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**29 January 2024**

Dear DESNZ,

Thank you for providing us with an opportunity to comment 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.

*The RAB model*

We recognise that this is a consultation on how the RAB model should be implemented, and not on whether it should be used, but think it would be useful if we set out our overarching concerns on the model itself upfront in order to give context to our subsequent views.

The RAB model is a well understood mechanism for financing monopoly infrastructure assets. It has proven to be an investable model in many cases, though this has usually been in its application to network assets where the asset being financed is much less novel, there are a significant number of comparable assets that enable effective cost benchmarking, and where the probability and likely materiality of major cost or construction time over-runs is relatively low. The Sizewell C ('SZC') project shares none of those characteristics.

By providing investors with a relatively guaranteed income stream, and one that commences during the construction phase, it can be convincingly argued that applying the RAB model to new nuclear projects could reduce the cost of capital that consumers have to pay.

Our concern has been, and remains, that consumers are not simply exposed to the cost of capital, but also the volume of capital that needs to be employed. If the volume of capital required balloons, the project may offer consumers poor value for money even if it is cheaply financed. Consumers may also be on the hook for any delays in the delivery of the project, still being required to pay a commercial return for the construction costs despite it not producing any output at that time.

New nuclear projects routinely come in late and over-budget. The department acknowledged this in the impact assessment accompanying the primary legislation enabling the delivery of the RAB model, noting that:

“On average, the construction period of a nuclear power plant is around 40% higher than expected at the point of FID from data of nth of a kind nuclear power plants built in Europe; and 90% higher than expected at the point of FID from data of all nuclear power plants built after 1990.”<sup>1</sup>

“On average, the construction cost of a nuclear power plant is around 20% higher than expected at the point of FID based on data from nth of a kind nuclear power plants built in Europe; and 100% higher than expected at the point of FID based on data from all nuclear power plants built after 1990.”<sup>2</sup>

We noted similar findings on cost and time overruns from a range of other studies in our response to an earlier consultation on whether the RAB model should be used.<sup>3</sup>

SZC is expected to be an above-ground replica of Hinkley Point C ('HPC'), the projected build costs of which have ~doubled from £16bn<sup>4</sup> to £31-34bn (in 2015 prices)<sup>5</sup> in the last eight years. Hinkley Point C was scheduled for completion in 2025 at the time its Contract for Difference ('CfD') was awarded, but this has now slipped to 2029-31.<sup>6</sup> The development of other European Pressurised Reactors at Olkiluoto in Finland and Flamanville in France have also seen severe cost and time overruns.

So in the round, both looking at new nuclear projects in general, and the type envisaged at SZC in particular, the scope for material cost and time overruns is very significant. Consumers need to be protected from those risks. They have no way to manage them, and are reliant on the department to take steps to ensure that they are not on the hook for cost or time overruns.

### *Problems with the presentation of the 2021 impact assessment*

The Government has previously suggested that introducing the RAB model would save consumers 'more than £30 billion on each new large-scale nuclear station.'<sup>7</sup> The basis for that figure is the accompanying 2021 impact assessment<sup>8</sup> published by

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<sup>1</sup> Para 66, ['Impact assessment: Regulated Asset Base model for new nuclear.'](#) BEIS, 26 October 2021.

<sup>2</sup> Para 52, *Ibid.*

<sup>3</sup> Page 3, ['Response to BEIS consultation on whether it should move to a Regulated Asset Base \(RAB\) model to finance new nuclear power stations.'](#) Citizens Advice, 11 October 2019.

<sup>4</sup> ['Building our industrial future.'](#) EDF, 2015.

<sup>5</sup> ['Hinkley Point C update.'](#) EDF, 23 January 2024.

<sup>6</sup> ['Hinkley Point C update.'](#) EDF, 23 January 2024.

<sup>7</sup> ['New finance model to cut cost of new nuclear power stations.'](#) Gov.uk, 26 October 2021.

<sup>8</sup> ['Impact assessment: Regulated Asset Base model for new nuclear.'](#) BEIS, 26 October 2021.

DESNZ's predecessor department BEIS, but in our view it failed to correctly allocate who bears the risk and how much risk they bear in the event of overruns.

The £30bn (or more) figure comes from paragraph 74 of that impact assessment, and reflects a cost comparison between CfD and RAB models set out in the immediately preceding tables, 2 to 4.

BEIS calculated the benefits of the RAB model, shown in Table 4, by deducting the total costs of building and financing a new nuclear power station under the RAB model, shown in Table 3, from the equivalent costs under the Contract for Difference ('CfD') model, shown in Table 2, in different overrun scenarios. Both tables show the costs of financing and building a new nuclear power station escalating significantly if there are cost overruns. The total overall project cost is shown to be cheaper under the RAB model.

This may be true, but - crucially - who bears those costs differs between the two models. Under the RAB model, the costs of overruns are likely to be shared between consumers and investors (exactly how is still unknown, as the sharing factors that will be in place are subject to negotiation). But under the CfD model, the cost of overruns are entirely borne by investors. Consumers pay the same strike price per MWh delivered under a CfD regardless of whether the plant comes in on budget, 20% over-budget or 100% over-budget.

In essence, the IA appears to have calculated the consumer benefits of RAB over CfDs as the difference between consumers paying the *full* cost of any cost overruns under the former model versus consumers paying the *full* costs of any cost overruns under the latter, when they would actually only pay *a proportion* of any cost overruns under the former, and *none* of the cost overruns under the latter. This is likely to have the effect of materially overstating the consumer benefits of the RAB model.

Noting this, and noting also that the expected costs and construction timeline of the nearest equivalent project to SZC, HPC, have evolved materially since 2021 we suggest that DESNZ publishes an updated impact assessment when it has reached outline terms with investors but before that deal is legally binding. It should give more detailed consideration to where costs and risks lie and how they are shared between the public and the licensee. It is important that the public can have confidence that the final deal robustly defends their interests.

In the remainder of this response we explore the specific questions posed in the consultation document.

**1) Do the licence modifications outlined within this consultation strike a reasonable balance between the need to support the financeability of the licensee and safeguarding consumer interests?**

Not at this time.

Many of the key components of the deal, such as the various WACCs, Lower and Higher Regulatory Thresholds, the Availability Incentive Multiplier and target Unit Capacity Factor simply haven't been set at this time. Without knowing what they are, it is impossible to judge how well the licence will balance financeability and consumer interests.

Given the likely cost of SZC will run into £tens of billions, the key commercial terms have the potential to drive huge future consumer benefits - or harm - depending on how they are set. Given that potential, we think that the outline agreement on these terms should be subject to public consultation before any final deal with investors becomes binding, in order to provide the opportunity for its value for money to be rigorously tested.

*CMA appeals*

The Nuclear Energy (Financing) Act 2022 makes provision that a relevant licensee nuclear company's electricity generation licence *may* include provision for it to appeal decisions relating to allowed revenue to the Competition and Markets Authority ('CMA'). The use of 'may' rather than a more definitive word suggests that legislators had not reached firm conclusions on whether an appeal route is necessary or not.

In our view, it would be better if no CMA appeal route is included in the licence.

We can understand why there may be arguments for the inclusion of one. Appeal mechanisms exist for other infrastructure asset providers regulated under the RAB model, such as electricity and gas networks. It may be felt that the absence of an appeal mechanism exposes the project developers to excessive risk that they may have no remedy in the event of an unfair or unreasonable decision by Ofgem, with knock-on adverse implications on the financeability of the project.

There are several reasons why we do not think the proposed appeals mechanism is a good idea.

Firstly, in the way it is framed it is unbalanced (one-directional).

Existing appeal rights for, eg, network price control appeals, allow for appeals by the networks themselves but also by other market participants such as network users and interested third parties. As such, appeals can be on the basis that a regulatory settlement is too harsh, likely to be brought by a network, or that it is too generous, likely to be brought by a network user or interested third party. From a bill-payer perspective, and from the perspective of natural justice, this results in some equality of rights between all affected parties - that Ofgem can be held to account either for being too generous or too harsh. That appeals could result in increased costs for bill-payers, but they could also result in reduced costs.

The licence as drafted does not follow that model, and only allows for the SZC licensee to appeal. Self-evidently, they would only appeal when they consider a licence modification is not in their financial interests. This creates a one-sided situation where the licensee can bank any regulatory errors that are in its favour, while disputing any that are not. That is not in consumers' best interests.

While superficially this problem could be resolved by making appeals rights bi-directional, so other parties could appeal if they thought the regulator had made errors in the licensee's favour, in our view this would not solve the problem. This is because the asset being built is so novel in its nature that the ability of third parties to understand whether costs are being efficiently incurred is likely to be close to nil. It is therefore unlikely that a third party could bring an appeal against inefficient cost overruns.

This issue of lack of third party understanding of efficient construction costs of this type of asset leads on to the second reason why we do not consider that an appeals mechanism of this type is a good idea - that the CMA itself is likely to struggle to adjudicate appeals.

The CMA is an economic regulator. When called on to adjudicate licence appeals, such as those in relation to industry code modifications or price controls, it is usually being asked to assess whether incentives or penalty regimes are reasonable or correctly configured; whether the design of the regulatory framework is appropriate. It is well qualified to do that, and there is a large pool of staff and experts (both internal and external) available to it to allow it to do so. But the appeals envisaged here relate to whether the construction costs of a nuclear power station are being efficiently incurred, not to whether the regulatory framework itself is reasonable. The CMA has no obvious expertise in nuclear construction costs. Given the novel nature of the asset being built, it is hard to know how it could build that expertise to allow it to carry out this function efficiently.

Our third concern with the appeals model is that it may create unhealthy incentives on the licensee to appeal all regulatory decisions that are not in its favour. As previously highlighted, the appeals mechanism as envisaged is one-sided, only allowing for appeals by the licensee for a more generous settlement. The only deterrents to bringing an appeal are therefore costs, the likelihood (or not) of success, and reputational considerations.

Based on public statements, the costs incurred by parties to appeals under the existing licence modification regimes appear to run between the £hundred thousands and the low single-digit £ms - the CMA would be able to give you more information in this area. They are also likely to absorb a significant amount of management time and attention. However, costs of that order of magnitude appear nugatory in the context of a construction cost that will run into tens of £bns. Given the upside-only nature of a one-sided appeals mechanism there may be very strong incentives on the licensee to appeal all determinations that it considers are not in its favour, as the downside of losing (the costs incurred in appealing) may be an order of magnitude lower than the benefits of winning. In our view, an appeals regime that incentivises appeals, and which can only result in the same or higher costs to bill-payers (and never lower costs) is not likely to be in consumers' best interests.

It should be noted that the removal of the CMA appeals mechanism would not prevent the licensee seeking legal redress against a poor regulatory decision (whether real or simply perceived) as judicial review rights would remain. Judicial review would allow for appeal on narrower grounds of procedural unfairness, rather than the merits based appeal process that is typical of existing CMA appeals mechanisms. In our view this would be more prudent, given the inherent difficulties in an appellate body judging efficient nuclear construction costs previously highlighted.

We recognise that the licensee and potential investors may feel very differently about the need for CMA appeals than we do and that the department may come under significant pressure to retain this appeals route in order to unlock financing for SZC. But we ask the department to recognise the risk that asymmetrical appeals rights, in relation to subject matter (nuclear construction costs) that the appeals body is likely to have limited expertise to opine on, present to bill-payers. If the department considers CMA appeals rights to be essential, we urge it to do further thinking on how it can mitigate the risk that it becomes a one-sided bet for project backers at bill-payers expense.

*The Independent Technical Advisor*

**Patron HRH The Princess Royal**

**Chief Executive Clare Moriarty**

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The role of the Independent Technical Adviser ('ITA') will be incredibly important in protecting consumers, and ensuring that only efficiently incurred costs are passed through to bill-payers.

As drafted, the licence appears to provide for the ITA to be both appointed by and paid for by the licensee. It is not clear to us from the wording of the licence whether the licensee's responsibility to appoint the ITA means that it will choose the ITA.

We are comfortable with the ITA being paid for by the licensee. Ultimately the ITA has to be paid for by someone, and insofar as its costs flow back to bill-payers through the licensees allowed revenues, we think this is a price worth paying for third party scrutiny of its costs.

We are not comfortable with the ITA being chosen by the licensee. This would be a clear conflict of interest. We believe the intention of Part A(3) of Special Condition 8 may be to signal that the Authority and Secretary of State ('SoS') may veto a proposed ITA that they consider unsuitable by withholding consent, but that provision is ambiguous and it may be that other interpretations are possible.

For the ITA to be credible they must be - and be seen to be by all stakeholders - genuinely independent of the licensee. The licence should set out a clearer process for ensuring the genuine independence of the ITA. It would be preferable for the ITA to be appointed by (and therefore seen as accountable to) the SoS or Ofgem, not the licensee.

We note that the pool of credible candidates for ITA may be very small, and that many of those best able to understand the costs of SZC may be, or may have been in the past, already associated with the project in some way. It is also possible that appointment as ITA may result in the loss of earnings opportunities for candidates, as, by creating a potential conflict of interest, it may prevent them working with or for the licensee on other projects. This could deter interest in the role. Given these issues, the appointment of the ITA may not be straightforward. We would suggest the licensee is required not to include any restrictive covenants in employee contracts that unreasonably prevent their future employment by the ITA.

The draft licence is silent on whether the recommendations and reporting of the ITA to Ofgem and the Secretary of State will be more widely published. We think that all such materials should be so as a matter of course. While we acknowledge that the ability of a wider audience to understand nuclear construction costs is likely to be very limited, it is nonetheless likely to improve public and stakeholder understanding of the evolution of the project.

### *Differentiation between public and private returns*

SZC will be financed through a combination of public and private capital. The Government is currently the majority shareholder in the project, and has already invested ~£2.5bn in it.<sup>9</sup>

The licence conditions set out how the licensee will receive a commercial return on their investment. But the Government is not a typical commercial investor. Its cost of debt is far lower than the private sector, due to the low risk of sovereign default. Its 'investors' - if they can be seen as that - are the public.

There is a difference in who will pay for the SZC depending on whether costs are attributable to citizens as taxpayers, or as bill-payers. Paying for energy infrastructure through bills rather than taxation is regressive, because it has the effect of pushing more of the costs onto lower income deciles.<sup>10</sup>

As such, we do not think that the Government should be seeking, or should receive, a commercial rate of return on its investments in SZC. It should be simply looking to cover its cost of debt. Any returns above this should be returned to bill-payers.

This should be reflected in the licence condition, or in an equivalently binding commitment from the Government to the public.

## **2) Do the incentives and penalties placed on the project through the modifications support the efficient and timely delivery of the project, ensuring greater value for money for consumers?**

Most of the incentives and penalties placed on the project are still subject to commercial negotiation and it is not possible to reach a judgement on how many risks and efficiencies will be shared based on the licence in its current form.

We recognise that the RAB mechanism intentionally transfers some risks from investors to consumers - that this is considered to be a price worth paying to deliver a lower cost of capital. However it is important to recognise that consumers have no way to manage the risks associated with cost or time overruns. The licensee does, and insofar as possible should bear these risks.

*Need for public consultation on the deal between the Government and the licensee before it becomes binding - and precedent for this in other RAB arrangements*

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<sup>9</sup> ['Further steps to prepare Sizewell C for construction.'](#) Gov.uk, 22 January 2024. .

<sup>10</sup> ['Funding a low carbon energy system.'](#) UKERC, 2018.



When agreement in principle has been reached between the Government and the project developers on the incentive and penalty regime, that agreement should be subject to public consultation before the deal is signed. We recognise that this would be unusual for a government contract, but it is normal practice for a regulated RAB asset. Network price controls are always subject to public consultation at the draft determinations stage. It is important that the Government has stakeholder feedback on the terms of the deal before it goes live, given its materiality.

### *The level of the DWACC*

The draft licence provides for three different Weighted Average Costs of Capital ('WACC') to be applied to the project, depending on what stage it is at, and whether it is delayed. An Initial WACC ('IWACC') will be applied throughout the pre-Post Construction Review phase. This will be replaced by a Real WACC ('RWACC') during the operational period. If construction is delayed it will be replaced by a Delay WACC ('DWACC').

What appears to be a strawman DWACC is included in the draft licence condition sent to named consultees, but redacted in the version published on the gov.uk website. Because of that redaction we will not comment on the precise figure used here, but we note that the basis for the strawman value is not explained and it appears to be a relatively small penalty for a situation that would cause significant consumer harm. It would be useful if DESNZ could set out its thinking behind how it will set this parameter. Given the DWACC will be set at a discount to the IWACC, but the level of the IWACC is as yet unknown, the ability of stakeholders to judge the strength of its incentive effect based on the published materials is currently very limited (although clearly the smaller the IWACC, the greater the incentive effect of a fixed bps reduction will be).

In our view, two points relating to the DWACC would merit further exploration.

The first of these is whether the DWACC should be set at a fixed percentage or should vary according to the duration of the delay. This is because there is greater consumer detriment the longer a delay is. Firstly, because consumers will be paying for an asset that has not been delivered for longer, incurring costs without benefits. Secondly, because its absence will result in knock-on consumer costs. For example, the failure of an extremely large generator to turn up on time will inevitably have implications for how much generation capacity will have to be purchased elsewhere through the capacity mechanism, and may also feed through to higher market prices insofar as it results in the market being materially shorter than it otherwise

would be. It would also delay the UK's pathway to net zero and result in larger greenhouse gas emissions for longer than would have been the case had the plant turned up on time.

Because of these factors, it appears to us that there may be a case for applying a ratchet to the DWACC discount, such that the longer the delay is the greater the penalty is to the licensee. This would provide sharper incentives on the licensee to get the project back on track.

The second area where a change to the model may be merited is to simply set the DWACC at the licensee's cost of debt. There is precedent for this in the RAB model applied to energy networks. Ofgem has said that it tries to set price controls such that poorly performing networks could potentially receive a return that is at or even below the cost of debt.<sup>11</sup>

Setting the DWACC at a level that allows the licensee to cover its cost of debt, but nothing more, should not endanger the financial stability of the project - as it could pay its debts. But by dropping the equity return to zero, it would provide an extremely strong incentive on investors to ensure the project gets back on track as quickly as possible.

The two principles above are not mutually incompatible and could be combined, eg the DWACC discount could be set to escalate the longer delivery is delayed, ultimately simply covering the cost of debt if the project is significantly delayed.

### *The level of the Lower Regulatory Threshold ('LRT')*

The Capex Incentive seeks to incentivise the licensee to manage its capital expenditure during the pre-PCR period by implementing a pain/gain share on allowable capital spend relative to the Lower Regulatory Threshold (LRT) up to the Higher Regulatory Threshold (HRT).

The consultation document sets out that *'The Secretary of State is expected to set the LRT at a point above the target outturn cost'*, but gives no indication of why, what the basis of his or her decision will be, and of how far above the target outturn cost it may be set. By setting the LRT above the target outturn cost the licensee is being given the opportunity to run somewhat over budget without penalty (though by how much will not be known until the LRT will be set).

We question why this should be allowed, as it will significantly dull the incentives on the licensee to bring the project in on budget. Given the strong commercial

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<sup>11</sup> ['RIIO reviews: financeability study.'](#) Imrecon for Ofgem, 2012.

incentives on the licensee to inflate the RAB to receive a higher return, we think the LRT should be set no higher than the target outturn cost.

Given the long term implications to bill payers of the LRT, we think that the Secretary of State should consult on its value before it is set.

#### *The level of the Higher Regulatory Threshold ('HRT')*

The HRT would be triggered in an extreme cost over-run scenario, prompting the Secretary of State to take a decision on whether to either allow further capital spend to be added to the RAB, or to fund further spending from taxpayer money - in essence, to decide whether bill-payers or taxpayers should be on the hook for spending beyond this threshold.

As highlighted earlier in this response, paying for energy infrastructure through bills rather than taxation is regressive, because it has the effect of pushing more of the costs onto lower income deciles.<sup>12</sup> We therefore think the HRT should be set as low as possible.

Given the long term implications to both bill-payers and taxpayers of the HRT, we think that the Secretary of State should consult on its value before it is set.

### **3) Do consultees consider that the operational performance incentives included in the proposed modifications encourage the right behaviours?**

#### *Terms of liquidity support*

Special Condition 56 sets out a mechanism to provide liquidity support to the licensee where a Significant Unavailability Event requires the licensee to buy back power in the market, in order to satisfy the trades it made prior to the outage.

While not explicitly stated, implicitly this should only possibly arise in circumstances where there is an unplanned outage at SZC, as if an outage had been planned the licensee should have traded out its position to reflect an event that is within its control.

That liquidity support is provided in the form of a loan that needs to be subsequently repaid.

This licence condition is complex and hard to follow, but in our reading of it we cannot see any form of penalty to the licensee that is associated with this liquidity

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<sup>12</sup> ['Funding a low carbon energy system.'](#) UKERC, 2018.

bailout. Should there not be one? If consumers are bailing out the licensee, it would appear reasonable that they receive some form of compensation for this. There is a time value to money that the lender (consumers in this case) should be compensated for.

*Billpayers should not be paying for the SZC sales pitch*

The consultation sets out that, through Special Condition 38, *'as part of its Allowed Revenue entitlement, the licensee will receive an annual use it or lose it allowance in respect of social benefits and communications costs'*.

Use it or lose it allowances are generally not conducive to offering consumers value for money as they encourage spending, often without meaningful incentive to ensure that spending is prudent or effective.

Three types of allowable costs are set out as falling under this Special Condition:

- social value and other initiatives incurred in the course of delivering the Project in a manner which promotes environmental and social goals;*
- initiatives to promote the pipeline of available workforce for the Project;*
- costs in respect of PR, advertising or publicity which solely relate to the Project or any initiatives put in place on either of the above two areas.'*

The first two of these appear to be relatively specific, and cover areas where, in principle, it may be reasonable for the licensee to carry out promotional activities. This does not mean that open-ended spend would be justified, and Ofgem will need to tightly manage what costs are allowed here.

However the third appears to be a rather open-ended catch-all, under which any kind of PR, advertising or publicity might be justified provided it relates to the Project (SZC) in some way.

If investors in the project wish to promote its general benefits at their own expense, that is their choice. But in our view, requiring bill-payers to pay for the cost of general project promotion would be unreasonable. It should not be the responsibility of bill-payers to build the licensee's brand.

As it takes over the role of regulator, we would expect Ofgem to set more specific boundaries/expectations on what PR, advertising or publicity money can be spent on to mitigate the risk that this money is used wastefully.

**4) Do the modifications set sufficiently clear expectations and boundaries for how the project company should operate in the market over time, and do the modifications contain sufficient flexibilities to account for future uncertainties in the energy market?**

*The potential for revenues from hydrogen or other sources, and the interactions with the ring-fencing provisions*

Revenue streams for generators are evolving, and likely to evolve further, as the economy decarbonises. In some cases, this will result in changes to how their electricity output is valued and therefore traded, with flexibility in particular likely to become more valuable as a greater proportion of generation on the system is either inflexible, or variable depending on weather conditions (or both). In other cases, major revenue sources that do not relate to electricity sales to the grid may open up.

In the case of SZC, a major potential source of new revenue is hydrogen production. Co-production of hydrogen and power is an explicit aim of the project.<sup>13</sup> The scale and potential revenues of hydrogen co-production are unclear at this time.

Other potential non-electricity revenue streams could include heat. There is also the potential for electricity revenue streams resulting from the use of storage<sup>14</sup> that could be facilitated by SZC's generation output, but where the revenue arising might be attributable to storage assets rather than to the generator itself. These types of revenue streams are speculative, but given the fast changing nature of the market and the long likely lifespan of the asset, not impossible.

We would expect the licensee, and the Government, may wish to explore whether these types of other revenues can be used to improve the investment case for SZC. If these attempts are successful the revenue raised from them is directly relevant to the return on investment that should be allowed for through their electricity generation licence. Put simply, if the licensee is making a significant amount of money from, eg, hydrogen production, this should reduce the amount of money that it needs to, and is allowed to, recover through electricity bills. Failure to implement that principle is likely to result in the over-remuneration of the project.

As this might imply, we think it is important that the licensee's return is based on its total revenues, and not simply those relating to electricity market activities. So it

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<sup>13</sup> [Sizewell C website](#).

<sup>14</sup> Eg by arbitraging the time of power export between periods of low and high power prices.

will be important that Ofgem is able to take into account the evolving revenue streams of the licensee, over the lifetime of the asset. We would welcome reassurance that this is the case under the licence as drafted.

The consultation document sets out the intention of Special Condition 5, 'Ringfencing', to 'limit the ability of the project to conduct activity outside the scope of the regulated activities under the licence' (as well as to promote the ongoing financial resilience of the project). It is not clear to us whether this could form a barrier to some of the activities previously mentioned, such as the production of hydrogen. If it does, this may not be a good outcome for consumers if the revenues produced from such activity could be used to reduce the amount of subsidy that they have to pay for through their electricity bills.

#### **5) Do consultees think that the modifications provide Ofgem sufficient oversight in its capacity as economic regulator of the licensee?**

Ofgem is likely to find its role as economic regulator of the licensee very challenging. It is extremely experienced in the RAB regulation of network assets. These tend to be far less novel, and with a wide range of comparator projects, both past and present, that allow it to effectively benchmark what the efficient costs of a particular type of project are. The recently passed Energy Act 2023 provides for the introduction of competition for the provision of significant new electricity network assets, which should allow for the price discovery of efficient costs through market forces. These types of tools will not be available to it for SZC.

There are few, if any, comparator projects against which Ofgem will have data to attempt to benchmark whether the costs of the SZC build are being efficiently incurred. Arguably HPC may be one, though there are several constraints on how relevant its cost data may be, such as:

- While SZC is expected to be an above ground replica of HPC, the other parts of its construction will differ;
- One would expect efficiencies to result from 'learning through doing' - so efficient costs at SZC may be lower than those manifest at HPC; and
- HPC is materially over-budget and late - it may not be a good example of an efficient build.

Despite these material constraints in how comparable HPC and SZC project costs may be, we think there would be value in Ofgem having access to HPC project cost information in order to help it try and benchmark SZC and understand credible build costs. For all the limitations to how comparable the data is, the regulator

having some comparator data is better than it having none at all. Disclosure of comparator information from the HPC project to Ofgem should be a requirement of the licence, or built into the commercial agreement that the Government reaches with the project developer.

We highlighted earlier in this response that the inclusion of a one-sided appeals mechanism, and natural incentives to appeal given the potential benefits of doing so may dwarf the costs, could hamper the regulator's ability to deliver good outcomes for consumers. We have also highlighted the severe information asymmetry issues constraining its ability to understand the efficient costs of delivering such a complex asset where so little benchmarking information may be available. To complicate matters still further, SZC's scale may mean it is seen to be 'too big to fail', with acute pressure falling on the regulator to ensure that new costs are added to the RAB to allow the project to progress even if it has fallen badly off track. Ofgem is picking up an unenviable role.

With that in mind, while not governed by the licence, it is important to note that Ofgem will need to be appropriately funded and staffed to carry out this complex role. Because the monies involved in the SZC project are so great, the impacts of its decision making on this project will very significantly impact on the wellbeing of current and future consumers. It is important that no corners are cut in funding this regulatory oversight, given how trivial the cost of the regulator is in comparison to the cost of the project. We encourage DESNZ to be mindful of this when reaching future funding settlements for Ofgem.

## **Other issues**

### *Inappropriateness of redactions in the published price control model*

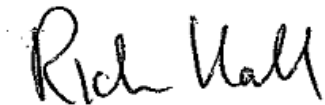
Special Condition 26, 'Price Control Financial Model', Part F and Special Condition 39, 'Cost of Debt Adjustment Building Block', Part F both provide that *'The Authority will publish up to date copies of the Price Control Financial Instruments on the Authority's Website, having first made any redactions that the Authority or the licensee reasonably identify as being necessary to protect commercially sensitive information.'*

We cannot see any scenario in which it would be appropriate for any aspect of the Price Control Financial Instruments to be redacted. This would not be consistent with the approach taken to other RAB regulated assets like energy networks, where the incentives, penalties and revenues of the licensees are known (published).

It should be further borne in mind that under a RAB model, bill payers are essentially investors in the SZC project, whether they like it or not. They should be able to see what they are paying for; this is a matter of basic accountability.

We think that these provisions for redaction should be removed.

Yours sincerely

A handwritten signature in black ink that reads "Rich Hall". The signature is written in a cursive, slightly slanted style.

Richard Hall  
Chief Energy Economist