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11th October 2017

Dear James,

Hinkley-Seabank – Consultation on Final Needs Case and potential delivery models

This response is provided on behalf of National Grid Electricity Transmission (NGET) in its role as Transmission Owner in England and Wales.

Needs Case

We welcome Ofgem's support of the economic and technical needs case for the Hinkley-Seabank (HSB) project. The process we followed to arrive at the strategic connection option and to successfully attain a Development Consent Order (DCO) approved by the Secretary of State has been robust, and involved a range of stakeholders. Our approach has reduced risk to the project, and so has already delivered benefits to end consumers in expediting the planning process. EDF announced its Financial Investment Decision earlier this year, and has made progress in the construction of Hinkley Point C. This means that the need for new network capacity is both financially and technically compelling, to enable consumers to benefit from low carbon electricity into the future.

Delivery Models

We have carefully considered the delivery models contained in the consultation and have focused on the potential benefits, costs and risks associated with the models. In addition to speaking to our customer, EDF, and a wide range of stakeholders, we have also engaged with independent experts and looked to draw lessons from other industries, including the emerging developments in the water industry on the Direct Procurement model. Based on those discussions our views are:

1. The overarching priority should be the timely connection of Hinkley Point C. Any additional risk of delay to the HSB project will result in greater costs for end consumers, which is evident from the economic assessment supporting the Final Needs Case for the project. Introducing an SPV model at this stage of the project would undoubtedly increase the risk of delay. The timetable within the consultation indicates that NGET would need to begin setting up an SPV during the consultation process, which seems unfeasible given that the SPV arrangements are currently at a high level concept stage. Evidence from the development of the CATO regime and the Direct Procurement model in water both show the complexities and time required to develop new regulatory models. This is incompatible with the fact that we are already engaging with our supply chain to ensure that key major components (such as cables and substations) can be in place in time.

2. There is a range of independent analysis citing issues with the SPV model and the analogous Direct Procurement for Customers (DPC) model in water. Many of these points are made in the First Economics paper on the SPV model, which we have included as an appendix to this response. The Bush/Earwaker paper[1] on Direct Procurement raises concerns that it could be "an exercise in putting pieces of essential infrastructure out of the reach of the regulator", and is inferior to a licence-based model such as CATO. A KPMG report commissioned for Ofwat on the DPC model raised a number of fundamental points which still required further work in developing the DPC model. One key element was establishing the "*precise risk allocation of the proposed DPC model is central to ensuring projects are financeable and attractive to investors*". This question of allocation of risk between NGET, the SPV and consumers is a material concern in developing the SPV model in time for the HSB project. Our own assessment raises a number of additional questions around how the SPV model would work in practice, and these are covered in the appendix to this response. A central theme is around complexity and unclear accountabilities in the SPV model. For example, at a macro level, fundamental legal issues exist with the SPV model as it is unclear how, under the Electricity Act 1989, an SPV can own and operate transmission assets without a transmission licence. The read across from the Bush/Earwaker paper highlights that even if the SPV could in some way operate under NGET's licence, it would be extremely difficult to fully contractualise NGET's ongoing licence and statutory obligations in respect of the project and the enforcement thereof in any delivery agreement as between NGET and the SPV. On a more practical level, there would need to be a transfer of the Development Consent Order (DCO) for which there is no precedent. This would require consent from the Secretary of State and all the obligations detailed in the DCO (such as Compulsory Purchase Order powers, mitigation requirements and indemnities) would need to be split out between NGET and the SPV, adding significant time, cost and risk.

3. In addition to the practical hurdles to introducing an SPV model, the KPMG report[2] for Ofwat on the DPC model concluded "*Generally investors considered that it would be difficult to beat the cost of capital of a regulated water company except, potentially, on a marginal cost basis where new debt in the DPC is financed at current market rates compared to an appointed water company that received a weighted average cost of capital reflecting both embedded and new debt*". We believe the same conclusion applies to the proposed SPV model. We would also note that consumers could benefit from the prevailing low cost of debt without the introduction of a complex SPV model.

We therefore conclude that the SPV model is not in the interests of consumers, as it increases the risk of delaying Hinkley Point C's connection, the consequences of which far outweigh any potential benefits of the SPV model, which are in any event far from clear. We also note that, putting the risk of delay to one side, independent research undertaken for Ofwat on the analogous DPC model questions the potential size of any benefits.

4. Based on the points above, we conclude that the competition proxy model is better for consumers than the SPV model, as it introduces much less risk into the delivery of the HSB project. The key question is therefore whether introducing a competition proxy model is likely to deliver material benefits against the status quo of the Strategic Wider Works (SWW) model. Our detailed response, contained in the appendix, provides our assessment of the potential benefits to consumers in the areas described in the consultation document (namely cost of equity, gearing, capital costs, operational costs and cost of debt). Our assessment is closely aligned with the conclusion in the KPMG report cited above, that the only possible source of

[1] http://www.first-economics.com/directprocurement.pdf
[2] https://0980a19b0bb02fe4a86d-0df48efcb31bcf2ed0366d316cab9ab8.ssl.cf3.rackcdn.com/wp-content/uploads/2017/07/KPMG-Direct-procurement-for-customers_KPMG_FINAL.pdf

value relates to capturing today's cost of debt. It is also worth noting that a 25-year revenue stream will result in an intergenerational transfer of consumer costs, as today's consumers will be funding an investment which will benefit consumers in the longer term. Under a 25-year revenue stream, consumers will be committed to a particular financing model for a significant period of time, so it is important that the model is designed carefully. Our assessment also reviews the potential benchmarks for the Competition Proxy model mentioned in the consultation document, explaining why interconnector projects and OFTOs would not be appropriate benchmarks. It is important that any impact assessment of the models compares the potential value of the competition proxy model against the counterfactual of periodic price controls, which review and reset the appropriate financial parameters as part of each periodic review.

5. The Strategic Wider Works (SWW) model is an established and proven regulatory model which minimises the risk to project delivery and is consistent with the RIIO framework, which contained the SWW model or the introduction of a third party (CATO) model. The SWW delivery model provides regulatory stability, which is an important factor in keeping down costs for consumers, and is established and well understood, having been used on several projects in Scotland to date. It incorporates a range of consumer-centric properties, such as the setting of ex-ante allowances and the Totex Incentive Mechanism. These mechanisms share risks and benefits between consumers and network companies, resulting in network companies striving to make savings for consumers. The cost of capital (cost of equity, efficient gearing and market indexed cost of debt) is set as part of a consultation process, and periodically assessed. It is worth noting that the majority of HSB construction spend will take place in the next price control period, and will therefore be subject to the appropriate level of Weighted Average Cost of Capital (WACC) determined by the next price control process.

We therefore conclude that, of the remaining two models, the SWW model has a range of consumer-centric properties and minimises the risk to project delivery. Any potential benefits of the competition proxy model, when compared with the SWW model, would arise where new debt is financed at current market rates compared to the weighted cost of capital reflecting both embedded and new debt.

T-Pylons

We note that Ofgem believes that further justification is required to demonstrate that it was necessary to use T-Pylons instead of regular lattice pylons. In our view, our decision was reasonable and in the interests of consumers, as it mitigated a very high risk that development consent would have been refused on the basis that the environmental effects of the scheme outweighed its benefits, or that appropriate mitigating actions had not been taken.

As acknowledged by Ofgem's consultation document, there is an economic need to progress with the project. Refusal of development consent would have resulted in a delay of over 2 years in order to amend the scheme to include the necessary mitigation. Whilst the impact of such a delay is difficult to quantify precisely, the SO's analysis suggests that delaying the connection would result in an average net welfare loss of at least £534m per year, and average consumer surplus losses of at least £227m per year.

We will work with Ofgem to demonstrate in our Project Assessment submission that the decision made to include T-Pylon in the design was in the overall best interests of consumers.

Extreme Weather Risk

As the consultation document recognises, extreme weather presents a risk to delivery of the Hinkley-Seabank project that could lead to significant cost increases. However, Ofgem does not agree with

the extent of extreme weather contingency. We will work further with Ofgem to seek to quantify extreme weather risk.

Notwithstanding the extent of the risk, the current regulatory treatment could lead to a windfall gain or loss, which is not in the best interests of consumers. We will therefore work with Ofgem and stakeholders to explore a more appropriate treatment of risk, including possible revision of the current Cost and Output Adjusting Event threshold arrangements.

Detailed Commentary

More detailed information on our assessment of all of the delivery models, T-Pylons and the treatment of weather risk and other matters are contained in the Appendix. We are keen to discuss our assessment with Ofgem as soon as possible, in order to remove the current regulatory uncertainty so that we can focus on progressing with the timely connection of the Hinkley Point C power station, which will enable consumers to benefit from low carbon electricity into the future.

I confirm that this response can be published on Ofgem's website.

Yours sincerely,

[By email]

Chris Bennett

Director, UK Regulation, National Grid

Question 1: Do you agree with our initial views on the appropriateness of the new, separable and high value criteria for the SPV and Competition Proxy models?

The SPV model has not been proven to deliver a sufficient consumer benefit to outweigh its additional costs and increase in risks: this is discussed in further detail in Question 8. It would not be an appropriate model under any criteria for either RIIO-T1 or RIIO-T2.

It is worth noting that, under the CATO model, only Strategic Wider Works projects were eligible for competition in RIIO-T1.[3]

For projects falling under the RIIO-T1 regime, Strategic Wider Works is the proven delivery model, having been used on several Scottish projects. It has a range of attractive incentive properties which benefit consumers. To date, the only reasonable alternative suggested is the Competition Proxy model, under which there may only be consumer value in changing the approach taken for cost of debt.

If the Competition Proxy model is to be used, the new, high value and separable criteria should still apply. These criteria should be formalised and fixed, so as to provide regulatory certainty for all stakeholders. However, each project meeting the criteria would also need to be evaluated on a case-by-case basis, to determine whether using the Competition Proxy model would deliver a consumer benefit.

- The New criterion will still be required. Applying a Competition Proxy model to non-load related projects would introduce additional complexity, potentially introducing extra costs and delays into a process which could be time-critical if assets in poor condition are being replaced. Applying a Competition Proxy model to assets which are not new, or indeed not separable, would also represent a segmentation of the main RIIO price control into several smaller elements, which could erode regulatory certainty and investor confidence.

- The Separable criterion will also be necessary. In order for the bespoke Competition Proxy revenue stream to cover the full costs of the relevant assets (including both Construction and Operations and Maintenance (O&M) costs), it will be necessary to clearly delineate these assets. In order for the new revenue stream to reveal the true costs of the relevant assets, it must cover all costs associated with these assets. To be able to assess the appropriate WACC for a single project, all of the costs associated with the investment would need to be identified.

- The High Value criterion is still relevant to the Competition Proxy model. If a lower value project were to be delivered under this model, the costs of activities such as assessing appropriate finance benchmarks and procuring project-specific finance may outweigh any consumer savings which could be delivered. The threshold should be indexed to RPI, as the additional costs associated with running the Competition Proxy process would also increase in line with RPI. We have already provided evidence[4] that the materiality threshold of £100m could be too low.

[3] https://www.ofgem.gov.uk/system/files/docs/2016/11/ecit_november_2016_decision.pdf
[4] https://www.ofgem.gov.uk/sites/default/files/docs/ng_response_appendix_2_fronteir_economics_rpt-cato_cba-08_01_16_-_final.pdf

Question 2: Do you think the criteria for identifying projects suitable for delivery through models intended to secure the benefits of competition should be the same, irrespective of which delivery model is used?

No. Although the criteria proposed so far may represent a minimum threshold for the use of an alternative model to be worthwhile, each project meeting those criteria should be subject to a bespoke cost-benefit analysis to determine whether consumer savings are achievable in practice.

Question 3: Do you agree that there is a technical need for the HSB project and that the proposed connection is compliant with SQSS requirements? If not, please give evidence.

Yes, we welcome Ofgem's conclusions that there is an economic and technical need for investment in transmission infrastructure in the South West in the form of an additional 400kV double circuit; an appropriate Cost Benefit Analysis (CBA) methodology and process has been followed; and the appropriate routeing option has been selected.

Question 4: Do you agree with our initial conclusions?

Undergrounding through the Mendip Hills AONB

We welcome Ofgem's confirmation that our undergrounding proposals are reasonable based on the evidence provided in our Final Needs Case submission. The use of underground cables in this area is important in discharging our responsibilities under the relevant planning policy, wider duties and legislation relevant to AONBs and is in line with the expectations of local stakeholders and communities.

Use of T-Pylons

We note that Ofgem believes that further justification is required to demonstrate that it was necessary to use T-Pylons instead of regular lattice pylons. In our view, our decision was reasonable and in the interests of consumers, as it mitigated a very high risk that development consent would have been refused on the basis that the environmental effects of the scheme outweighed its benefits.

Stakeholders played a significant role in selecting and shaping the T-Pylon following the Department of Energy and Climate Change's Pylon Design competition, in collaboration with the Royal Institute of Architects and National Grid.

The main benefits of selecting T-Pylon in the project are derived from both the visual mitigation and mitigation of the risk of a delay.

Mitigation of Consent Risk

The proposed use of T-Pylons on the Hinkley-Seabank project was the subject of a robust and transparent examination by the Planning Inspectorate and has been granted development consent by the Secretary of State, following an in-depth review of our decision making. The report by the Examining Authority for the HSB proposals agreed with our use of the T-Pylon and stated that it was "satisfied with the thoroughness of the appraisal for recommending pylon type." This process took into account stakeholder views and balanced the costs and benefits of our proposals, as required by the Government's National Policy Statements for energy infrastructure. Information on the extent of the cost differential was placed before the examination.

The Government's 'frontloaded' planning system for Nationally Significant Infrastructure Projects (NSIPs), under which infrastructure providers must propose well-developed proposals, means it is not possible to test and quantify counterfactual outcomes associated with promoting alternative schemes. Indeed, the TNEI report prepared to inform Ofgem's consideration of the Final Needs Case acknowledges that "the counterfactual outcome cannot be known as it is impossible to know the determination of the Examining Authority and Secretary of State should an alternative scheme have been proposed".

We therefore must make balanced judgements as to which options to take forward, based on an appraisal of options, the views of stakeholders (which we are legally obliged to take into account under the NSIP regime), statutory duties, planning and environmental legislation, planning policy and forecast costs. We therefore consider that the test that Ofgem is potentially seeking to apply (i.e. providing certainty that a counterfactual lattice-only scheme would have been refused consent) is unachievable and goes beyond the test in the licence of "sufficiently well justified".

It takes 16-18 months from application to the Secretary of State's decision. For procedural reasons (e.g. the duty to consult on proposals) it is only possible to make limited changes to a scheme once the application for consent has been submitted. It would not therefore have been possible to switch lattice pylons for T-Pylons. In the event that the Secretary of State had considered that, in the absence of mitigation, the landscape and other environmental impacts of the scheme outweighed its benefits, there would have been no alternative but to refuse consent. As our own environmental studies (in the form of the Pylon Design Option Report), along with the consultation feedback, both supported the use of T-Pylon there would have been a very high chance that consent for a lattice-only scheme would have been refused.

Assuming refusal of a counterfactual lattice-only scheme, it would have been necessary to start the process of amending the scheme to include further mitigation. We would have needed to complete a new process of design and consultation. This process would take at least 12 months. There would then follow a second 16-18 month period to achieve a decision on the second application (i.e. at least an additional 28 months in total). We therefore had to be mindful of the risk of refusal when bringing forward a proposal.

As acknowledged by Ofgem's consultation document, there is an economic need to progress with the project. Whilst the impact of a delay to the consent is difficult to quantify precisely, the SO's analysis suggests that delaying the connection would result in an average net welfare loss of at least £534m per year, and average consumer surplus losses of at least £227m per year.

It can therefore be seen that the impact on consumers in the event of refusal of a lattice-only scheme would have been substantial. There would also have been significant additional costs associated with the further work involved (e.g. further environmental studies and the costs of participating in a second examination).

We will therefore work with Ofgem to further demonstrate in our Project Assessment submission that the decision made to include T-Pylon in the design was in the overall best interests of consumers.

Extent of T-Pylon cost differential

The consultation document states at para. 2.22 that, in NGET's view, the additional cost of using T-Pylons instead of conventional lattice pylons is £65m (see Table 2 and elsewhere). This does not accurately represent our view and we do not agree that this is a realistic reflection of the differential.

It should be noted that the differential cited is the result of a hypothetical exercise to compare costs between the two pylon types, which was provided for illustrative purposes at Ofgem's request. £65m is the maximum differential derived by simply substituting the estimated capital costs of lattice for T-

Pylon and the removal of T-Pylon development costs and, in our view, the real differential in practice is likely to be less than this. It should be noted that the assumed costs of using lattice pylons for the HSB project are not taken from a 'bottom up' estimate and can therefore not account for other possible drivers of greater cost in using lattice pylons (e.g. the possibility of different routeing; greater consent costs owing to local opposition for lattice pylons; potential greater mitigation requirements).

In our view, it is likely that lattice pylons would have posed significant challenges: increasing consent risk and/or driving a need for more mitigation (as noted above), and therefore introduced additional costs. This is especially the case given the significant degree of interest in the scheme amongst local stakeholders and communities, and support for the use of T-Pylons.

Reliability of Willingness to Pay (WTP) research

We note Ofgem's conclusion that the submitted Willingness to Pay (WTP) analysis carried out by PwC "relies too heavily on previous analysis carried out on different locations that are not fully comparable to HSB". The technical report prepared by TNEI to support Ofgem's consultation states that in its view there is a "lack of primary research specific to the landscape character along the connection route and therefore the need to employ a benefits transfer methodology".

The PwC study did in fact make use of primary research, in the form of a survey of 1,000 UK residents, in order to adjust WTP values from previous studies to allow for differences in characteristics between landscapes using the established 'benefits transfer' method. A limitation of this approach, as set out in the PwC report, is that it does not elicit new primary WTP values. However, the uncertainty arising as a result of this limitation is dealt with by the expression of WTP values as a range, reflecting robust upper and lower bounds.

In our view, this means that the study is robust and reliable for the purpose for which it was intended. The benefits transfer approach also saved time and costs for consumers, and enabled the use of innovation work that had already been funded.

Landscape Benefits

Ofgem's current consultation takes a very narrow view of the benefits of T-Pylons, focusing only on WTP values (see above) and makes no reference to the reduced visual impact given their lower height. The TNEI report underplays the benefits in avoiding visual impacts as compared to conventional lattice pylons. We have attached to this response a report from TEP, the independent environmental consultancy that provided the landscape and visual advice informing our consultation process and submission to the Planning Inspectorate. The report provides a commentary on the landscape assessment in TNEI's report.

T-Pylon Development Costs

Ofgem considers that a portion of the £17m T-Pylon development costs appears to relate to generic design work that was not undertaken specifically to develop T-Pylons for use on the HSB project. Only development costs that in our view are specific to the HSB project were included in the costs for the Final Needs Case. We welcome the opportunity to further consider this matter at the Project Assessment stage.

A large portion of the additional costs relate to the test and training scheme at the Eakring training centre. Although in the longer term, this investment will benefit future schemes potentially using T-Pylons, the decision to progress with Eakring was made to facilitate the planning and environmental decision making processes to take place on the HSB project, in order to give confidence that the T-Pylon was deliverable. By this time, as a result of the consultation, we had greater certainty that T-Pylons would be used. The Eakring project helped to reduce risks associated with design,

procurement, installation and operation. It was considered that delaying or not proceeding with the Eakring investment would expose the HSB project to increased contingency risks regarding construction methods.

The knowledge gained through the Eakring scheme is being used to optimise the design for the T-Pylons used on the HSB project, and in particular continuing value engineering activities to reduce estimated costs. The construction knowledge gained through the Eakring scheme has been shared with our OHL contractors, all of whom were given access to the completed route to develop and practice conductor installation techniques in preparation for market engagement.

Risk Management

As Ofgem's consultation document recognises, extreme weather presents a risk to delivery of the HSB project that could lead to significant cost increases. However, Ofgem does not agree with the extent of the £116m extreme weather contingency. We will work further with Ofgem to seek to quantify extreme weather risk and how this should be treated in the regulatory regime.

Given that the occurrence of extreme weather and flood events is uncertain, in our view a form of uncertainty mechanism may be appropriate as this could result in better outcomes for consumers than pricing extreme weather contingency fully into the estimate in our Project Assessment submission. It remains a question of with whom the risk should lie.

We will therefore work with Ofgem and stakeholders to explore a more appropriate treatment of risk, including possible revision of the current Cost and Output Adjusting Event threshold arrangements.

We welcome Ofgem's confirmation of the suitability of the risk methodology for other risks.

DNO costs

We note Ofgem's comments on DNO costs. We need to secure the funding for WPD to undertake its works, as this is not included in their RIIO-ED1 price control settlement. We are working closely with WPD and Ofgem to agree the appropriate process for justifying these costs. We would expect to agree the process and provide any supporting evidence as part of our Project Assessment submission.

Funding of WPD's activities will be fixed as part of the SWW process, but Ofgem has mandated separately that WPD should pass through its efficient costs to us. Therefore further consideration of how exactly this process would work is required, in order to protect end consumers and avoid unintended risk or reward. At this stage we are assuming that the COAE provisions would be the appropriate mechanisms to manage changes to DNO costs. We are happy to further discuss how to deal with this if Ofgem are concerned about using COAE provisions.

In order to ensure the project is progressed in a timely manner we are moving forward on the assumption that the split of NGET/WPD works is as per Appendix Ki.iii (Third Party Costs) in the Final Needs Case. If Ofgem has any difficulty with this approach it should make its position known.

Question 5: Are there any additional factors that we should consider as part of our SWW Final Needs Case assessment?

There is insufficient consideration of the importance of delivering the HSB project on time to connect EDF's nuclear power station. As noted above (see 'T-Pylon Cost Differential' section), any delay to the power station's connection date would result in a significant dis-benefit to consumers. Construction of the power station is well underway, and the timescales for the delivery of this complex

project (involving co-ordination between transmission and distribution networks) mean that regulatory certainty is required. Running a tender for an SPV at this late stage may cause concern among stakeholders and communities, to whom commitments have already been made as part of the DCO, which may need to be transferred.

Question 6: Do you agree with our assessment of HSB against the criteria for competition, including our view on potentially repackaging the project so that it meets all the criteria?

HSB, as currently packaged, meets the new, high value and separable criteria. However, the SPV model is not workable under any criteria, and Competition Proxy could only at best offer some savings in the area of cost of debt.

Question 7: Do you agree that the SPV model or Competition Proxy model would deliver a more favourable outcome for consumers relative to the existing status quo SWW delivery arrangements under RIIO?

No, it is not clear that an alternative model to SWW would deliver a favourable outcome for consumers. The SPV model is not workable for numerous reasons, and the Competition Proxy model could at best deliver a consumer benefit in only one of the five areas cited by Ofgem. These points are expanded later. In contrast, SWW offers an efficient delivery model that is already proven for Scottish projects, incentivises companies to deliver efficiently, and therefore gives the best chance of timely project delivery.

The SPV model introduces a range of risks to the project which increase costs to consumers, compared with the SWW approach which is fully understood. Given the timescales associated with HSB, there is a pressing need to begin procurement in autumn 2017 so that the project can be delivered in time to meet EDF's contracted connection date. There is therefore not sufficient time to appropriately develop any alternative regulatory model in order to meet the required timescales, without introducing additional risks associated with an untested model.

A model other than Strategic Wider Works would commit consumers to a particular level of cost and risk for 25 years. It is therefore important to take time to develop the model correctly to ensure that the risk allocation and level of funding continues to be appropriate both for consumers and for the company financing the assets.

Sources of Value

Ofgem cites savings in capital and operational expenditure, and financing savings in debt, equity and gearing, as benefits of an alternative model. However, we do not believe that significant consumer savings can be realised in practice under the proposed alternative models.

- Significant savings in capital expenditure would not be achievable under an alternative regulatory model. We already subject the majority of project delivery activities to competitive tender, in order to ensure we obtain the best prices for consumers. These contracts will be reflected in our Project Assessment submission. We have already begun procurement in order to meet EDF's contracted connection dates, meaning that the procurement process is being carried out in parallel with this consultation. An alternative regulatory structure may increase costs if tender participants were to price in the uncertainty associated with an unknown regulatory model, and in any case may not provide an opportunity to reduce the majority of capital costs, particularly when many elements of the design are already fixed by the DCO.

- Operational expenditure only represents a small proportion of our submitted costs for HSB. These costs are already benchmarked against comparable companies, and benefit from economies of scale associated with our portfolio of assets. Further, fixing revenues for a long period of time removes the opportunity for consumers to benefit from innovation and efficiency improvements. It is therefore unlikely that an alternative regulatory model could provide any significant savings in operational expenditure relative to the counterfactual.

- From an overall cost of capital perspective, the KPMG report for Ofwat[5] highlights that investors are unlikely to be able to beat the regulated cost of capital (outside of applying prevailing debt rates) without significant transfer of risk to consumers. An SPV model is not needed to capture the prevailing low cost of debt for consumers, which is the only area of potential benefit we believe to result from an alternative model.

- From a more specific cost of capital perspective we note that:

    - It is not clear which financing cost baseline is being used as the counterfactual for Ofgem's quoted savings, given that WACC has not yet been set for the RIIO-T2 or later price controls.

    - The cost of debt is currently at a historically low level. It is therefore possible that consumer savings could potentially be made by capturing the prevailing low cost of debt, but this depends on assumptions of future market behaviour and the pricing of the particular debt structure contingent on the regulatory construct. It would have to be recognised that this is a change from the RIIO model, and that any new model could pose additional risks which could outweigh the benefits, particularly when consumers would be committed to fixed costs for a 25-year period regardless of the prevailing financial conditions and industry setup.

    - Using a bespoke cost of equity value for an individual project is unlikely to deliver savings for consumers, as the risk associated with an individual project is generally greater than that associated with a portfolio, particularly when construction activities are still to take place. Locking in the cost of debt for a 25-year period transfers interest rate and credit spread risk to equity holders, who may expect a higher cost of equity to reflect this. For there to be a reduction in cost of equity under SPV or Competition Proxy, there would need to be a change in risk ownership away from the asset owner, resulting in a commensurate increase in risk for consumers which would need to be fully understood.

    - The RIIO-T1 cost of equity was set based on the risks borne by NGET in the overall RIIO-T1 period, including the significant uncertainty in capital requirements and the nature of the Hinkley-Seabank connection. The sensitive impact of cost of equity assumptions on investment means that the upcoming RIIO-T2 discussions represent the right time to assess any changes. The majority of expenditure for HSB lies within the RIIO-T2 period, and would therefore be funded under RIIO-T2 assumptions if the SWW model were to be used.

    - Ofgem should not use OFTO data or project finance as a reason to suggest the gearing for HSB should be higher than our gearing in RIIO-T1 of 60%. The risks of these projects are not commensurate with the risks of HSB, particularly in relation to construction risk which, to date, OFTOs have not borne. Potentially more valid

[5] https://0980a19b0bb02fe4a86d-0df48efcb31bcf2ed0366d316cab9ab8.ssl.cf3.rackcdn.com/wp-content/uploads/2017/07/KPMG-Direct-procurement-for-customers_KPMG_FINAL.pdf

benchmarks for gearing would be projects such as interconnectors or Thames Tideway Tunnel which include construction.

SPV Model Specific Views

The SPV model would not result in a favourable outcome for consumers. The benefits envisaged by Ofgem are mostly not realisable, and it is not clear that any benefits which may exist would outweigh the increase in costs and risks associated with this untested model. Ofgem has not specified the baseline against which the cited financing savings are measured, given that the financing arrangements for a project delivered under SWW would be subject to periodic price control reviews as part of the RIIO framework.

- The only potential material source of value associated with the SPV model is capturing the prevailing low cost of debt: this is supported by KPMG's analysis of Ofwat's Direct Procurement model[6]. This source of value will only exist if Ofgem is able to accurately predict the financial markets over a 25-year period: setting revenues too low could result in SPV default, and setting revenues too high could pass unnecessary costs onto consumers. As stated above, the other suggested sources of value are not likely to be material.

- Using a project financing approach introduces additional costs due to the extra activities required to assure investors that the project is financially viable. It is also likely that a portfolio can achieve favourable financing costs in comparison to a single project, as the risk profile would be spread across the portfolio.

- Establishing an SPV to deliver the project would result in additional costs to consumers which would arise from our running of the tender process and monitoring of the SPV's performance. There would also be additional interfaces and duplication, which could further erode any of the available consumer savings.

- The SPV model also contains other inherent flaws. It is not clear who would own and operate the transmission assets, given that such activity is subject to the requirement for a transmission licence as set out in the Electricity Act 1989. As the SPV would not have a transmission licence, it would not be able to participate in transmission, and Ofgem would have no direct relationship with the SPV, thus reducing its regulatory powers of enforcement. Whilst Ofgem could modify NGET's transmission licence in order to permit some form of relinquishment of operational control over transmission assets to an SPV, this would alter one of the fundamental tenets of the licence model. Additionally, if the SPV were to cause us to breach our licence or statutory obligations, it would not be possible for the consequences of any resulting enforcement action to be passed on to the SPV under any delivery agreement between NGET and the SPV. Liability will ultimately remain with us, with the result that the SPV does not represent a viable third party delivery model.

- Understanding the risk allocation between NGET, consumers and the SPV is key to determining the appropriate project cost of capital and whether consumers are bearing more risk than they would under the SWW model. The consultation implies that there is a transfer of risk to consumers in the removal of regulatory reset options for a 25-year period. It also states that prospective SPVs would not be required to reflect high impact and low probability risks in their bids. Therefore, as the risk profile is different from SWW, SWW does not provide an appropriate baseline against which to determine benefits. Under the new contractual structure, it is unclear where less transparent and currently inherent contractual risks lie. Until

[6] https://0980a19b0bb02fe4a86d-0df48efcb31bcf2ed0366d316cab9ab8.ssl.cf3.rackcdn.com/wp-content/uploads/2017/07/KPMG-Direct-procurement-for-customers_KPMG_FINAL.pdf

such obligations are appropriately placed in a contractual framework, it cannot be possible to carry out a robust cost-benefit analysis of the SPV model. In any event it is unlikely that risk could be perfectly split and so there will be an element of layering increasing costs or end consumers taking on increased risk. For example, it is not clear how the SPV's owners' compliance with certification requirements would be monitored, and whether the SPV would need to have a relationship with EDF to handle nuclear site licence obligations (as the TOs have in Scotland). More generally, there would need to be further consideration of asset safety obligations, to determine the SPV's contractual and legal relationship with third parties requiring isolation from its network.

- Ofgem assumes that we can run the SPV tender process. However, assessing another company's financial strategy is not a core activity for NGET, and could result in an overly risk-averse approach, particularly if we may be assumed to be responsible for the assets if the SPV defaults. Any additional due diligence required would introduce an additional cost to the process. The Bush/Earwaker report[7] warns that "companies will need to recognise that direct procurements involve a different, more complex range of skills than existing well developed procurement processes. They need to equip themselves in good time with the necessary skills, including financial and legal advice. "

- The proposed SPV model is complex, with many possible variables and permutations, and many unanswered questions remain. It is therefore unlikely that, in the time available before the model has to be implemented, an optimum model could be designed and thoroughly consulted upon. By comparison, several years of work had gone into the design of the CATO model, and many aspects of this work are not transferable to the SPV model. It is important that any issues associated with the regulatory model do not impact on the delivery of Hinkley Point C power station, as a delay to the power station's connection date would result in an overall economic dis-benefit for consumers.

- Further, given the timelines associated with the HSB project, there would not be sufficient time to implement an SPV model. In order to tender for an SPV, we would have to run a compliant spot tender to include the design, build, maintain and finance elements. This could take up to 24 months (in line with the timescale originally quoted to appoint a CATO). We would have to engage the market allowing consortia to form, write the terms and conditions of the NGET-SPV contract, provide works information for the various elements, build an evaluation model, and determine interface and termination arrangements. As the process has not been carried out before, it can be expected that it may be lengthy and complex. There is not sufficient time in the programme to carry out all of these steps without moving the connection date.

Competition Proxy Model Specific Views

- The Competition Proxy model, although conceptually interesting and more straightforward than the SPV model, is not without its own complexities (although these are less material to project delivery than the issues with the SPV model). As Competition Proxy commits consumers to costs for 25 years with no periodic review, it would be important to ensure that the revenue stream is set carefully at the beginning of the period, using a thorough cost-benefit analysis. Any cost-benefit analysis of the Competition Proxy model must take into account that there may be some additional costs associated with procuring financial products which capture today's cost of debt, which may diminish the net savings available.

[7] http://www.first-economics.com/directprocurement.pdf

- For the Competition Proxy model to be appropriate, suitable benchmarks would need to be used. The risk allocation would need to be precisely defined in order to be clear which comparators are relevant: this detail has not yet been provided by Ofgem. It would also be important to consider carefully how the project would be treated at the end of the revenue period.

Question 8: What are your thoughts on the SPV model, including:

(a) The structure of the model and length of revenue term?

Regardless of the structure of the model and length of revenue term, the SPV model is not likely to deliver a material consumer benefit.

The SPV model would introduce additional complexity and new processes, such as the SPV appointment process, SPV-NGET relationship, SPV-customer/stakeholder relationships, Ofgem scrutiny of the tender process, and procedures to mitigate perceived conflicts of interest during the tender process. These activities add both cost and complexity, and any issues which arise could impede the efficient delivery of the project.

In addition, it is not clear who would own or operate the transmission assets, given that such activity is subject to the requirement to hold a transmission licence under the Electricity Act 1989, and particularly given that the description in the consultation refers to the SPV operating HSB but NGET retaining operational control. It is not clear how the SPV would be incentivised to steward the assets appropriately, given that it is only responsible for them for 25 years.

It is important to note that under an SPV model, consumers would be committed to the revenue stream for a significant period of time, and that without knowing the future financial climate or energy industry setup it is possible that consumers could be committed to paying costs which would seem unreasonably high in the future. According to the Bush/Earwaker report[8], this was the case for many of the Public-Private Partnerships set up by Scottish Water between 1996-2001: these 25-40 year contracts were perceived to offer good value in the early years, but despite subsequent reductions in the prevailing cost of capital and efficiency savings implemented within Scottish Water, consumers were still committed to paying costs which were above the rate which would have been established by a periodic price control, and the companies were tied into specific ways of working.

(b) Should construction funding start during construction, or once it has completed?

Regardless of the timings of construction funding, the SPV model is not likely to deliver a material consumer benefit.

(c) The contractual and regulatory arrangements?

The contractual and regulatory arrangements proposed under the SPV model are not likely to deliver a material benefit to consumers.

The SPV model would reduce Ofgem's powers of enforcement, as the regulator would not have a direct relationship with the SPV. This is reflected in the Bush/Earwaker paper[9] on Ofwat's comparable Direct Procurement model.

As the SPV would sit under NGET's licence, NGET would be the subject of any enforcement actions resulting from the SPV's activities, which could include exposure to a Penalty or Customer Redress Order potentially for up to 10% of NGET's turnover, action from a person affected by NGET's inability to comply with a Final or Provisional Order, giving rise to an unlimited claim or ultimately revocation of

[8] http://www.first-economics.com/directprocurement.pdf
[9] http://www.first-economics.com/directprocurement.pdf

NGET's licence. It would not be feasible for us to pass these liabilities on to the SPV as part of its delivery contract, as no party would agree to this without adding a significant premium to its tendered revenue stream. Under the current proposals, NGET would still retain responsibility and liability for the transmission assets, and it would not be possible to fully pass on this responsibility via the Delivery Agreement. In light of the potentially serious consequences it would seem to be imperative for NGET to have some form of step in rights if the SPV were to default, which could impact on our financing costs. An increase in NGET's financing costs would eventually be passed onto consumers.

The change to the current arrangements envisaged by the SPV Model would also pose a potential risk to NGET's Third Internal Energy Market Package certification, particularly in circumstances where the SPV shareholder has generation interests. The time to work through any such changes at both a domestic and EU level would also pose a risk to the timely delivery of the works.

As the SPV's revenue would be fixed before construction begins, the SPV would have to meet any additional costs associated which arise during the construction process, as no totex sharing or post-construction review arrangements seem to be proposed. The SPV is likely to factor this additional uncertainty into its tendered revenue stream. However, the proposal in the consultation that an SPV would not be expected to reflect high-impact and low-probability risks in its bid means that it would not provide an appropriate benchmark for incumbent TO costs, and such risks would still sit with NGET.

In the event of an external change such as in environmental legislation, the SPV could demand an unreasonable increase to its revenue stream, which could expose NGET and consumers to significant additional costs.

(d) The identified benefits?

Given that the undeveloped SPV model would introduce uncertainty to project delivery which could result in a delay to Hinkley Point C's connection date, it is difficult to see how it could deliver a material net consumer benefit when the increase in risks for consumers and affected stakeholders are taken into account. We would therefore be interested to learn how Ofgem has derived its cited £30m-£120m savings, as these are unsubstantiated and we have not been able to replicate them.

As discussed above, any project delivered under NGET's licence should use the RIIO efficient gearing, and we do not believe that an individual project would attract an improved cost of equity compared to a portfolio.

There are no notable savings to be made in capital or operational costs. The need for us to let contracts ahead of SPV establishment (to which suppliers may price in risk as this consultation is concurrent with our procurement process), and our existing approach of running competitive procurement exercises for the majority of elements of major projects, means that further savings in capital costs are unlikely to be delivered by an SPV model. The ongoing operational costs associated with the Hinkley-Seabank assets are currently benchmarked and subject to economies of scale, and in any case will not represent a significant share of the total project costs. There is therefore no scope for material savings here.

The only possible source of value could result from capturing the prevailing low cost of debt, however this would be outweighed by the additional costs and risks associated with the SPV model, which are explored further below.

In the longer term, the introduction of a new regulatory regime at a relatively late stage in this project could result in a perception of additional risk for other projects in the future.

(e) Any potential downsides or implementation risks?

There are significant downsides and implementation risks associated with the SPV model. Firstly, the model would represent a fundamental change to the way critical infrastructure is regulated. As the SPV would not have its own licence or relationship with Ofgem, Ofgem's regulatory powers in relation

to the critical HSB assets would be less than they would be under an SWW, CATO or Competition Proxy model, and it is not clear how such an approach meets Ofgem's duties. The SPV does not therefore represent a viable third party delivery model. It is not clear who would own and operate the assets, given the ambiguous wording within the description of the SPV on page 8 of the consultation document, and the restrictions within the Electricity Act 1989 on those who are not licensees owning and operating transmission infrastructure.

The risk allocation structure of the SPV model is not clear. We would not be able to fully transfer the risks and liabilities within our licence and its statutory duties to an SPV, and any risks that can be transferred will not be without a significant increase in project costs. The result is that we would still be liable for any financial penalty resulting from the SPV breaching our licence conditions, meaning that the SPV does not represent a viable third party delivery model.

The additional complexity and interfaces in the proposed model would add cost and risk in both the construction and operation phases. We would also be required to undertake additional activities, such as running the tender process and overseeing the SPV: these would need to be funded, resulting in costs to consumers. It is also not clear how the SPV assets would interact with the RIIO regime.

In general, the SPV model has not undergone sufficient development in comparison to the CATO regime, which was subject to multiple consultations over several years. There are therefore many unanswered questions associated with this model.

In terms of implementation risks, the indicative timeline provided by Ofgem refers to "SPV set-up and full incorporation" occurring in Q3-Q4 2017, in parallel with the consultation in Q3 2017 on the delivery approach to be applied for HSB. As the SPV model would not have been fully defined until a decision is made in Q1 2018, it is not clear how the SPV could be set up within these timescales, and the complexity of these activities happening in parallel adds significant risk.

From a procurement perspective, it is unclear whether we could conduct a procurement event under our current frameworks and then novate the agreements to an SPV outside of the National Grid Group, if National Grid is at most a minority shareholder of the SPV. This is likely to represent a material change under the Utilities Contract Regulations (as the Employer would be different). If this occurred, a new procurement event would need to be run, which would impact on the programme for delivering HSB. From a Competition Law perspective, National Grid is a dominant market player, and a situation whereby timings restrict an SPV to only being able to contract with those suppliers with a pre-existing arrangement with National Grid may not be appropriate. Further, at this stage it is unclear whether the SPV would be required to run its own tender event as a Utility as defined under the Utilities Contract Regulations.

Contractual issues may arise with the untested SPV which could introduce a delay to project delivery. In addition, contractors may perceive the unfamiliar SPV model as risky and not participate in tenders when they do not know who they would partner with, or they may price in some additional risk. Early engagement suggests that bidders may use a different bidding strategy if they think that the SPV model could be used. Depending on whether we are to retain a shareholding in the SPV, and the identity of the SPV partner, then any relevant merger clearance processes would also need to be considered and followed.

Some suppliers may also be uncomfortable with the concept of signing a contract with us which could then be novated to an SPV, because of the risk that the SPV could be a company which is a competitor of theirs. This would result in the SPV company holding a contract with a supplier company, and therefore having visibility of its competitor's prices and methods of operation.

There may also be some practical implementation issues in seeking to start delivery in the current SWW model and then moving to the SPV delivery model, as our implementation approach may not immediately fit naturally with those of other organisations or delivery frameworks.

We do not agree with Ofgem's analysis of the benefits of potential delivery models against the status quo: see our response to question 7. Further, there has not been a robust Cost Benefit Analysis (CBA) which takes into account the additional costs and risks associated with an SPV.

The uncertainty associated with the use of the untested SPV model could have longer-term implications for NGET's financing, as credit rating agencies are likely to consolidate the SPV's debt onto NGET's balance sheet, which could impact on our credit rating. In the longer term, a decrease in credit rating could impact on our financing costs, and any increase in our financing costs would eventually be passed onto consumers.

(f) Any other considerations?
It is important to bear in mind that the Hinkley Point C power station is of high national significance, and any delays to its transmission connection would incur a significant dis-benefit to consumers. This project is not a suitable candidate for an untested and undeveloped regulatory regime.

Any assessment of the costs of the SPV relative to the counterfactual must take into account that the SPV does not bear the full risks of its operations, as it sits under our licence. We would need to be funded for these risks.

Although Ofgem is correct to state that the benefit of a DCO is capable of being transferred to another person (known as the Transferee) in part or all the benefit, under the proposed SPV model not all of the benefits would be able to be transferred. This is because WPD would retain responsibility for the DNO works, and in line with the Electricity Act 1989 we would not expect the SPV to be responsible for asset ownership or operation. Furthermore, Ofgem has not recognised the complexities of transferring any or all of the benefit of the provisions of the order. There are a number of issues to be considered:

- We may only transfer or grant the benefit of the Order with the consent of the Secretary of State;
- The Secretary of State must consult the Marine Management Organisation (MMO) before giving consent.
- We are not authorised to transfer or grant the benefit of the Order in so far as it relates to the WPD works: only WPD may do so;
- Article 7(4) of the Order makes clear that a transfer or grant of the benefit of the provisions of the Order must be "subject to the same restrictions, liabilities and obligations" as would apply under the Order if those benefits or rights were exercised by NGET or WPD.

The Order or Planning Act 2008 does not prescribe a process for securing the consent of the Secretary of State to a proposed transfer of powers. We consider that there may be many matters on which the Secretary of State would wish to be satisfied before approving a proposed transfer or grant of powers, given the very extensive nature of the powers granted by the DCO e.g. evidence that the Transferee or Lessee has sufficient financial standing. Therefore, the timeframe for securing approval from the Secretary of State is unknown and untested at this stage.

The process of DCO transfer is therefore likely to be lengthy and complex, and can only take place where the SPV has sufficient financial standing. In addition, the timeline shown in section 3 shows that we would need to commence the DCO before an SPV is appointed: this would introduce further complexity as a number of requirements would be discharged, including contributions provided under the S.106 Agreement, whilst the SPV tender is in progress. Moreover, works to construct the

authorised development and discharge of requirements of the DCO would be constantly evolving, making it increasingly complex to transfer the benefit of the Order.

The SPV model could result in concerns for some local stakeholders, due to renewed uncertainty of the identity of who the delivery party. The concerns of communities should be appropriately considered by Ofgem as part of evaluating the potential of new delivery models, particularly SPV. We agree with Ofgem that any SPV delivery model would need to fully meet the requirements of the consent granted.

If we were to maintain the DCO in full, it would be difficult for us to guarantee that the SPV, in which we would not have a controlling share, would discharge its legal duties as specified in the DCO.

Question 9: What are your thoughts on the Competition Proxy model, including:

(a) The structure of the model and length of revenue term?

Compared to the SPV model, the Competition Proxy model has some more positive aspects, although SWW still represents the most attractive delivery model for consumers. For example, Competition Proxy maintains the continuity of NGET delivering the project. As we have developed the project so far, including securing planning consent, we are best placed to deliver the project in line with stakeholders' expectations. NGET delivery avoids the complexity and cost associated with an SPV tender process and additional interfaces, and does not impact on our planned procurement timelines.

The appropriate length of revenue term must be considered carefully. There is a compromise to be made between a long revenue term, which decreases the project's yearly cost to consumers and minimises intergenerational transfer of costs, and a short revenue term consistent with the duration of debt bonds available in the market. Further analysis would be required in this area.

(b) Should construction funding start during construction, or once it has completed?

A model under which funding does not begin during construction would have implications for project financeability. Given that the construction period for Hinkley-Seabank is approximately 7 years, investors would require a high rate of return to compensate for a delay in earning a return on their investment. Credit rating agencies would take account of the timings of cash flow when lending to us, which would result in increased costs of debt and equity for the project. A model whereby investors can earn a yield during the construction period is likely to attract a wider pool of investors, increasing competition and therefore reducing the costs of financing the project.

(c) How we identify comparable benchmarks?

Although Ofgem refers to a range of projects which could be used to benchmark financing costs, none of these projects are exactly comparable to HSB. A suitable benchmark would have a similar risk allocation structure to HSB, with a similar balance of risk between the network operator and consumers. It would also involve both construction and operation periods, in a similar ratio to HSB. The nature of the investment should be similar to HSB.

Some of the suggested benchmarks have a significantly different risk allocation structure to HSB.

- The Thames Tideway Tunnel was subject to a Government Support Package, which insulated investors from many of the risks associated with the project and enabled a low WACC to be bid.

- During their operational period, OFTOs often rely on generators to carry out O&M activities, meaning that the OFTO itself generally does not bear significant cost or risk, as it is in the generator's interests to ensure that it still has a route to market and therefore that its

transmission connection remains in good condition. As standalone licensed companies, OFTOs have also been able to use high gearing without impacting on the rest of a portfolio.

- Interconnector investors would factor in their expectation of future revenues from the asset into their assessment of an acceptable level of Interest During Construction (IDC). Interconnector investors may be willing to make a loss during the construction phase which will be recovered once the interconnector is operational: this is not analogous to HSB.

Some of the benchmarks also refer to investments of a different nature to HSB.

- The Shetland project refers to distribution rather than transmission: it is commonly acknowledged that transmission activities are higher risk (this can be seen in the beta values: NGET's RIIO-T1 beta is 0.94, and the RIIO-ED1 beta is 0.9). The winning bidder for Shetland will also hold its own distribution licence. For Shetland, the construction period represents a smaller proportion of the revenue period than it does for HSB: this implies that an appropriate gearing level for HSB would be lower than that for Shetland.

- The interconnector and OFTO IDC benchmarks only refer to the construction period, and the OFTO O&M benchmark only refers to the operational period.

- OFTO assets are assumed to no longer be required at the end of the revenue period: the expected lifetime of Hinkley Point C power station is significantly longer than 25 years.

- The use of OFTO Interest During Construction (IDC) is not appropriate. Given that all OFTO assets to date have been built by generators, this has not been tested as a suitable cost of capital. The OFTO IDC values do not arise from a realistic data set, as they draw on a confused combination of world returns and the UK risk-free rate.

For any comparator, Ofgem would need to show the marginal difference to the RIIO-T1 cost of equity, in order to transparently demonstrate that the differences in risk have been appropriately adjusted for, and the assumptions made are clear.

In our view, the most suitable benchmark proposed so far is SSEN's tender for a new energy solution for Shetland, given that it incorporates both construction and operation activities. However, it is important to note that distribution activities are lower risk than transmission, and that for Shetland, the construction period represents a smaller proportion of the revenue period than it does for HSB. It would also be necessary to fully analyse the extent to which risks are shared between the network and consumers on each project.

(d) The identified benefits?

As per our comments above, given the timescales for Hinkley-Seabank, and our current approach of competitively tendering large construction elements to contractors, no material savings in capital expenditure would be possible under an alternative regulatory model. There is also limited scope for savings in operational expenditure.

We recognise that the prevailing cost of debt is currently at a historically low level, and it is therefore possible that some consumer savings could potentially be made by capturing this. However, it is important to consider that a Competition Proxy model would commit consumers to a fixed cost for a significant period of time regardless of the prevailing financial climate, and therefore careful consideration must go into the setting of financial parameters to ensure that the deal continues to represent value for money in years to come.

Using a bespoke cost of equity value for an individual project is not likely to deliver savings for consumers, as the risk associated with an individual project is generally greater than that associated

with a portfolio, particularly when construction activities are still to take place. We would therefore expect to see a higher cost of equity under a bespoke project-specific revenue stream.

Given Ofgem's assumption that our efficient gearing level is 60%, any project within our portfolio must not cause an overall change in our gearing. An increase in gearing for one project must therefore lead to a decrease in gearing elsewhere: this would result in a zero-sum game for consumers.

It is also worth noting that project-specific financing can introduce the requirement for a range of additional activities to give investors comfort that the project is a sound investment. These activities introduce a cost, which would eventually be passed onto consumers.

We note Ofgem has derived £30m-£120m savings from alternative financing arrangements which we have not been able to replicate.

(e) Any potential downsides or implementation risks?
For the Competition Proxy model, the main downside is the lack of time available to develop the model properly, given the pressing need to begin construction work. A lack of thorough development and cost-benefit analysis could result in consumers being committed to unsuitable costs for a significant period of time. It is worth noting the recent Citizens Advice publication[10], which warns that "Ofgem should, as far as possible, stop trying to forecast costs over a long time period".

Although there may be an opportunity to make some consumer savings by capturing the prevailing low cost of debt, it may be preferable to review the suite of competition models available as part of the RIIO-T2 work, by which time more information on the likely timings of CATO legislation may be available.

(f) Any other considerations?
HSB is a project of strategic national importance, connecting a new nuclear power station to the grid. If the Competition Proxy model is to be used to capture the prevailing low cost of debt, it is important that the development of the model does not compromise the timely delivery of the power station, or create regulatory uncertainty which could have an undesirable washback to future projects.

[10] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/EnergyConsumersMissingBillions.pdf