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Dear DESNZ RAB licence consultation team,

Thank you for providing us with an opportunity to comment on your second consultation on proposed modifications to Sizewell C Limited's electricity generation licence in order to implement the Regulated Asset Base ('RAB') model. This consultation response is entirely non-confidential and may be published on your website.

Approach to setting the cost of equity

Option 2 provides a logical approach to setting the cost of equity, and we note the success of a similar approach when applied to the Thames Tideway project.

Its effectiveness here is likely to be bounded by how competitive the bidding process is, and that is a matter on which we are unsighted. If there is a liquid pool of bidders, competition between them could drive down the cost of equity to the benefit of consumers. But there may not be.

Bidders' perceptions of potential gains and risks that would need to be priced into their cost of equity will depend on the overall configuration of the RAB model, including gain and pain-sharing components that are outside the scope of this consultation. As we have noted in previous consultation responses, and as the department noted in its impact assessment, new nuclear plants have a very high probability of significant construction delays and cost overruns. A lower cost of equity may be delivered by allocating more of those risks to consumers, and less to investors. But we would caution DESNZ against chasing the lowest cost of equity if it can only be achieved by heavily exposing consumers to overrun risks.

From a consumer protection benefit there is a trade off between the cost of capital they need to finance (the lower the better) and the volume of capital they need to repay (again, the lower the better). Pushing overrun risks from investors onto consumers may reduce the former but increase the latter (and vice versa). Given this tension, we would expect the department to assess the value of money of the overall RAB package against a range of possible outturn cost and construction time scenarios. It will need to be able to provide the public with confidence that any deal provides fair value across that range.

We can see pros and cons of allowing the Risk Free Rate (RFR) to be adjusted in line with market conditions, as envisaged by Option 3. This could reduce the risk of

windfall gains and losses accruing to either investors or consumers that exists under Option 2. It is very hard to predict in which direction such windfalls could occur given the uncertainty inherent in long term economic forecasting. It is possible that some investors might offer a materially lower cost of equity if RFR protection is included in the model.

Cost of debt and level gearing

We suspect that existing debt market indices like iBoxx are unlikely to be of great relevance when establishing the cost of debt for this project; in its novelty and scale it is not particularly comparable to traditional pipes and wires assets regulated through the RAB model.

It also seems highly probable that the mix of public and private debt for this project will be quite unusual when compared to traditional RAB regulated assets, with a greater proportion of public financing than is usually the case.

We support the principle of including gain/pain share arrangements that encourage investors to efficiently manage their debt, in order to reduce total costs to consumers, however we note that it may be difficult to calibrate these correctly on an ex ante basis given the difficulties in setting the initial cost of debt identified above. This may bring heightened risks of windfall gains or losses that are driven more by financial engineering and/or information asymmetries than by actual efficiency.

We also note that the proposed notional gearing of the project is on the high side compared to other regulated sectors, including ones like water where there are publicly acknowledged problems with the financeability of some firms due to excessive debt burdens (eg Thames Water). While it is cheaper for consumers to finance debt than equity, some care should be taken to ensure that the model does not result in heightened risks of future financial failure that would likely have to be socialised across bill or tax payers. Given both recent volatility in interest rates, and that their level in the period since the 2008 Global Financial Crisis has been historically anomalous, we would expect to see evidence that the Government has conducted robust modelling against a wide range of future debt cost scenarios in reaching a financial investment decision.

Yours sincerely

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Patron HRH The Princess Royal **Chief Executive Clare Moriarty**
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