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

I am writing in response to the above consultation. Although Northern Powergrid is not a UK transmission asset owner or operator, our wider group, Berkshire Hathaway Energy, has extensive experience of running transmission networks across North America. The consultation also raises issues that are directly relevant to all energy networks, and it is these issues on which we primarily focus. We have therefore summarised our key points below, without attempting to answer all of the detailed consultation questions.

Firstly, the competition proxy model appears to involve no competition. Ofgem would be setting a project specific price control.

Secondly, regulatory commitment to a deal within price control periods is of key importance to any investor operating under Ofgem's RIIO framework. We note that the consultation states that 'As part of our RIIO-T1 final proposals, we confirmed that all SWW projects, such as HSB, could be considered for delivery through a competitive process' and on this basis Ofgem seems to ask no questions about whether it is reopening the RIIO-T1 deal through this consultation. However Ofgem must trace through whether it's newly developed approach is in fact consistent with the RIIO-T1 *Final proposals*, given that it is no longer subjecting the project to a competitive process; otherwise it is missing a key factor from its impact assessment.

Thirdly, we believe Ofgem's benchmarks of the appropriate rate of return, derived from OFTO auctions, are not appropriate. Generators carry construction risk in the OFTO case, and OFTOs are not exposed to construction related faults, whereas National Grid will carry the construction risk in the Hinkley case. The statement in Ofgem's comparison of risk between the models – that construction risk is broadly the same – appears questionable. There may also be other material risk differences. We set out our own analysis of differences in risk in **Annex A**, based on the offshore regime compared to onshore RIIO regimes in general. While this analysis is not directly applicable to the competition proxy model, it may highlight risks associated with this model that Ofgem has not fully considered to date. We do accept that Ofgem could reduce some of the Hinkley project risks to the

OFTO level by design (for instance it would be possible to remove all construction risk from National Grid – albeit this is not the case under the proposed model as we understand it).

Finally, Ofgem's recent RIIO-2 framework consultation shows that the counterfactual will be a tougher settlement compared to RIIO-T1, with a lower cost of equity and a cost of debt that is reset based on the current costs of the companies. If Ofgem takes this project out of National Grid's main portfolio, it will find it needs to set a higher cost of debt percentage on the residual business. The net-benefit to consumers from the start of RIIO-2 may be zero, leaving only a short term gain.

We think the points above should cause Ofgem to pause and question whether it makes sense to dedicate resource to pursuing the competition proxy model for this project. The only merit we can see is that it may allow Ofgem to reduce the investor risks on this specific project to the OFTO level – if Ofgem is willing to transfer this risk to consumers (for instance through full pass through of construction costs).

With significant issues at stake in the RIIO-2 process, we believe that Ofgem ought to prioritise its resources towards the development of an effective framework for the forthcoming price control period. This includes developing a viable model of genuine competition in transmission (not just site specific NGET price controls), which might involve looking again at licensing arrangements, or at the relevance of distribution voltages. Ofgem should also be dedicating resource to improving the current process of competition between distribution networks for new extension assets. This could help ensure that the benefits of new low cost-to-serve areas flow to energy consumers, and not property developers (or IDNO networks regulated under a light touch regime) as is currently the case.

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Annex A: Comparison of OFTO risks with onshore RIIO risks

Driver of risk	Offshore transmission	Onshore RIIO sectors
Construction	**Zero.** Assets already constructed.	**High.** Major ongoing construction programmes with committed deliverables
Maintenance	**Low.** Faults associated with construction are protected	**Moderate.** No protection within period to cost exposure to newly developed faults
Regulatory obligations	**Moderate.** Availability risk (a low probability high impact event): but construction defects are protected	**High.** Significant exposure to onerous legal obligations, with potential for major fines, plus incentive exposure on operational performance
Financing	**Low.** The contract is locked for 25 years and the finance structure can be tailored to match	**High.** Significant ongoing financing activity and companies carry risk, for example if they differ from peers
Asset life	**Shorter.** 25 year asset life partly mitigates recovery risk	**Longer.** 45 year asset life extends recovery risk
Competition	**Negligible.** Regulatory framework limits risk after contract award. Risk limited to bid activity such as bid-rigging	**High.** Must provide input services to competitors. Competition risk applies to day to day business decisions
Safety	**Low to moderate.** Offshore assets are buried on the seabed. Some exposure onshore, typically remote	**High.** Many assets close to end users. Transco was fined £15m in 2005: Prevailing fine levels have increased since
Environmental issues	**Low to moderate.** Changes to law could affect de-commissioning costs: but this is a pass through cost	**Low to moderate.** Older assets present some risks. Cost exposure within period, not beyond
Employment law changes	**Low.** Very small operational base limits exposure to employment law changes	**Moderate to high.** Large workforce so changes in employment law can have significant impact
Political risk	**Low.** Off the political and media radar	**High.** Politically prominent
Overall	***Low risk***	***Significantly higher risk***