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Dear James,

**Consultation on a proposal to modify Special Condition 6I of National Grid Electricity Transmission's RIIO1 electricity transmission licence to implement the Hinkley-Seabank decision**

This response is provided on behalf of National Grid Electricity Transmission plc (NGET) in our role as Transmission Owner in England and Wales. As the party delivering the project, we welcome the opportunity to respond to this consultation on Ofgem's proposals for licence modifications to implement the final determination of the efficient capital costs of the Hinkley-Seabank (HSB) Strategic Wider Works (SWW) transmission project.

We broadly welcome the proposed modifications to Special Condition 6I of the NGET transmission licence. However, we have several detailed comments on the following issues:

- The detailed definition of the HSB output;
- The Cost and Output Adjusting Event (COAE) arrangements – in particular on the removal of ground conditions and planning risks from the COAE schedule and detailed drafting of the descriptions of certain risks on the COAE schedule;
- The treatment of any delays to the HSB project, including if Hinkley Point C is delayed or cancelled; and
- The procedure for amending the NGET transmission licence.

These are discussed in turn below.

**Definition of the HSB output**

We confirm that we agree that 1) the proposed spend profile to be added to Table 3 reflects the correct profile, and 2) the technical deliverables in the new Table 5 accurately reflect the scope of the proposed HSB project.

We agree that 2024/2025 is the correct delivery date for the HSB output, as confirmed in the proposed modifications to Table 3. However, we consider 'Q3' to be too specific, inconsistent with rest of the licence, and overly restrictive. The required delivery dates for other SWW outputs scheduled in Table 1 are given as financial years (B6 Series and Shunt Compensation Boundary, Harker–Hutton–Quernmore

conducting, and Penwortham quadrature boosters are given as 2014/15; Western HVDC Output is given as 2016/17). We suggest a similar approach is adopted for the HSB output.

### **Cost and Output Adjusting Events (COAE)**

We broadly support the principle of amending the COAE arrangements to cover more and specific risks. Our November 2019 response to the consultation on the assessment of capital costs for the project raised some concerns with the overall risk treatment proposed, which were not reflected in Ofgem's subsequent decision in May 2020. We still believe that a 10% materiality threshold for the qualifying risks, with no upfront allowance for these risks, would expose us to an unacceptable degree of risk. We proposed in our response that either 1) the risks should be fully funded ex ante at their P50 values, with a lower materiality threshold, or 2) excluded from the upfront contingency and be subject to COAE arrangements, but with no threshold, or a low enough threshold to ensure that exposure is not material, linked to the cost of running the assessment process (i.e. transactional cost).

### **Ground conditions and planning risk**

The May funding decision document stated that the COAE modifications would cover risks for the HSB project "in addition" to the three risks covered by the existing COAE provision – i.e. extreme weather; the imposition of additional terms or conditions of any statutory consent, approval or permission; and unforeseen ground or sea-bed conditions.

However, the current consultation states that this was a drafting error, the statement did not accurately reflect Ofgem's decision, and the decision is in fact that, of the three existing COAE risks, only extreme weather will be included in the list of risks eligible for the COAE mechanism for HSB. This is because, in Ofgem's view, an efficient up-front allowance in relation to the other two risks will be provided.

It is unreasonable to introduce such a significant departure from the position outlined in the May 2020 funding decision through licence drafting.

Ofgem's current position means that we carry an unlimited risk of additional costs arising from unforeseen ground conditions or additional terms or conditions of any statutory consent.

Our understanding of previous discussions was that no COAE risks would be removed from the existing mechanism, and our approach to quantification of risk allowed for the fact that high materiality additional costs in these areas would be covered, subject to the relevant threshold. It was therefore not necessary to quantify and value these risks beyond the P50 confidence level.

This is of particular concern for ground conditions, which has the potential to add significantly to costs. It would not be efficient to factor this risk fully into the contingency when there is an expectation that allowances can be adjusted to allow for extreme events. The same logic applies to costs arising from additional terms or conditions of any statutory consent, albeit that the potential costs are relatively lower because a Development Consent Order is already in place for the works.

The position outlined in the proposed licence modification would therefore expose us to a significant degree of additional risk, which we have not had the opportunity to factor into our risk management approach. We therefore object to the removal of these two risks from the COAE mechanism for HSB, as it would expose us to an unacceptable degree of risk, without the opportunity to ensure that the ex ante contingency allows for this exposure.

## **COAE (definitions)**

The definition of some of the risks changed between the October 2019 consultation position and the May 2020 funding decision. We are generally content with the descriptions in the draft paragraph 6I.14(b). However, we have some concerns with 6I.14(b)(ii) and (iv), relating to Brexit and contractor insolvency respectively.

In the October 2019 consultation document, Brexit risk included ‘trade tariffs’ and ‘labour issues’ potentially resulting from immigration controls. These no longer appear explicitly in the new definition. We are concerned that the reference to ‘legislative or regulatory changes including changes to the rate of VAT’ is not sufficiently specific to cover tariffs and labour issues, which are among our principal risks in the delivery phase.

We also believe that the reference to “liquidation” should be broadened to ensure that it captures other wider business reasons that a contractor would not be able to complete the contracted work. For example, a contractor entering administration may have similar practical impacts on the HSB project as liquidation.

We would welcome a detailed discussion on this drafting prior to the formal statutory licence drafting consultation.

## **Treatment of late delivery**

The May 2020 funding decision document confirmed Ofgem’s view that costs associated with the delay or cancellation of the Hinkley Point C (HPC) project will not be included within the COAE mechanism, contrary to the October 2019 consultation position. The decision stated that, if there was a significant delay, or cancellation, to the HPC project, any associated costs to HSB would be considered separately.

No alternative arrangements have been proposed in the current licence modifications. It is possible that, if the HPC project were delayed or cancelled, the most economical and efficient course of action may be to delay the delivery of the HSB output, or not to deliver it at all. However, in those circumstances, in the absence of arrangements covering this scenario, delaying the HSB output beyond 2024/25 or stopping delivery would be in breach of the transmission licence obligation to deliver the HSB output.

We understand that, in accordance with Ofgem’s current proposals in its RIIO-T2 Draft Determinations, ready for the beginning of RIIO-T2, the HSB output will either be added as an output at the end of the new proposed Large Onshore Transmission Investment (LOTI) condition or as an output elsewhere in the NGET transmission licence. Given that RIIO-T2 Price Control Deliverables (PCDs) would be agreed at the Project Assessment stage, this approach to the incorporation of the HSB output into the NGET RIIO-T2 transmission licence means that it would not be possible for HSB to become a PCD, and therefore it will remain as a licence obligation in RIIO-T2. This means that the potential for technical breach of licence due to late or non-delivery would remain in RIIO-T2.

We would welcome further clarification and discussion on the proposed treatment of late or non-delivery of the HSB output prior to the formal statutory licence drafting consultation.

### **Procedure for licence modification**

Our understanding is that this current 17 July 2020 consultation is not a statutory consultation, but rather an informal consultation to gather stakeholder views prior to a subsequent statutory consultation under section 11A of the Electricity Act 1989 (as amended) to formally implement the licence modifications into the NGET transmission licence. We agree with this approach, as the changes proposed to Special Condition 6l are, in our view, beyond the scope allowed by the change process provided for by the provisions of Special Condition 6l.33.

As discussed above there are elements of the proposed licence changes that need to be discussed further and clarified prior to such statutory licence modification consultation being published.

### **Other attachments and confidentiality**

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

Yours sincerely,

[By email]

Chris Bennett

Director, UK Regulation, National Grid