



Department for  
Energy Security  
& Net Zero

# Regulated Asset Base Licence Consultation

Government Response to the Consultation  
on Modifications to Sizewell C Limited's  
Electricity Generation Licence



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# Introduction

On 6<sup>th</sup> November 2023, the Secretary of State for Energy, Security and Net Zero (hereinafter referred to as “HMG”) launched a consultation seeking views on proposed modifications to Sizewell C Limited’s (SZC) electricity generation licence.

The modifications outlined within the consultation document seek to allow SZC to collect revenue through a Regulated Asset Base (RAB) model and put in place a series of incentives and penalties to drive the efficient construction, commissioning and operation of the project.

The RAB model was established under the Nuclear Energy Financing Act 2022. SZC is intended to be the first project to use the RAB. The licence modifications seek to allow private investors to enter the project, whilst ensuring consumers and taxpayers are protected. By bringing in further investment, the project will be able to benefit from additional knowledge, expertise and commercial focus, supporting cost effective and timely delivery of the project.

To ensure that HMG had considered the appropriate balance of risk, a range of bodies were consulted on the proposed modifications:

- SZC
- Office for Gas and Electricity Markets (Ofgem)
- Citizens Advice
- Consumer Scotland
- Environment Agency (EA)
- Office for Nuclear Regulation (ONR).

We also consulted with EDF in their role as a shareholder in the project and potential new investors in SZC who had progressed through the pre-qualification questionnaire stage of the equity raise. Due to commercial sensitivities surrounding the ongoing equity raise process, the names of potential investors who responded to the consultation have not been specified, nor have the comments of consultees been specifically attributed.

The consultation questions were as follows:

- 1. Do consultees consider that 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?**
- 2. Do consultees consider that the incentives and penalties placed on the project through the modifications will support the efficient and timely delivery of the project, ensuring greater value for money for consumers?**
- 3. Do consultees consider that the operational performance incentives included in the proposed modifications encourage the right behaviours?**
- 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?**

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

Consultees were encouraged to read the consultation document in conjunction with the draft licence published on GOV.UK.

The consultation closed on 29<sup>th</sup> January 2024. A range of views from consultees were received, all of which HMG has considered carefully to help to shape the final licence design. This document summarises the feedback received from consultees and HMG's response to these. This document also sets out next steps for the modification of the licence.

## Summary of Responses

A number of responses to the consultation were received. Respondents included all the statutory consultees as defined in the Nuclear Energy Financing Act:

- SZC Ltd (the “licensee”)
- Ofgem (the “economic regulator”)
- EA
- ONR

Consultation responses were also received from:

- EDF
- Consumer Scotland
- Citizens Advice
- Pre-qualified equity investors

Consumer groups and pre-qualified equity investors were consulted to ensure that HMG was able to obtain feedback on consumer interests and financeability, which could promote long-term benefits for consumers through improved project delivery. Due to commercial sensitivities surrounding the ongoing equity raise process, names of pre-qualified investors who responded to the consultation have not been included throughout this document, nor have any details that could jeopardise their anonymity or the competitive nature of the equity raise.

HMG also received a response from the Stop Sizewell C campaign. Given they are not a statutory consultee, and the other consultees provided input on relevant points, HMG has not included any specific responses as to the points which they raised.

The responses to the consultation were varied and provided a wide range of views. These have been considered carefully and will shape the final licence modifications.

While this consultation did not seek views on the decision to finance the SZC project through the RAB model, the responses were broadly supportive of the use of a RAB, as well as the

specific modifications proposed. Further feedback focused on the risk allocation, the incentives and penalties structure, and how the company should operate within the market. Some responses also discussed the role of Ofgem.

General feedback from consultees included:

- The need for transparency and engagement with consumers ahead of the final licence modifications. It is for this reason we have published this consultation response ahead of final modification of the RAB Licence. As committed to during the passage of the Nuclear Energy (Financing) Act, HMG intends to publish a value for money assessment at the point of any Final Investment Decision.
- HMG also launched a further consultation on 18<sup>th</sup> March 2024 in relation to the Cost of Debt Adjustment (CDA), the methodology in setting the Initial Weighted Average Cost of Capital (IWACC), and Lower Regulatory and Higher Regulatory Thresholds (LRT and HRT).

Suggestions for minor amendments to terminology within the licence drafting for clarity were also included. HMG has considered these changes and will reflect those it considers appropriate in the revised draft.

Where consultees provided comments on Ofgem's Economic Guidance, these have not been considered as part of our response as they were outside the scope of the consultation. However, we have shared this feedback with Ofgem for their consideration.

HMG remains committed to striking a fair deal. When exercising the power under subsection 6 (1) of the Nuclear Energy (Financing) Act, the Secretary of State must have regard to:

- the duties of the Secretary of State under sections 1 and 4(1)(b) of the Climate Change Act 2008 (carbon targets and budgets);
- the interests of existing and future consumers of electricity, including their interests in relation to the cost and security of supply of electricity;
- costs, expenditure or liabilities of any description that the nuclear company may reasonably be expected to incur in carrying out its activities;
- the need to secure that the nuclear company is able to finance its activities;
- the need to secure that the nuclear company has appropriate incentives in relation to the carrying out of its activities; f) such other matters as the Secretary of State considers appropriate.

HMG has had regard to each of these factors as it has considered the consultation responses.

## Question 1

**Do consultees consider that 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?**

### General summary of responses

We welcome the comments surrounding the indicative balance of risk set out within the draft licence, and the policy aims and objectives behind each proposed modification.

Some consultees agreed that the proposed modifications strike a reasonable balance between supporting financeability and safeguarding consumer interests. HMG will continue to work closely with all parties to ensure that consumer interests are recognised throughout the implementation of the proposed modifications.

Other consultees responded to this question by highlighting the challenge in making a conclusive assessment of the risk balance at this point given some information, such as the monetary values of the Higher Regulatory and Lower Regulatory Thresholds (LRT/HRT), is yet to be finalised.

As set out in the summary of responses section, there are number of actions we are considering to ensure that the modifications to the licence are completed in a transparent manner. HMG assessed it would be unhelpful to prejudge numbers whilst due diligence and assurance processes remain ongoing and, in some cases, a final decision has not yet been taken on the methodological approach for setting the relevant figures. As highlighted previously, there is ongoing consultation on this methodology.

The remaining responses to this question were varied, with most responses calling for further clarity on the definitions of the proposed modifications and providing specific feedback on certain licence conditions.

Specific matters raised by consultees and HMG's response to them is set out below.

### Licence Revocation

Within the consultation document, HMG provided a summary of the proposal for Special Condition 12 (Revocation). The special condition set out the limited circumstances in which, and the procedure by which, Ofgem can revoke the special conditions, in whole or in part. At the time of revocation, if there is a shortfall in the Funded Decommissioning Programme (FDP) fund, Ofgem may only partially revoke the licence. The licence will only be fully revoked when a pre-agreed sum of money, which is sized to meet the FDP shortfall outstanding, has been funded by consumers.

One consultee raised concerns regarding a scenario where the plant closes earlier than the expected life horizon, which could lead to a partial revocation of the licence if there were a shortfall in the FDP fund. The consultee's concerns were centred around the cost implications of a partial revocation scenario on consumers and whether it is appropriate for consumers to continue to contribute towards the decommissioning fund for SZC if the plant was no longer operational.



## **HMG Response**

HMG acknowledges the consultee's concerns regarding the implications of a shortfall in the decommissioning fund on consumers. Recognising the importance of managing this risk, shortfalls in the decommissioning fund are already mitigated in a number of ways through the proposed structure. The current approach allows for full funding prior to the end of the expected asset life to ensure that decommissioning fund payments can always be made by the licensee, even if the plant is in outage or special administration.

Recognising that HMG has duties to protect the interests of consumers, the structure has been carefully designed to allow the Secretary of State to consider whether any shortfall should be funded by consumers or taxpayers at the relevant time. The licence modifications therefore allow the Secretary of State to direct Ofgem that it should not partially revoke the licence, but fully revoke the licence and, in such case, any shortfall would be funded through the Government Support Package. This approach remains consistent with Ministers commitment to Parliament during the passage of the Nuclear Energy (Financing) Act, that taxpayer exposure to risks associated with decommissioning must remain highly remote.

## **Tax Allowance Adjustment**

As part of special conditions 33 and 49 (Tax Building Blocks during the pre-Price Control Review (PCR) and Operations phase respectively), the licence sets out the mechanism by which tax adjustments may be applied to the Allowed Revenue as determined by Ofgem.

Some consultees requested greater clarity within the definition and calculation of the Tax Allowance Adjustment and the implications of this on the licensee in the case an adjustment was to be made. In particular, some consultees sought greater clarity on definitions and timings. Consultees also requested that a mechanism is introduced whereby a review of true-up of tax can be requested if the licensee becomes aware of any material divergence between notional calculations and actual tax amounts.

## **HMG Response**

HMG has considered consultee feedback. The current approach is in line with the position adopted by Ofgem for other companies it regulates and no compelling justification has been presented for departing from this approach for the nuclear RAB.

## **Allowable Spend**

The draft licence sets out the definitions of Allowable Spend and how they are to be calculated in each relevant charging year. The licence provides for three key categories of allowable spend: (i) Allowable Capital Spend; (ii) Allowable Operational Spend; and (iii) Social Benefits and Communications Cost spend. Allowable Capital Spend is logged to the RAB, whereas Allowable Operational Spend and Social Benefits and Communications Cost spend form part of the licensee's annual Allowed Revenue entitlement.

Some consultees argued that the current definitions of allowable spend do not provide sufficient clarity, and have instead advocated for a broad definition of allowable project costs which encompasses all the different categories of spend. They also argue in favour of tighter definitions of excluded costs to give investors greater certainty over costs they may be required to bear.

One consultee called for all project costs, unless spend is improperly incurred, to be classed as 'allowable' for the purposes of clarity to investors and to ensure that undue delay relating from

the time taken to agree costs does not negatively impact on consumer bills. Some consultees raised concerns about the requirement for expenditure to be incurred 'directly' in connection with the project.

### **HMG Response**

HMG acknowledges the feedback from consultees and has further reflected on the approach to defining allowable spend. Overall, HMG considers that the current definitions achieve its policy objectives to ensure that the licensee can recover any spend that is incurred in the delivery of the project, subject to defined categories of Excluded Project Spend, and ensure that costs of an operational nature are compensated through the licensee's fast money allowance. It also continues to consider a distinct allowance for Social Benefits and Communications Costs as important. The approach to this is set out below.

Whilst HMG is content that the overarching construct for allowable spend remains suitable, it considers that some enhancements may be made to deliver greater certainty the licensee and investors as to the costs that would be treated as allowable. In particular, HMG is minded to amend the definition of Allowable Capital Spend to tie this to "expenditure incurred or to be incurred by the licensee in connection with the Project (as described in the Project Specification) during the Pre-PCR Phase, other than any Excluded Capital Spend." The Project Specification will be incorporated as part of the licence.

The Secretary of State is also minded to refine the categories of Allowable Operational Spend, including to clarify its scope.

The definitions of Excluded Capital Spend and Excluded Operational Spend have been considered in detail and HMG is not persuaded that any changes to these definitions are required.

### **Yield Cap**

The proposed licence modifications include a Yield Cap which would apply from Licence Modification until the Commercial Operating Date (COD) is achieved. The Yield Cap would ratchet down in the event of delays beyond Scheduled COD, ultimately leading to a distribution block after a specified period of delay. The purpose of the yield cap is to incentivise the delivery of the project to schedule in order to avoid any undue delays which could impact on consumers.

Several consultees queried the proposed level of, and methodology for setting, the Yield Cap. Consultees suggested it should be set in line with other RAB assets to ensure the project remains investable. Some consultees argued that the proposed Yield Cap definition could adversely impact the financeability of the project if it was not set at a market level. Others commented on the importance of ensuring robust incentives on timely completion. One consultee suggested that no Yield Cap should be included in the licence.

### **HMG Response**

HMG notes the comments made by consultees. In developing the approach to the Yield Cap, HMG has sought to take into account both the specific issues associated with a nuclear asset and the wider regulatory structure. This includes other incentives placed on the licensee.

In light of the feedback received from consultees, HMG continues to believe that it is in consumers' interest to have a Yield Cap. However, HMG has decided to review the level of the Yield Cap to ensure it is set at a level commensurate with current macro-economic conditions

and the nature of the RAB asset. HMG is also minded to clarify the mechanism by which the Yield Cap will operate. It will also continue to be applied on a downward ratchet basis in order to strengthen the schedule incentive and prevent additional costs to consumers resulting from schedule delays. The yield cap will fall away once COD has been achieved.

In reaching a decision to amend the yield cap, HMG has taken into account comments received from consultees in respect of the incentive effect of this mechanism, as well as the impact on the cost of equity and therefore the impact on consumers.

### Allowed Revenue Floor

The Operational Incentives Adjustment effectively provides the licensee with an Allowed Revenue floor on the minimum revenue it will be entitled to receive in a given year, subject to the Revenue Support Cap. Revenue support provided through the revenue floor is repayable by the licensee in future years in accordance with the terms of the licence.

One consultee raised concerns with the revenue floor, specifying that the effectiveness of the revenue floor will depend on the level at which it is set. The consultee put forward a series of recommendations for the revenue floor, including that it should be set at a level that is sufficient to cover all operating costs while allowing enough headroom to service debt. The consultee also recommended that any adjustments to the revenue floor should be appealable to the Competition and Markets Authority (CMA).

### HMG Response

HMG has considered the feedback on the Allowed Revenue Floor. HMG is content that the licence is appropriately calibrated between consumer interests and financeability. HMG is further satisfied that sufficient mechanisms are already in place for the licensee to be able to appeal to the CMA where appropriate. Further detail on this issue is considered below.

### Revenue Support Cap

The draft licence sets out the definition and calculation of the revenue support cap. The purpose of this is to set a limit on the aggregate amount of liquidity support the licensee can have outstanding for repayment at any given time.

Some consultees suggested that the revenue support cap creates a risk that the licensee would not have access to sufficient revenue support in the event that significant unplanned outages or extreme spikes in electricity prices are felt by the licensee in multiple consecutive years. Some consultees recommended that the revenue support cap be removed in order to avoid this risk.

### HMG Response

HMG has considered the concerns raised by consultees, but considers that the proposed approach to the revenue support arrangements strikes the right balance between the need to ensure the licensee has sufficient liquidity to fund its regulated activities, whilst also setting a limit on consumers maximum exposure.

The revenue support cap is sized by reference to 50% of the licensee's allowed revenue over a rolling three-year period. Whilst there are some extreme risks that might not be fully covered by

this support, HMG believes these scenarios are appropriately remote. It has considered data which indicates that the probability of a prolonged double unit outage is very low. HMG consider the cap is suitably calibrated, taking account of the licensee's ability to repay outstanding revenue support amounts.

### Relevant Change in Circumstance (RCC)

The licence includes a Relevant Change in Circumstance (RCC) reopener during the Pre-PCR Phase. The details of this reopener are set out in the draft licence modifications but, at a high level, the two key triggers for an RCC are: (i) a qualifying change in law or regulation or (ii) an unforeseen pandemic which is officially recognised by the World Health Organisation or otherwise results in Government ordered restrictions. An RCC would only apply where the relevant event results in a change to capex or opex costs or savings which is more than a de minimis threshold.

The effect of an RCC would be to adjust the LRT and HRT, mitigating the risk of specified events which are outside the licensee's control. HMG's position in the consultation was that an RCC which results in an increase to the LRT and HRT could only be implemented with the licensee's consent, but that Ofgem would be able to trigger a downwards RCC without the licensee's consent. Some consultees commented on the need for more certainty as to when an RCC could be implemented.

Some consultees also raised specific issues about the potential impact upon investability and financeability of the RCC position proposed. Some were particularly concerned with the drafting in the current licence with regards to factors outside of the licensee's control, arguing that it places an inappropriate level of risk with the licensee for factors resulting from an RCC Trigger Event.

One consultee proposed an amendment to the RCC process to enable the licensee to notify Ofgem of any RCC trigger event, and to broaden the definition of the RCC HRT Adjustment to include more areas, such as Force Majeure events.

One consultee argued that an RCC should not result in an increase to the HRT. Another called for a maximum cap on equity at the HRT level at the time of revenue commencement, arguing that RCC and inflation could increase equity requirements, placing unnecessary financial risk with equity investors.

### HMG Response

In light of responses from consultees, HMG has decided to amend the consent right in respect of an RCC alteration of the HRT and the LRT, so that licensee consent is required for all RCCs that would result in a change to either threshold level, not just in relation to a threshold increase. This change recognises the importance of providing a level of certainty and control around the LRT and HRT thresholds. However, it is noted that if no change to the thresholds is either sought or granted, the capex incentive would still apply and consumers would not be exposed to an increase in costs.

HMG has decided not to make amendments to the proposed approach to HRT adjustments, noting the importance of the LRT and HRT moving together in order to preserve the scope of the capex incentive which is an important consumer protection..

## Performance Incentives and Buyback

HMG recognises the importance of using incentive mechanisms in the regulatory regime to promote and reward the correct behaviours and drive strong performance. HMG consulted with the view that the suite of performance incentives, in particular the availability incentive, aligned well with areas within the licensee's control, and were appropriately calibrated to drive the desired behaviours. While some incentives are relatively simple and symmetrical, others such as the availability incentive require greater complexity to ensure appropriate outcomes for both the licensee and consumers. Furthermore, they fed back that the measurement of actual unit capacity factor should exclude outages for events outside the licensee's control to lessen the risk profile.

With regards to capex incentives, some consultees recommended that these should be constructed on a different pain/gain share basis, with consumers bearing more risk. More generally, some consultees recommended that the availability incentive should result in a pro-rata percentage uplift in the allowed revenue based on overperformance, arguing that this would provide symmetry with the downside penalty for unavailability.

One consultee provided feedback on buyback, expressing their concern about the financial implications upon the licensee during an unplanned outage scenario. Similarly, another consultee also expressed their concerns with buyback and the associated exposure of the licensee to market risk under the current drafting, calling for buyback and the Market Price Incentive to be removed in lieu of the existing availability incentive.

On the Market Price Adjustment mechanism, one consultee called for greater flexibility to change the Baseload Market Reference Price (BMRP) pre-COD and that it should be calculated in the same way as is done under the Contract for Difference (CfD) model. Another consultee suggested the Market Price Adjustment should be removed entirely.

Some consultees suggested that, to support the financeability of the project, there should also be an accelerated depreciation profile during the pre-PCR phase without discretion for Ofgem to change this approach. Additionally, parties raised their concerns with regards to liquidity support. One consultee called for amendments to the licence condition to allow for liquidity support during unplanned outages, to assist with the costs of power buyback from the pre-PCR to COD period. Another argued that liquidity support should be made available from COD, not the first PCR determination.

## HMG Response

HMG fully acknowledges all the responses and, as detailed already, has carefully considered how amendments to the definitions of certain conditions may be made to clarify their intention and the parameters within which all stakeholders will interact with the licence.

HMG has decided not to make amendments to any of the performance incentives outlined in this section. The position included in the draft licence represents work to model a fair allocation of risk. HMG has decided to make changes to other performance incentives, including the curtailment element of the Availability Incentive and the Through Life Capacity Incentive, as detailed elsewhere in this document.

The principle of the proposed pain/gain share is the basis on which the capex and opex incentives have been designed, whilst other incentives, such as the Market Price Incentive and Totex Incentive, are subject to their own cap and floor. The incentives have been designed to balance securing the appropriate incentives on the licensee to manage its expenditure and

trade and perform efficiently, whilst also seeking to ensure that the impact of incentives is appropriately bounded such that investability is not undermined.

Whilst most incentives in the licence are designed to operate on a purely symmetrical basis, the Availability Incentive has deliberately been designed to appropriately reflect the benefit of outperformance on availability to both the licensee and consumers, ensuring that the company is properly incentivised to minimise outages. When designing the incentive, HMG has taken into consideration that Allowed Revenue covers all company costs and that the availability target is reset by the Authority at the PCR and each subsequent periodic review. HMG considers it remains appropriate for any availability upside to be calibrated by reference to the additional revenues generated by the licensee and it would not be appropriate for consumers to pay additional upside above the actual market revenues generated. The impact of the downside penalty should all be considered in light of other features of the structure. In particular, the revenue support mechanisms which help support the licensee's solvency following significant unavailability events and the revenue floor which has the impact of smoothing the impact of the penalty over time.

In respect of the BMRP, HMG notes that the licence already includes flexibility for Ofgem to select a different reference price at future periodic reviews. Were Ofgem to make a change to the reference price, this would constitute a licence modification which may be appealable before the CMA. HMG further considered the call to remove the Market Price Adjustment from the licence. On balance, HMG considers that this incentive is appropriate in the context of the policy objectives to boost baseload power and to ensure that the licensee is appropriately incentivised to maximise its revenues from the market, reducing the overall cost to consumers.

On buyback, HMG is not minded to make any changes. This is based on the general principle that electricity generators ordinarily manage this risk and that other generators take the risk of balancing the system should their generating plant be in an unplanned outage. Given the licence provides liquidity support in these scenarios, it is appropriate for the licensee to hold the remaining risk.

HMG is not minded to make any changes to the RAB Licence in respect of depreciation profile, as this is primarily a matter for Ofgem in its Economic Guidance. Whilst an accelerated depreciation profile may be appropriate in some circumstances, this would need to be considered by Ofgem in the round at the time, having regard to its statutory duties. Consultees should refer to the Economic Guidance for further details on how Ofgem may exercise this discretion, including the factors it would take into account when determining the appropriate depreciation profile.

Following further consideration on liquidity support, HMG recognises the challenges that the licensee may face in accurately forecasting its market revenues during the period from COD to the PCR. As such, it is minded to amend Special Condition 25 to defer the licensee's obligation to forecast its market revenue for the purposes of setting difference payments until the Operations Phase. HMG is still considering the mechanism for securing that market revenues received by the company are adequately protected prior to the reconciliations being effected and relevant protections will be included in the final licence modifications.

## Question 2

**Do consultees consider that the incentives and penalties placed on the project through the modifications will support the efficient and timely delivery of the project, ensuring greater value for money for consumers?**

### General summary of responses

Overall, consultees were broadly in agreement that the incentives and penalties detailed within the proposed licence modifications could support the efficient and timely delivery of the project.

There were contrasting opinions from consultees on different aspects of the licence. Some consultees fed back that the incentives and penalties placed too much risk with the licensee and that further incentive support or more lenient penalties would better support the efficient delivery of the project. Others argued that some of the penalties and incentives would need to go further to be wholly effective. One consultee noted that considerations should be given to the potential costs that would be incurred as a result of underperformance and for HMG to ensure that there are sufficient safeguards in place to avoid consumers bearing these.

The below paragraphs focus on specific areas of concern raised by consultees and HMG's response.

### Excluded Capital Spend

Excluded Capital Spend is spend not directly attributed to the successful delivery or operation of the project and therefore is not considered Allowable Capital Spend under the RAB.

One consultee argued that the current definition of Excluded Capital Spend could adversely impact the dynamic contract management required for the project. This could inadvertently delay the efficient and timely delivery of the plant's construction if procurement of contracts is delayed due to unnecessary verification and pre-approval steps.

### HMG Response

HMG recognises the complexity of the construction contracting, but is of the view that the current proposed approach is sufficiently flexible. HMG believe that the proposed change by the consultee is unnecessary and cuts across other limbs of the licence condition. The categories of Excluded Capital Spend have been specifically crafted as a safeguard against improper spend being logged to the RAB.

### Capacity Incentives

The capacity incentives are designed to incentivise successful delivery of the plant in a proportionate way. SZC can either be rewarded or penalised depending on the actual capacity of the plant once constructed, subject to an overall cap and floor.

Several consultees commented upon the Capacity Incentives. One argued that the current drafting rewards the licensee too heavily. Another was content that the condition will incentivise the correct behaviours from SZC, both to meet the performance target for delivery in the pre-PCR period and to improve capacity from COD to PCR determination. However, they also called for the licence to contain greater protections in relation to the incentive to avoid the licensee from being penalised due to an event outside of its control.

Some consultees argued that it is not appropriate for investors to bear the risks associated with the Capacity Incentive. One consultee suggested that these sit best with the technology provider during the PCR phase.

### **HMG Response**

Having given further consideration to the approach to capacity incentives, HMG is not minded to adjust the core mechanics or the allocation of risk, given its role in ensuring consumers benefit. HMG is content the current approach strikes a suitable balance between incentivising the licensee to optimise capacity and not unduly exposing the licensee to penalties.

A key feature of this incentive is the ability to make adjustments to reflect capacity degradation or improvements over time. This means that the licensee will both have an ongoing incentive to optimise capacity and the ability to recover RAB deductions which might have been made in the past. This incentive is subject to an overall cap and floor, set by reference to a proportion of the RAB value as at the PCR, which ensures suitable bounding.

### **Delay Weighted Average Cost of Capital (DWACC)**

To incentivise the company to deliver the project to time, HMG proposed a DWACC in instances of delay from scheduled COD.

Some consultees raised concerns about the disproportionate impact of long delays on consumers, recommending that HMG considers a tiered approach to delay penalties with higher penalties for longer delays. Other consultees argued that the current proposed DWACC was inappropriate given the risk profile of the asset, calling for penalties to increase based on the period of delay, with minimal penalties in the immediate term subject to incremental increases over time.

One consultee suggested the DWACC should be calibrated to cover the licensee's cost of debt but nothing more. There was also a call for further clarity as to how the proposed DWACC had been calculated.

### **HMG Response**

In light of the feedback from consultees, particularly on the risk to consumers relating to the proposed drafting of the DWACC, HMG has decided to introduce a tiered approach to delay penalties and staggered incremental increases to the DWACC penalties. This ratcheting mechanism will also include a grace period until the second anniversary of scheduled COD, after which point the DWACC would reduce incrementally over a set period until scheduled COD is achieved. This change builds on the responses made to this consultation from those consultees advocating for increasing penalties based on the period of delay.

It is recognised that the DWACC is one of multiple licence features which is aimed at incentivising timely delivery. This was taken into account when designing this new mechanism. This has led HMG to conclude that it is not necessary to apply the DWACC from the first point of delay, noting that other delay incentives, such as the yield cap, continue to impact the licensee.

### **Regulated Weighted Average Cost of Capital (RWACC)**

The draft licence sets out the definition of RWACC, and details how the RWACC will be determined by Ofgem at the PCR determination and every subsequent Periodic Review (PR) determination.



On the RWACC, some consultees claimed that the relative levels of RWACC and Initial Weighted Average Cost of Capital (IWACC) should be balanced to ensure fairness between current and future consumers and investors. This could avoid the risk of unintentionally incentivising potential investors to withdraw their stake in the early stages of the project, which could have consequences on value for money for consumers.

Some consultees also fed back that further information was required on how the RWACC would be set and the level to be determined by Ofgem, alongside notional gearing.

### **HMG Response**

HMG has considered feedback on these points. Noting that the IWACC and RWACC are intended to be distinct. The IWACC will be set by the Secretary of State in accordance with the methodology which is separately being consulted on at present, whereas, the RWACC falls to be determined by Ofgem as regulator (at the Post Construction Review and each subsequent periodic review) in the Operations Phase. As such, HMG is not minded to make any changes to the definition.

### **Operational Expenditure (Opex)**

Opex is one component of the licensee's Allowed Revenue during the Pre-PCR Phase. It allows the licensee to receive fast money, rather than the expenditure being capitalised to the RAB and compensated over time. The licensee's allowance in respect of allowable operational spend during the Pre-PCR phase will be set by the Secretary of State at revenue commencement and will be paid subject to a 50/50 sharing mechanism with consumers for cost overruns and underruns. The Opex allowance set at revenue commencement will be subject to a reopener, around the time of mechanical completion of Unit 1, where there is material change from the Opex costs assumed at revenue commencement.

One consultee raised concerns with the lack of flexibility surrounding Opex reopeners. They argued that it would be prudent to allow greater flexibility to adjust the Opex allowance once the licensee has a better idea of the pre-PCR operating costs, rather than the estimates made at revenue commencement. They suggested this will better incentivise shareholders, supporting the efficient and timely delivery of the project. They also believed it would prevent the project being hindered by an inaccurate allowance during the pre-PCR phase, a sentiment also echoed by other consultees.

### **HMG Response**

HMG notes the concern raised by consultees in respect of the uncertainty of operational expenditure. However, HMG notes that one significant element of opex is expected to be the licensee's fuel costs. For this reason, the re-opener has been set shortly prior to the time the licensee is expected to incur material fuel costs. Variations from the opex allowance are further mitigated through sharing of cost overruns and underruns. For these reasons, HMG is content that the position set out in the consultation draft should be retained.

Further consideration is being given to refining the categories of Allowable Opex. In this regard, HMG is minded to amend the definition of Allowable Opex to clarify which costs will be treated as Allowable Operational Spend and which will be treated as Allowable Capital Spend. In considering these detailed definitions, HMG is reflecting on the balance of reducing the impact on consumers over the lifecycle of the project versus intergenerational fairness.

## Applications for Extensions to Scheduled COD

The proposed licence sets out the parameters within which the licensee can apply for an extension to Scheduled COD and under which circumstances.

One consultee argued that the current timings surrounding reporting and information requirements surrounding Applications for Extensions to Scheduled COD could result in delays that could ultimately penalise investors in the event of unagreed delays. They therefore suggested that the process for determining an extension to Scheduled COD be simplified with the licence, specifying that timelines should be as brief as possible.

### **HMG Response**

HMG has considered feedback on the reporting requirements. HMG felt that the licence gave enough time to the licensee to submit their application. HMG recognises that the process following an application is necessarily an iterative one, and the timescales need to recognise that some extensions of time claim may be complex and require time to assess in full. For straightforward claims, it is possible that they will be completed in a shorter time than the licence allows.

## Force Majeure

The proposed licence set out the circumstances or events which would be classified as Force Majeure.

One consultee expressed concerns that the current proposed definitions of Force Majeure and the defined list of Force Majeure events do not include potential events outside of their control as licensee. They called for a broader, non-exhaustive list of potential Force Majeure events to better support them in acquiring an extension to scheduled COD if required due to events outside of their control. Some consultees point to precedents such as Hinkley Point C in support of the argument for a non-exhaustive definition of force majeure.

One consultee noted concerns that the definition of Force Majeure event is expressly tied to an event or circumstance beyond the reasonable control of the licensee which directly causes the licensee to be unable to comply with all or a substantial part of the licensee's Regulated Activities, rather than simply relating to a delay in reaching COD by the relevant date.

### **HMG Response**

HMG has carefully considered the comments surrounding changing the definition of Force Majeure. HMG has decided to retain an exhaustive definition of Force Majeure Events. An exhaustive list will ensure that Ofgem has greater certainty over the circumstances in which an extension of time claim may be brought. To deliver this certainty whilst also ensuring the licensee is protected from events outside its control, the list of force majeure events has been broadly cast including to recognise specific areas where the licensee has identified concerns.

Whilst consultees have pointed to different precedent positions, HMG considers that these precedents are not appropriate comparators. For instance, Hinkley Point C is not supported by a RAB model and instead has a CfD. As that project does not receive any revenue during construction, this means that the impact of delays to COD would be felt differently.

However, HMG has decided to revise the reference to “the event or circumstance directly causes the licensee to be unable to comply with all or a substantial part of the licensee’s Regulated Activities” to instead refer to “the event or circumstance causes the licensee to be

unable to attain COD by the Scheduled COD or the Longstop Date". This is consistent with the impact of Force Majeure on the delays to Scheduled COD.

### Cost of Debt Adjustment (CDA)

The purpose of the CDA building block is to: (i) protect the licensee from deviations during the Pre-PCR Phase between the actual cost of debt and the Cost of Debt assumed in the IWACC due to changes in the market cost of debt; and (ii) to incentivise SZC to manage its debt costs and raise any Private Debt efficiently.

One consultee noted that the CDA mechanism would be a useful incentive to support efficient and timely delivery of the project. They called for further clarification on when the Cost of Debt Adjustment mechanism will come into effect and further information on how it will be calculated.

### HMG Response

HMG notes the feedback in relation to the CDA mechanism and would refer to the ongoing consultation on CDA methodology. HMG welcomes further feedback through this process.

### Social Benefits and Communications Allowance

As part of its Allowed Revenue entitlement, the licensee will receive an annual, use it or lose it allowance, set prior to licence modification, in respect of social benefits and communications costs. Allowable Social Benefits and Communications costs may include costs in respect of:

- 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.

One consultee raised concerns regarding the Social Benefits and Communications Allowance definition. They argued that the current definition requires clarification of the types of activities that would be covered under the allowance, in order to effectively deliver on the project's aims for social benefit and communications costs. They suggested that the allowance could either be absorbed as part of the project's broader allowable costs, or the definition of the allowance should be broadened to allow the project to deliver further benefits that support wider HMG policy objectives. They suggested there should be flexibility for how the allowance is set over a three-year period, allowing roll-over of funds and opportunity for longer-term forecasting of costs.

Another consultee expressed their concerns with the Social Benefits and Communications allowance and whether it would encourage the right behaviours. They noted that the 'use it or lose it' allowance incentivises spending without meaningful controls to ensure spending is prudent or effective, and therefore does not provide value for money for consumers.

### HMG Response

HMG is not minded to amend the definition of the allowance. HMG is content that the wording included within the licence strikes the correct balance between allowing the licensee sufficient

flexibility on social benefits and communications spend whilst ensuring that this spend is commensurate with the aims of the allowance and will allow monitoring by the regulator.

HMG considers the choice of an annual 'use it or lose it' allowance appropriate in the context of spend which relates to investments which may or may not be required in future.

HMG is working closely with both the licensee and Ofgem to determine an appropriate figure for the allowance and ensure there are stringent plans and strategies in place to maintain oversight post FID. This will include oversight of spending plans through the company's own corporate governance; the company's Accounting Officer oversight of spending through their obligations to Parliament; and through the audit rights of the regulator for spend against the allowance.

### Question 3

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

##### General summary of responses

Overall, consultees were mostly in agreement that the operational incentives included within the proposed modifications encouraged the right behaviours. This includes incentivising the licensee to maximise availability, maintain and optimise plant capacity, spend efficiently and optimise the price achieved for power sales. Some consultees argued that the incentive package framework could be simplified to avoid building unnecessary complexity into the revenue mechanics.

Consultees broadly agreed that the framework for operational performance incentives can protect consumers. One expressed their agreement with the approach that related decisions are deferred until the post-PCR period, where Ofgem will act as the regulatory authority. They suggested that HMG should consider how it will ensure sufficient technical expertise and resource is available to consumer representatives during the operational phase and consider ringfencing of the licensee's trading energy market.

The below paragraphs focus on specific areas of concern raised by consultees and HMG's response.

##### Availability Incentive

The purpose of the Availability Incentive is to incentivise the licensee to operate and maintain the Plant to ensure it remains fully operational at the optimum level so consumers can benefit from the electricity generated.

Several consultees reflected on the Availability Incentive in response to this question. One welcomed the emphasis that the Availability incentive placed around safety. One noted that the licence should encourage the licensee to focus on social and environmental sustainability, alongside the economic priorities of the project. Other consultees noted that the licensee should not be penalised as a result of the operational performance incentives for events which are outside of their control, as highlighted in responses to previous questions.

One consultee noted that unavailability due to a change in law or regulation, or a Force Majeure event, should not be captured within the Availability incentive, due to this being outside of the licensee's control. They further suggested that where Actual Capacity falls below the Minimum Performance Target it would be unfair for SZC to be penalised twice, instead suggesting that the condition be amended to set Rated Capacity at Actual Capacity. One consultee also proposed that the definition of Curtailment should be widened to provide protection against Transmission System outage.

A consultee also raised their concerns that, under the current proposed operational incentives framework, the licensee would not fully benefit from outperformance, whilst being fully penalised for underperformance. They suggested that to further incentivise the right behaviours, both over and underperformance should be calculated as a percentage of Base Revenue plus tax, as opposed to the separate approach defined within the current draft licence. Another consultee expressed similar concerns, suggesting amendments to the availability incentive to ensure that the licensee was not penalised for unplanned outages outside of their control. This would involve implementing a 50/50 pain/gain share for performance as specified within their response to Question 1.

### **HMG Response**

HMG has carefully considered the points raised by consultees. In light of the feedback received, HMG has decided to adjust the revenue support and availability incentive regimes to simplify the structure, whilst broadly maintaining the proposed risk allocation between the licensee and consumers. Further information is included in the below section on Outage Support. HMG considers it appropriate that the licensee is strongly incentivised to maximise plant availability in order to achieve value for money for consumers.

Following feedback from consultees, HMG has decided to amend the definition of Curtailment to remove certain carve outs. This will ensure that, where the plant is unavailable due to a black start or emergency de-energisation, it would not be treated as unavailable for the purposes of the Availability incentive.

### **Totex Incentive**

During the operations phase, Ofgem will apply a 'Totex' approach for all capital and operational expenditure. Ofgem will determine the Annual Totex Allowance and the Totex Capitalisation Rate at the PCR and thereafter at each PR. The Totex Building Block provides for the fast money portion of the actual Totex spend to be added to the Allowed Revenue, subject to a painshare/gainshare incentive on the variance between the Totex allowance set by Ofgem and the licensee's actual Totex spend within the price control period. This incentive is subject to a cap and floor, when considered alongside the Market Price Incentive (i.e. the ODI Incentive Cap and Floor).

One consultee called for greater clarity on the Totex Incentive definitions, including simplified and clearer definitions of the ODI Incentive Cap and ODI Incentive Floor.

Other feedback included calls for the Totex Allowance to be able to be adjusted in the case of a material operational expenditure requirement and for an adjustment can be applied if costs unexpectedly increase for reasons other than a Significant Unavailability Event. Feedback also emphasised the need for the Totex allowance to clarify whether the costs of meeting all safety and environmental requirements are included within the allowance, rather than being limited to safety critical costs.

## **HMG Response**

HMG is mindful of the need to limit reopeners to where necessary and are not persuaded that further Totex reopeners are justified. The reopener in respect of material capex requirements as a result of a Significant Unavailability Event has been included on an exceptional basis noting that, in the ordinary course, the Totex allowance will in any event be reset at each Periodic Review by Ofgem.

With respect to the nature of costs covered by the Totex allowance, Ofgem explains in its Economic Guidance that the Totex allowance is expected to cover costs that have been justified and evidenced by a clear cost breakdown and hence would cover more than just safety critical costs. For guidance on what type of costs will be covered by the Totex Allowance, consultees should refer to Ofgem's Economic Guidance.

## **Buyback**

The purpose of the Buyback of power mechanism is to provide additional support to the licensee where an outage or material reduction in availability requires the licensee to buy back power in the market at a price above the price it will be sold forward by the licensee.

Some consultees raised queries around Buyback risks. They highlighted that the licensee will bear full exposure to buyback risks, which are outside of their control due to the reference price being set by Ofgem and the volatility of market wholesale prices. They argued that, if there are material differences between the set reference price and achieved market prices, there could be significant discrepancies in allowed revenues.

One consultee also raised further concerns around events outside of the licensee's control which may impact on the plant's capacity and the operational performance incentives and penalties as a result.

## **HMG Response**

In light of the concerns raised by consultees, HMG has decided to defer the obligation for the licensee to forecast its market revenue for the purposes of setting difference payments until the Operations phase. Further information on the amendments HMG has decided to make can be found in the below section on Market Revenue Adjustment.

HMG has decided not to make any changes to buyback mechanisms and is content that the level of risk resulting from the buyback provisions is set appropriately.

## **Ofgem discretion**

Some consultees expressed concerns about uncertainty as to how Ofgem will determine certain aspects of the incentives at the PCR Determination. Others recognised that some degree of flexibility for Ofgem to make adjustments to the operational phase incentives is important, given that Ofgem will need to make decisions based on conditions at that time to appropriately incentivise the licensee whilst having regards to financeability.

## **HMG Response**

On balance, HMG considers that the combination of the licence and Economic Guidance strikes the right balance between certainty for the licensee and ensuring Ofgem have sufficient discretion to take account of the prevailing circumstances.

## Outage Support Simplifications

One consultee observed that there are some overlapping and potentially conflicting features of the framework, which may build unnecessary complexity into the revenue mechanics. They proposed the following opportunities to simplify some of the revenue:

- Significant unavailability revenue support to be treated as a difference payment adjustment rather than part of allowed revenue.
- Aligning thresholds to a single revenue floor.
- Removing one of the revenue support repayment building blocks and having a single repayment mechanism.
- Providing all unplanned outage support on in-year basis.

## HMG Response

Following further consideration of the outage support mechanics, HMG agrees that the outage support regime would benefit from simplification. In this regard, HMG is minded to revise the licence to address the proposals made by the consultee with the exception of the proposal to align thresholds to a single revenue floor, noting that this would have an unintended impact on the risk allocation between the parties. Risk sharing between the licensee and consumers which was included in a reduction to the repayment of significant unavailability support would instead be reflected in an adjustment to the way the Availability Incentive Multiplier works in circumstances where the licensee has not achieved the Availability Target.

## Question 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?**

### General summary of responses

Consultees were broadly satisfied that the proposed modifications set clear expectations and boundaries for how the project company should operate in the market over time. However, multiple consultees felt that the licence could benefit from greater flexibility to account for future uncertainties in the energy market.

Another consultee noted that they believed the licence modifications could be strengthened through more references to sustainability requirements. HMG fully acknowledges these comments and is considering these suggestions, alongside others for minor amendments to drafting of certain conditions.

The below paragraphs focus on specific areas of concern raised by consultees and HMG's response.

## Ringfencing and Single Till

The ringfencing and single till mechanisms are designed to limit the licensee's ability to conduct activities outside the scope of the regulated activities and to ensure that all revenues received by the licensee are appropriately accounted for.

One consultee noted that the licence should contain greater flexibility for the licensee to operate in non-nuclear electricity revenue streams. This could include hydrogen production. They suggested that the licence should contain an incentive that encourages the licensee to maximise revenue in all potential energy markets, with a review pre-COD to ensure the licence reflects the prevailing energy market structures at that time.

Another consultee echoed these suggestions, noting that the ringfencing provisions as currently defined in the licence could prevent the licensee from exploring potential for other market revenues. They recommend that the licensee's return should be based on total revenues, not those limited to the nuclear electricity market.

One consultee expressed concerns that any additional revenue gathered through activities such as hydrogen production or heat capture in the future, would be classified as 'Supplemental Revenue', under the 'Single Till' approach outlined in the current licence. They believed that this would work against the licensee's allowed revenue. Instead, they suggested an amendment to allow all parties to benefit from potential ancillary services through flexibilities in the licence. Their suggestions included introducing a sharing factor on Supplemental Revenue, and an amendment to ensure that the definition of Supplemental Revenue was sufficiently clear to fully account for costs of all interactions with the power market.

## HMG Response

As the nuclear RAB regime is specifically designed to support the delivery of baseload nuclear power, it is important that consumer support through the Economic Licence is focused on the design, construction, commissioning, operation and decommissioning of the Project. It is important that the licensee properly accounts for all revenues which are received, whether those revenues are generated through the sale of electricity, heat or other ancillary services.

HMG acknowledge the comments raised by consultees relating to expansion into other future potential energy markets and ensuring that future revenue streams are appropriately captured in the licence. HMG wants to ensure there is sufficient flexibility built into the licence to ensure that the licensee is able to explore opportunities for wider benefits of the project, whilst recognising that it is essential that consumer interests are protected.

Therefore, HMG is content to consider including flexibility for future offtakes of heat by allowing facilitating infrastructure in the scope at the design and construction phase of the project, and that this should be captured in the project specification annex of the licence before revenue commencement. It is not the intention that work on other non-nuclear projects which may have different subsidy regimes should be included within the regulatory ringfence and future decisions on connections will be made as appropriate at the time.

It is HMG's view that it may be in consumers interests that the plant retains flexibility over its design life to respond to changing energy demands. It may be therefore appropriate to include in the project costs some flexibility for alternative uses of by-products such as heat, providing arrangements are in accordance with the requirements of the licence and revenues are accounted for through the Single Till.



Notwithstanding this position, HMG would observe that within these constraints the licensee is free to explore revenues from ancillary services. Companies within the wider SZC group may also seek alternative funding to support activities to further other low carbon generation technologies outside of the regulatory ringfence, unless otherwise agreed with Ofgem at the time.

### Outage and Unavailability Support

If, due to a Significant Unavailability Event, the Licensee considers it will achieve less than 80% of its Allowed Revenue, it may submit an application to Ofgem for in-year revenue support under the conditions of its RAB licence. Where an application is approved, Ofgem would communicate to the revenue collection counterparty an updated Allowed Revenue and volume assumption to apply to its Difference Payment calculation for the remainder of the Charging Year.

The purpose of these protections is to provide liquidity support to ensure that the licensee can fund its regulated activities during the operations phase. Supporting the licensee through significant unavailability periods is intended to support the licensee to remain solvent and operational thereby allowing consumers continue to see the benefits of their contribution through continued electricity generation for the remainder of the regulatory period.

One consultee flagged their concerns with the level of market risk the licensee would remain exposed to over time. They believed that the current revenue support cap could prevent SZC from acquiring additional support due to unforeseen events, such as an extreme uplift in electricity prices or multiple consecutive unplanned outages. They also raised concerns with regards to excessive shocks on electricity suppliers as a result. The consultee suggested the cap on revenue support should therefore be removed.

They also suggested that the licensee should be encouraged to focus on safety, operating effectively and maximising availability rather than market risk, and that this would be best achieved through either agreeing an alternative hedging approach and market price index, or through the removal of the Market Price Incentive. They clarified that this would be best accompanied without a requirement for buyback liquidity support to be repaid, and therefore with any residual training passed back to the consumer.

One consultee also suggested that there should not be a requirement for buyback liquidity support to be repaid.

### HMG Response

In light of the feedback from consultees, HMG has decided to make certain amendments to the revenue support and availability incentive regimes in order to simplify the structure, whilst maintaining the proposed risk allocation between the licensee and consumers.

The revenue support cap is calibrated such that, in most cases, the licensee would be expected to be able to access sufficient liquidity through the licence regime. Attention has been drawn to a theoretical possibility that a confluence of events may result in an extreme downside case. However, the historic performance of nuclear reactors shows that this is a low probability event. Furthermore, HMG considers that this theoretical possibility must be weighed against the need to ensure there is a limit on consumer funding.

## Baseload Market Reference Price (BMRP)

Some consultees raised concerns with the requirement for the licensee to sell its outputs at the BMRP. One consultee noting that the BMRP creates uncertainty for the project in terms of achieved return and that Ofgem's economic guidance should provide further detail on how the balance of this incentive will be maintained. Another consultee noted that there appears to be a gap between COD and the end of the pre-PCR phase where the Authority is unable to reset the reference price until the PCR. This means that revenue flows and licence obligations will be dependent on the licensee achieving the BMRP, irrespective of whether the reference price is appropriate at that time. The consultee reflected that the licence modifications should be amended to allow Ofgem to reset the reference price during this period, in the event the BMRP is not the most appropriate reference price at that time.

### HMG Response

HMG remains content that setting the Market Price Incentive around the BMRP is broadly proportionate and consistent with wider HMG policy preferences. HMG considers the BMRP to be a suitable choice for the day 1 Reference Price, noting that this is currently used as the CfD reference price for baseload electricity generation.

The BMRP has been selected to incentivise the licensee to trade in the baseload market. Evidence of other baseload generators indicates that it is possible to capture the BMRP with a high level of accuracy. However, given the extended duration of the regulatory period, it is possible that changes to the methodology for calculating the BMRP, wider energy market over time (e.g. changes emerging from the Review of Electricity Market Arrangements) or a shift in the nature of services provided by licensee, could result in the BMRP ceasing to be a suitable Reference Price for this incentive. Ofgem will therefore review the suitability of the Reference Price at the PCR and each PR, having regard to the factors set out in its Economic Guidance.

In light of comments from consultees, HMG is minded to amend Special Condition 25, in order to defer the licensee's obligation to forecast its market revenue for the purposes of setting difference payments until the Operations Phase.

HMG is satisfied that the use of BMRP does not create a gap between COD and the end of the pre-PCR phase. This is because the Market Price Incentive does not apply until the PCR and there is no obligation on the licensee to forecast revenue until then.

## Question 5

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

#### General summary of responses

Feedback from consultees to this question was varied. Some consultees welcomed the provisions currently set out in the economic licence regarding the role of Ofgem as the Authority.

#### Appeals to the Competition and Markets Authority (CMA)

Some consultees raised concerns that the special condition referencing referral rights to CMA limits the nature of appeal rights afforded within the Nuclear Energy (Financing) Act, and also

limits appeal rights to the Pre-PCR phase in certain circumstances. One consultee called for appeal rights to be broadened so that they are not solely applicable to the Pre-PCR phase, for the circumstances under which an appeal can be made to be broadened and to be re-drafted to be better aligned with the drafting of the legislation. Another consultee suggested that definitions should be reviewed to ensure that regulatory decisions which may impact the Allowed Revenue are not excluded from the right to appeal. By contrast, another consultee commented that the appeals process is too heavily weighted in favour of the licensee and that it may incentivise appeals.

### **HMG Response**

HMG notes the concerns raised in relation to the scope for the licensee to appeal Ofgem determinations before the CMA. In this regard, HMG would observe that the ordinary position for other companies which Ofgem regulates is set out under the Electricity Act 1989. This stipulates that licence modifications can be appealed before the CMA. In the case of nuclear RAB licensees, government specifically legislated under Nuclear Energy (Financing) Act to allow for broader rights to appeal certain decisions which relate to the licensee's allowed revenue. In order to give effect to this right, the licence modifications provide for certain decisions in relation to the allowed revenue during the Pre-PCR Phase to be appealable to the CMA.

However, once the asset is operational, HMG is not persuaded that there is sufficient justification for treating the licensee differently than other network companies as regards their ability to appeal Ofgem decisions. To help give the licensee greater clarity, HMG is minded to amend the licence to clarify the nature of amendments to Variable Values that would not be treated as a modification, and to make it clear that the wider rights to appeal to the CMA are limited to the Pre-PCR Phase.

### **The role of Ofgem**

One consultee called for Ofgem's role to be enhanced, with the Independent Technical Advisor (ITA) being appointed by Ofgem and Ofgem having additional oversight during the pre-PCR phase. The consultee also called for either Ofgem or the ITA to make a public assessment of the likely RAB outturn to provide consumers with further information on the development and operation of the project. Another consultee expressed concern with Ofgem's capacity and resource to undertake its regulatory duties as defined within the proposed licence modifications.

Contrastingly, one consultee noted that under the current proposed licence modifications Ofgem already has a substantial level of oversight during the Pre-PCR phase, particularly in relation to approval of amendments or waivers of approved contracts and new supply chain agreements. They argued that this level of oversight could result in inefficiency and delay. The consultee suggested that the modifications should allow for the licensee to appeal to the CMA with regard to decisions taken by Ofgem in relation to approved contracts.

Another consultee called for greater clarity on the boundaries between decisions that will be taken by the Secretary of State and decisions that will be taken by Ofgem as the Authority in line with their statutory duties. This has the aim of ensuring that Ofgem is aware of which areas may require the Secretary of State to make the final decision, such as on scheduled COD requirements or an FDP shortfall.

Another consultee noted that the current modifications place reliance upon a positive working relationship and alignment of approach between the licensee, Ofgem and the ITA which may

introduce a degree of uncertainty for potential investors. This sentiment was echoed by an additional consultee who commented that there may be a mismatch between the priorities of the regulator and the licensee, with potential implications for equity investors.

### **HMG Response**

HMG has considered feedback on the role of the ITA and the functions for appeals to be made to the CMA. HMG has decided to make minor drafting clarifications to clarify the applicable special condition. In light of feedback received, HMG has also decided to clarify within Special Condition 26.10(a) and Special Condition 39.16(a) the definition of the PCFM Variable Values and 'variable' inputs to the CDA Calculation Model, to confirm that these are not inputs determined at the regulator's discretion and are therefore not appealable before the CMA.

With respect to Ofgem's oversight, HMG notes that consultees have expressed a range of opinions. Overall, having regard to the scale and value of the project, HMG considers the current approach generally strikes a suitable balance between the need to ensure that Ofgem have the information it needs to be able to hold the licensee to account and protect consumer interests, without unduly burdening the licensee or creating unnecessary inefficiencies.

However, HMG is minded to make changes to provide Ofgem with a more proportionate and targeted role in relation to regulation of Approved Contracts and Agreed Supply Chain Contracts.

HMG notes the call for greater clarity on the boundaries between decisions that will be taken by the Secretary of State and decisions that will be taken by Ofgem. HMG considers that the distinction is already clearly delineated.

### **Reporting Requirements and Provision of Information to the Independent Technical Advisor**

One of the consultees raised concerns with the licence modifications on reporting requirements and governance measures. They fed back that, as currently defined, they are excessively burdensome and are disproportionate on the licensee, requiring significant administrative resource. Similarly, on enhanced stakeholder engagement requirements, they suggested that these were disproportionate and unnecessary due to the existing stakeholder engagement mechanisms detailed within the licence. The consultee recommended that these requirements be streamlined and reviewed to ensure they are proportionate to legal and regulatory requirements.

Another consultee called for greater transparency and certainty surrounding the Ofgem's approval and determination mechanisms in relation to certain licence conditions. This included extensions to Scheduled COD, further detail on how the Authority intends to work with other regulators and which regulatory regime would take precedence in the event of a conflict.

Other consultees discussed the role of the Authority in relation to the ITA and requested further clarity on the exceptional circumstances within which the authority could make a contrary determination to the ITA.

### **HMG Response**

In light of the feedback from consultees, HMG has decided to clarify Special Condition 8.9 to make clear that the licensee's obligation to provide information to the ITA does not require it to do anything outside of its control, or to allow the ITA to do anything that would materially disrupt the licensee's business unless it is essential to the ITA's report. HMG will also ensure

that the licence allows for an appropriate approach to discharging ITA obligations where an ITA is unavailable due to exceptional circumstances.

HMG recognises that the licensee will be subject to regulation by a number of different regulators. Ofgem has indicated that it expects to work collaboratively with the ONR and EA, building on its existing track record of working with other bodies. Collaboration between relevant regulators is expected to be further supported by liaison between to bring key regulators together with the company and the Secretary of State to consider matters in relation to the project.

## Summary and next steps

HMG would like to thank all consultees for their engagement and feedback.

As highlighted within this document, HMG has decided to make a series of changes to the licence based on the feedback received from consultees. Whilst many of these changes are minor drafting clarifications to certain Special Conditions, the document has highlighted the below key areas of movement:

- Amendments to the Yield Cap.
- Tiered approach to Delay WACC.
- Deferral of requirement to forecast Market Revenue until Operations phase.
- Changes to revenue support and availability incentives.
- Amended definition of Allowable Capital Spend.
- Amended definition of Force Majeure but retaining an exhaustive list.
- Changes to the LRT and HRT relating to an RCC event.

The final version of the RAB licence will be shared with consultees. Given the scope and nature of the changes proposed to the licence modifications, HMG does not currently envisage carrying out further consultations on the RAB licence but reserves the right to revise this position.

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This consultation is available from: [www.gov.uk/desz](http://www.gov.uk/desz)

If you need a version of this document in a more accessible format, please email [alt.formats@energysecurity.gov.uk](mailto:alt.formats@energysecurity.gov.uk). Please tell us what format you need. It will help us if you say what assistive technology you use.