interests of consumers, the suggested benefits of the outlined models need to be weighed against any additional risks to the successful delivery of the HSB transmission line and Hinkley Point C project, and any resultant detrimental delays and increased costs that will be passed to consumers as a result.

If you have any questions on the points raised in this response, please contact John Spurgeon, Head of Regulatory Policy email: john.spurgeon@energynetworks.org

Yours sincerely



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cc Jeremy Pocklington, DG Energy & Security, BEIS

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