The voice of the energy industry

Nuclear Energy (Financing) Bill

Energy UK written evidence

Executive Summary

- The Government's intention to secure a final investment decision on a large-scale nuclear plant by the end of this Parliament is a positive step, and Energy UK welcomes the introduction of the Nuclear Energy (Financing) Bill to facilitate the implementation of a regulated asset base (RAB) model.
- Energy UK notes that four times today's low-carbon capacity is required to reach net zero by 2050 and supports the RAB model as a significant driver in the reduction of the cost of capital.
- Energy UK believes that the UK should pursue a mix of low-carbon technologies in the expansion of the electricity sector, with strong growth in renewables supported by a replacement of the ageing UK nuclear fleet, as well as other new technology solutions all complemented by increased system flexibility and storage.
- The RAB model will be important for both the delivery of nuclear energy and keeping bills down as successfully demonstrated by the Thames Tideway Tunnel.
- Energy UK stresses the importance of ensuring that appropriate consumer protection is central in the design of the RAB model to ensure the increase in consumer risk exposure is significantly outweighed by the lower cost of capital.

Nuclear Energy (Financing) Bill: Top priorities

Energy UK supports the intention of the Nuclear Energy (Financing) Bill to help implement a financing model which has the potential to significantly reduce projects costs by reducing cost of capital.

Nuclear has played a key role in the UK electricity system since 1956 and has provided a safe and reliable source of low-carbon electricity to the system. Seven out of the eight remaining operational nuclear power stations are due to reach their end-of-life by 2030 creating a capacity deficit of ~7.5GW. Energy UK supports the view that the UK should pursue a mix of low-carbon technologies of which nuclear must form a critical part.

The RAB Model

A RAB model would reduce the cost of capital for new nuclear projects in the UK and widen the pool of potential investors to include institutions such as pension funds by enabling projects to provide a return to investors during construction. The RAB model works by sharing certain risks between investors and end users, and by providing targeted protection for investors against low probability but high impact risks (where it would not be efficient for investors to bear those risks). The National Audit Office (NAO) report[1] on the Hinkley Point C CfD identified that the costs of nuclear projects are very sensitive to financing costs and recommended that alternative financing models such as RAB should be considered to provide better value for consumers.

[1] https://www.nao.org.uk/report/hinkley-point-c/

While we note that the RAB model has been successfully used for many years, this would be the first time that a RAB model has been used in the competitive generation market and great care needs to be taken to ensure that competition is not distorted. As with all support mechanisms, there must be checks and balances on how RAB financed assets are able to compete in the merchant market, with the clear objective of avoiding distortions.

The RAB model should in theory offer value for money because the lifetime customer benefit that results from a lower cost of capital should significantly outweigh the impact of the increase in customer risk exposure. However, whilst the concept of energy customers paying during the construction of a project should result in lower cost to consumers, we do note that it nonetheless still passes a significant risk to customers, who might, in the most extreme case, end up paying for something which has no guarantee of delivering.

Cost overruns and delays during the construction phase could be significant, as evidenced by recent nuclear projects across Europe, with a risk of part of these costs being added to bills. In order for customers to feel the benefit of a RAB model for nuclear, it is crucial that they are appropriately protected against the remote high impact risks. Prior to any specific project being granted a RAB, it is essential that Government consults on the detailed operation of the model to ensure that it will indeed protect customers as expected. We also note that these risks should be lower for "next of a kind" projects, which can take advantage of the experience gained on earlier projects.

Economic Regulatory Regime

As outlined in the Government's 2019 Consultation[2], there will need to be a newly appointed economic regulatory regime (ERR) which will be a crucial part of the RAB structure and is needed both to protect the interests of customers and to provide reassurance to investors that regulatory decisions will be made in an impartial manner based on evidence and experience from similar RAB frameworks.

We note that there are lessons to be learnt from network regulation in relation to determining the Weighted Average Cost of Capital and proposals for a GSP, and we believe that Ofgem as an existing independent regulator with experience of RAB frameworks is best placed to meet these requirements.

Technical issues and areas of uncertainty

Section 19 – Supplier obligation

To enable the model to succeed in delivering value for money for customers, it is important to get the detailed design of the model right, including the revenue regulations. The RAB model should determine an appropriate risk sharing arrangement between the project company, the supply chain, investors, taxpayers and energy suppliers and customers.

As a point of principle, the arrangements for supplier cost recovery should also not expose suppliers to significant risk of short-term cost increases that cannot practically be recovered

[2] https://www.gov.uk/government/consultations/regulated-asset-base-rab-model-for-nuclear

in customer tariffs or contracts. Furthermore, they should not introduce or encourage further distortions in the retail market. This means ensuring there is a robust framework in place that reduces the risk of supplier payment default and, therefore, mutualisation of cost, to the lowest level possible.

We welcome the Government's intention to provide support subject to ensuring that any project will deliver value for money and we recognise that the overall impact of the RAB model will reduce costs to consumers. However, placing additional levies on energy bills results in outcomes for customers that are regressive, because, unlike general taxation, levies on energy bills do not take into consideration of customers' ability to pay. We have, therefore, long stated that in an ideal world Government's environmental and social support policies to be funded through general taxation. Furthermore, we believe it will be important for Government to be clear with customers how any new levies, including a RAB, will impact their energy bills.

With this in mind, it will be important that the Government looks at how it can move to a fair and consistent way of allocating the costs and benefits of supporting all low carbon technologies for the public as part of its forthcoming affordability review. This includes the distribution of policy costs between general taxation, electricity and gas bills to assess whether the existing split is appropriate. The current distribution already presents a barrier to decarbonisation, particularly to the electrification of heat.

Section 25 – Consultation

We welcome section 25(e) which requires the Secretary of State to consult with electricity suppliers before making revenue regulations . We would urge that the regulations further consider how to ensure value for money for suppliers and consumers through the right allocation of risks and benefits

Consumer protection

We believe the following questions need to be carefully considered to ensure that customers are not detrimentally affected by a RAB model for nuclear:

1. **What protection could be offered to customers in the very unlikely event of the project aborting before completion?**

   The appropriate treatment may depend on the reasons why the project is aborted.

   It is essential that there are clear incentives on the project to deliver. However, we also recognise that the underlying intent of the RAB model is to reduce costs to consumers by providing targeted protection for investors against low probability but high impact risks.

   A discontinuation payment from government to protect customers could also be considered in some circumstances..

2. **Who will be responsible for consumer protection and how will they influence how the project is being run to ensure this protection?**

   One of the key functions of the Regulator will be to protect the interests of customers.

In particular, the Regulator must monitor the project rigorously to ensure that it meets its obligations and that incentives on investors are set appropriately.

The role of nuclear in facilitating broader decarbonisation

- Nuclear energy facilitates decarbonisation beyond electricity generation and can provide power for electric vehicles and heat electrification.
- Nuclear power could also be a major low-carbon source of hydrogen for transport or heating as well as used for co-location of battery storage technology.
- The vast majority of nuclear jobs are created outside of London, often in remote parts of the UK and can create significant economic benefits to these areas which will be vital to the Government's levelling up agenda.
- There are studies ongoing which link nuclear stations with direct air carbon capture and storage (DACCS) and could make them carbon negative, which is another crucial element to meeting net-zero, by balancing off residual emissions in agriculture and aviation.
- Energy UK supports the view that the UK should pursue a mix of low-carbon technologies, with strong growth in renewables supported by a replacement of the ageing UK nuclear fleet, as well as other new technology solutions all complemented by increased system flexibility and storage. In order to do this at the lowest cost, we need to have a diverse energy mix including nuclear power.

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies, right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses.

The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

Should the Committee have any queries or require any further information on this written evidence please contact Kisha Couchman (kisha.couchman@energy-uk.org.uk).