



Ofgem  
9 Millbank  
London  
SW1P 3GE

Email to: [NTIMailbox@ofgem.gov.uk](mailto:NTIMailbox@ofgem.gov.uk)

20 March 2018

### **Hinkley-Seabank project (HSB): minded-to consultation on delivery model**

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

The Hinkley-Seabank project will deliver the transmission infrastructure needed to support the connection of Hinkley Point C. Hinkley Point C is a very significant project for GB consumers delivering much needed reliable, synchronous, low-carbon generation, and construction of the station is well underway. It is critical that the transmission infrastructure necessary for the export of power from the station is delivered on time and that the regulatory framework to support funding for HSB is robust. In particular it is important that negotiations between National Grid and Ofgem around the funding of the Hinkley-Seabank line and the potential use of this novel delivery model should not impact the delivery of HSB and specifically delay the connection of our Hinkley Point C project. The cost of and delays to the connection of Hinkley Point C would dwarf any potential gains that consumers might achieve from the HSB delivery model.

As we have previously stated, we support measures that will help to bear down on network costs to the benefit of electricity consumers including measures to introduce greater competition into electricity transmission. We agree that these measures (Competition Proxy and SPV) should be considered on a case by case basis for large future transmission links. Ofgem highlights that there are potential consumer savings from the introduction of the competition proxy delivery model relative to the status quo Strategic Wider Works approach under RIIO for the Hinkley-Seabank project.

We have not undertaken our own assessment of the cost of capital ranges proposed by Ofgem for the Competition Proxy delivery model but these parameters must be set high enough to attract finance to invest in this critical transmission infrastructure. We support Ofgem's efforts to bear down on the cost of capital, subject to ensuring that projects are financeable, and that use of any novel delivery model is robust and will not impact on timely delivery. We do not support the use of the Special Purpose Vehicle model for HSB – this approach needs to be developed materially further to be effective which timescales for delivery of HSB do not permit.

**EDF Energy**  
90 Whitfield Street  
London W1T 4EZ  
Tel +44 (0) 20 3219 6911

[edfenergy.com](http://edfenergy.com)  
*EDF Energy plc.  
Registered in England and Wales.  
Registered No. 2366852.  
Registered office: 90 Whitfield Street,  
W1T 4EZ*

On the specific points in the consultation, we support Ofgem's proposal to include revenue during construction to help reduce costs for consumers. It may be appropriate to include equity funding during this period as well as debt finance which may facilitate a wider range of investors and have the potential to bring the overall cost down.

While there is merit in aligning certain key regulatory aspects of the Competition Proxy model with the existing OFTO and Interconnector regimes, we are not convinced that it necessarily applies to the financing term of onshore assets where the asset technical and commercial life is longer than 25 years. Ofgem should consider whether limiting the financing term to 25 years is in the best interest of both current and future consumers.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or me.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in black ink that reads "Angela Hepworth".

**Angela Hepworth**  
**Corporate Policy and Regulation Director**

## Attachment

### Hinkley-Seabank project: minded-to consultation on delivery model

#### EDF Energy's response to your questions

##### **Q1. Do you agree with our minded-to position to pursue the Competition Proxy model for HSB?**

We support measures that will help to bear down on network costs to the benefit of electricity consumers including measures to introduce greater competition into electricity transmission. We support the use of competition proxy as long as a realistic cost of capital can be determined that allows the project to be investable and does not impact on the delivery timescale for the connection of HPC.

We agree that it is not appropriate to use the Special Purpose Vehicle (SPV) competition approach for HSB. The SPV should be developed in much more detail and introduced at an earlier stage in the development of new transmission investments. The timescale is simply too short to hold an SPV competition without risking delay to HPC's grid connection dates impacting our costs and schedule. We do, however, agree in principle that a framework that allows competition for cost of capital, by providing an investable package is preferable from a consumer value for money perspective to a framework which requires investor returns to be set administratively.

Finally, Ofgem states that the cost of the project is currently estimated at close to £800m whereas National Grid refers to total cost of around £650m in its [press release](#). This discrepancy should be clarified.

##### **Q2. What are your views on the appropriateness of the cost of capital ranges developed by CEPA (presented in Table 3.1), and where within the ranges do you consider the rates for HSB would lie?**

We think that setting the cost of capital to replicate a competitive project finance outcome through an administrative process is challenging and we have not attempted to ascertain the appropriateness of the cost of capital developed by CEPA. This underlines the benefit of using a competitive process to set the cost of capital for projects over a proxy approach. As noted above, though we agree that in this particular case using a fully competitive model is not appropriate given the development work required for the SPV model.

We do not have a view on the specific ranges but it is critical that the concluded view on the cost of capital must be high enough to support attracting finance to this important transmission infrastructure development.

**Q3. Are there any potential costs or benefits of the Competition Proxy model that we haven't considered?**

We agree that Ofgem have considered the key costs and benefits. However, quantifying the benefit of the Competition Proxy model is subject to considerable uncertainty given that it is not clear what the final cost of capital for the HSB project will be; nor what future financing costs will be applied in future price controls. Given these uncertainties, quantifying the benefits using the RIIO-T1 counterfactual may be overstating the value, particularly given that Ofgem has already strongly stated that allowed returns at the next round of price controls (RIIO 2) will be lower.

In evaluating the consumer benefit of any novel delivery model, Ofgem should bear in mind that the overwhelming interest of consumers lies in having the transmission infrastructure delivered on time.

**Q4. Do you agree with our proposed approach to setting NGET's revenue allowance for HSB, including permitting NGET a revenue allowance during the construction period?**

In general, we believe there is merit in aligning certain key regulatory aspects of the Competition Proxy model with the existing OFTO and Interconnector regimes. However, the asset life of onshore transmission (45-55 years) is significantly longer than OFTOs (25 years) and interconnectors (25 years). We believe that the depreciation period should generally align with the expected technical and commercial life of the asset. In the case of HSB, Hinkley Point C has a 35 year Contract for Difference and would expect to operate for a materially longer period. As HSB is also for wider use, by consumers and other generators, and will technically last longer than 25 years it is not clear that this fairly allocates costs between different vintages of consumers.

While we note that Ofgem conclude that 25 years is the optimum revenue period for consumers, we understand that the Thames Tideway project, for example, is financed over 120 years. While recognising its differences, we believe that it is possible to attract investors who are willing to finance projects over a longer period and create regulatory frameworks that still attract lenders.

We are supportive of the proposal to include an allowance for revenues during the construction phase. Allowing debt to be serviced during the construction phase will reduce interest during construction and benefit the credit profile of the project lowering financing costs and ultimately costs to customers.

However, we consider that if a competitive tender were being run (which the delivery mode is a proxy for) then it could also be beneficial for customers to allow an equity return during the construction phase. Some equity investors (for instance pension funds) have a strong preference or requirement that committed capital earns a yield. Allowing an equity return during construction could thus widen the pool of potential investors,

increase the level of competition in provision of finance and help drive a lower cost of finance for competitively tendered projects.

**Q5. What are your views on the two alternative approaches to setting cost of debt and equity during the operational period?**

In a competitive tender model with the length of construction period, we think there are benefits to allowing a mechanism similar to 'Option 2' so that rates of return can be adjusted to reflect prevailing debt market conditions and the cost of debt embedded in an efficiently financed project. Such an approach will reduce investor exposure to financial risks that are largely beyond their influence, would therefore lead to lower investor return requirements, improve the credit assessment of the project and ultimately benefit customer value for money. Customers would also directly benefit from sharing the impacts of unanticipated reductions in financing costs over the life of a project.

On this basis it may be appropriate to incorporate a similar mechanism for cost of debt in the Competition Proxy model.

The investor perspective of allowing an adjustment to cost of equity would need to be considered to see whether this would also have benefits for customers. Furthermore, as noted by CEPA, the potential for an adjustment mechanism for cost of equity to be more complicated than for cost of debt should also be considered.

**Q6. Do you agree with our proposed regulatory arrangements to implement Competition Proxy?**

As mentioned above, we are supportive of Ofgem finding ways of bearing down on the cost of capital, subject to ensuring that projects are financeable, and that use of any novel delivery model is robust and will not impact on timely delivery. Subject to these provisos, we would be supportive of its extension to other onshore local circuit cables in the future where the criteria are met – until the CATO regime is allowed for by new legislation.

- **What do you think of our proposals in relation to setting capex?**

We agree in principle with the proposed approach for setting capex.

While it may not make that much difference we assume that an efficient project design would be to target a technical solution to meet the expected useful life of the assets rather than targeting a design that meets the proposed 25 year regulatory period.

- **What do you think of our proposals in relation to arrangements during the operational period?**

We consider that it is appropriate to adjust allowed operating costs to reflect certain changes in these costs. On this basis, it may be preferable to set allowed operating costs as part of the post construction review, and we agree with the principal of having operating cost re-openers. The scope of the potential cost adjustments should be set with investor requirements and incentives in mind to achieve an efficient outcome.

**Q7. Do you agree with our proposed treatment of low probability, high impact events that NGET cannot control?**

Yes.

**Q8. What are your views on whether a specific allowance set as part of Project Assessment, or a pass-through of incurred taxation constitutes the most appropriate approach for HSB?**

A pass-through may be more appropriate if it would reduce investor risk without compromising investor incentives to achieve efficiency.

**EDF Energy**  
**March 2018**