Decision

Eastern Green Link 2 – Project Assessment

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This document confirms our decision on the project assessment of National Grid Electricity Transmission (NGET) and Scottish Hydro Electric Transmission's (SHE-T) Eastern Green Link 2 (EGL2) project, under the Accelerated Strategic Transmission Investment (ASTI) mechanism in the RIIO-2 Price Control Framework. In particular, it sets out our final decision on the efficient capital costs that we will allow NGET and SHE-T to recover for the delivery of the project.

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Executive Summary

ASTI framework

The British Energy Security Strategy set out the Government's ambition to connect up to 50GW of offshore generation to the electricity network by 2030.[1] Facilitating this ambition will require significant reinforcements to the onshore electricity transmission network and a change to the current regulatory framework in order to accelerate delivery of large projects.

As such, in December 2022 we published a decision to introduce a new ASTI framework.[2] We set out the initial list of ASTI projects, our decision on exempting strategic projects from competition, the new process for assessing and funding ASTI projects and the range of measures we are introducing to protect consumers against additional risks that changing the process brings.

EGL2 is being delivered by a Joint Venture (JV) between SHE-T and NGET under ASTI.

Summary of our decision on the Project Assessment

This document confirms our decision to provide NGET and SHE-T with a total funding allowance of £3,449,161,471[3] (2018/19 prices) for the delivery of the EGL2 project under the ASTI mechanism. It also confirms our decision to establish routes for further funding of specific uncertain costs that the JV expect they might incur.

The total funding allowance includes £2,709,190,955 on direct costs as well as £739,970,516 of indirect costs and risk. We will introduce a new reopener in order to manage the increased risks and new areas of uncertainty that we have identified on this project.

Lastly, we will implement a COAE materiality threshold of 0.75% (equivalent to a threshold of £25.9m) specifically for this project.

Next Steps

In order to give effect to this decision, we will be consulting as soon as possible on the licence and guidance changes that are necessary to implement it.

1 British energy security strategy - GOV.UK (www.gov.uk)
2 Consultation on accelerating onshore electricity transmission investment | Ofgem
3 All costs in this document are in 2018/19 prices, unless otherwise indicated.

1. Introduction

Section summary

In this section we provide the context of the project, published documents that are relevant to this project and how we collect feedback on this decision.

Context and related publications

1.1 The GB onshore electricity transmission network is planned, constructed, owned and operated by three transmission owners (TOs): National Grid Electricity Transmission (NGET) in England and Wales, Scottish Power Transmission (SPT) in the south of Scotland, and Scottish Hydro Electric Transmission (SHE-T) in the north of Scotland.

1.2 In July 2022, we published our conditional decision[4] to approve the Final Needs Case (FNC) for the Eastern High-Voltage Direct Current (HVDC) projects under the Large Onshore Transmission Investment (LOTI) re-opener mechanism, subject to the projects obtaining the necessary planning consents.

1.3 The proposal for the Eastern HVDC projects consists of two separate reinforcement projects:

- Torness to Hawthorn Pit subsea HVDC link, with NOA code: E2DC, referred to as EGL1, prepared by a joint project team from SPT and NGET; and
- Peterhead to Drax subsea HVDC link, with NOA code: E4D3, referred to as Eastern Green Link 2 (EGL2) prepared by a joint project team from SHE-T and NGET.

1.4 In December 2022,[5] we decided to introduce a new Accelerated Strategic Transmission Investment (ASTI) regulatory framework. This framework will assess, fund and incentivise the accelerated delivery of the large, strategic onshore transmission projects required to deliver the government's ambition to connect up to 50GW of offshore wind generation to the network by 2030.

1.5 In August 2023,[6] we published our decision to modify the Special Conditions (SpCs) in the electricity transmission licences required to give effect to our ASTI decision, introducing the following new SpCs:

[4] Eastern HVDC - Decision on the project's Final Needs Case (ofgem.gov.uk)
[5] Decision on accelerating onshore electricity transmission investment (ofgem.gov.uk)
[6] Decision to modify the special licence conditions in the electricity transmission licences: Accelerated Strategic Transmission Investment | Ofgem

3.40 Accelerated strategic transmission investment Pre-Construction Funding Re-opener, Price Control Deliverable and Use It Or Lose It Adjustment (APCFt);

3.41 Accelerated strategic transmission investment Re-opener and Price Control Deliverable term (ASTIRt); and

4.9 Accelerated strategic transmission investment output delivery incentive (ASTIIt).

1.6 In March 2024 we published our minded-to consultation on the project assessment for EGL2. The summary of this consultation is provided in Chapter 2 of this document.

Our decision-making process

1.7 We have assessed the submitted costs for EGL2 and have consulted on our proposed allowances of the economic and efficient costs. Following analysis of the responses[7] received we have outlined our decision in this publication and the dates of the full decision-making process are outlined in the table below.

[7] These are published here: Eastern Green Link 2 (EGL2) project assessment consultation | Ofgem

Decision-making stages

Date	Stage description
27/03/2024	Stage 1: Consultation open
26/04/2024	Stage 2: Consultation closes (awaiting decision), Deadline for responses
13/08/2024	Stage 3: Responses reviewed and published
13/08/2024	Stage 4: Consultation decision/policy statement

General feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We would also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to stakeholders@ofgem.gov.uk.

2. Overview of our minded-to consultation and responses

Section summary

This section outlines the requested cost allowances for EGL2, as submitted by the JV. It covers the key points that we set out in our March 2024 minded-to consultation and includes an overview of the responses that we received to that consultation.

Requested cost allowances for EGL2

2.1 The JV submitted its initial costs for delivering EGL2 to Ofgem in November 2023.

Direct construction costs

2.2 It requested £2,709,190,955 to fund direct construction works for EGL2. This would cover the costs of the new HVDC cable, subsea installation and converter stations to transmit the new generation from Scotland to England. The JV stated that demand and commodity inflation is prompting significant cost increases on all electricity transmission projects, increasing lead times for specialist equipment due to manufacturing constraints and driving a change in appetite for the transfer of risk.

Indirect costs and Risk

2.3 The JV requested £819,614,376 for indirect costs and P50 level of confidence funding. A further [redacted] was requested for P80 level risk funding, [redacted] on deferred risks, [redacted] on hedging and they also requested [redacted] on Price Adjustment Mechanisms (PAMs).[8]

2.4 As part of the indirect costs, the JV requested consultancy costs of £848,423 which it subsequently noted that had been erroneously added in the submission.

2.5 The indirect cost funding also included £67,230,272 of funding to recover costs associated with increased organisational costs (enhancing staff capability to deliver the project, improved structures and operating costs) that the JV is expected to incur to deliver the ASTI portfolio (termed ASTI Overhead).

2.6 The indirect costs also included £7,624,379 for a proposed social value and community benefit fund, as well as £48,264,998 for a proposed sustainability innovation fund.

[8] We have redacted the submitted costs that we consider commercially sensitive.

P50 and P80 level of confidence funding

2.7 Costs confidence levels are a measure of confidence in the project's estimated costs constructed using probability. They are used to gauge the appropriate level of funding against the likelihood of the project being successfully delivered for a given cost. Ofgem's approach is to normally fund projects to a P50 level of confidence only.

2.8 A project costed at the P50 confidence level means that 50% of estimates exceed the P50 estimate and that, by definition, 50% of estimates are less than the P50. In other words, it is a middle estimate (but not the mean). A P80 level of funding exceeds a P50 level as a greater volume and value of risk will be funded under P80, with a correspondingly greater likelihood that the project will be delivered within that cost estimate.

2.9 For EGL2, the JV provided the costs related to both the P50 level of funding [redacted] and the P80 [redacted]. It requested funding based on a P80 level of confidence for EGL2, providing three reasons for seeking funding at a higher-than-usual level.[9]

Deferred risks

2.10 The JV identified four types of highly uncertain project cost risks, which they expect to become clearer in the near future. These risks were: Unexploded Ordnance (UXO) target investigations to determine whether UXOs are present; UXO Clearance / detonation if a positive identification is made; planning risk associated with bringing the cable ashore in NGET's licence area; and estimating uncertainty associated with enabling works in NGET's licence area, essential to enabling the integration of EGL2 on to the electricity network.

2.11 They said that further refinement, mitigation and investigation are required on these risks, to lower the risk costs and thereby reduce the burden on consumers.

2.12 They asked that they do not include these in their quantitative costed risk analysis and that Ofgem do not review these risks at a PA stage. They confirmed that they plan to submit an updated position on this once further work has been completed to fully ascertain and understand the complete risk position.

2.13 They expected to submit a request for further funding in 2024, so that total project allowances would be adjusted to reflect Ofgem's view on their efficiency.

[9] These reasons are set out in paragraph 2.16 of the minded-to consultation document: [Eastern Green Link 2 – Project Assessment (ofgem.gov.uk)](https://www.ofgem.gov.uk)

Based on their most recent update, the JV have indicated that the potential outturn indicative range of these costs is [redacted].

Price Adjustment Mechanisms (PAMs)

2.14 A Supply Chain Indexation Price Adjustment Mechanism (PAM) is a contractual mechanism for managing changes to the contract price post award. Costs are treated as pass-through and therefore not pre-determined but treated by ex-post allowance adjustment, which is trued up on an annual basis based on indices.

2.15 EGL2 is one the first projects that has necessitated the introduction of funding arrangements for PAMs across supply chain indexation. PAMs have been demanded by the supply chain to manage costs which they have not been able to fix, and which remain highly volatile in the current climate, in particular commodities such as copper, aluminium and oil.

2.16 The JV estimated the total exposure to the PAMs on EGL2 at being between [redacted] and [redacted]. It noted that these are not fixed limits, but instead are subject to change as indices change.

2.17 The JV therefore sought allowance for these risk-related costs at PA.

Currency Hedging

2.18 The JV proposed to use currency hedging as a method of managing cost uncertainty at the point of the PA submission. The JV explained in its submission that due to the unpredictability, applicable currency and cost profile of uncertain costs (like risk) it is impossible to accurately forecast a fully hedged foreign exchange position. They notified us that EGL2 intends to enter into an option arrangement.

2.19 This strategy offers protection to the consumer and the TOs from downside foreign exchange rate movements across an agreed proportion of the uncertain spend phased profile, by locking in an option to buy foreign currency at a determined rate. It also offers the consumer an opportunity to benefit from upside foreign exchange rate movements.

2.20 The JV suggested that as the project progresses, and the risk phasing evolves, there could be additional costs for re-phasing the foreign exchange option, as the dates assumed at the time of placing the option are updated to actual transaction dates.

2.21 The JV proposed that as the option fee and rearrangement fees are not pre-determined, an ex-post adjustment should be made to reflect these costs in allowances with allowances trued up on an annual basis based on hedge option activity.

Cost and Output Adjustment Event (COAE)

2.22 The JV also requested that we set the COAE threshold to 0.75% for EGL2. It believed that the default 5% (as per Part E of SpC 3.41) was too high a threshold to breach and that it would expose them to increased unfunded risks.

Our minded-to consultation position

2.23 In March 2024, we presented our minded-to position to allow the JV a total of £3,449,161,471 costs for the delivery of EGL2 and to set the COAE threshold at 0.75%. The reasons behind this are set out below.

Direct construction costs

2.24 On direct construction costs, we were minded-to allow the requested direct costs of the project (£2,709,190,955).

2.25 We considered that the JV could have taken more steps to attract and retain potential bidders. However, we also recognised the challenging operating environment EGL2 faced and the difficulty the JV had in securing bids from a supply chain experiencing high levels of customer demand.

2.26 Our view was that it would not be in customers' interests to make reductions to the direct costs requested by the JV, since it was unclear whether making reductions would lead to any efficiencies being gained. Any such efficiencies would likely be marginal and offset by increased constraint costs caused by delays in renegotiating the procurement contracts.

2.27 Lastly, we noted that Ofgem's and the TO's current direct cost benchmarks no longer reflect current contract rates. Innovation and changing market conditions have led costs to increase significantly over the past years, making benchmarks based on historic data obsolete to an extent. We believed that the direct costs submitted reflect the market's current price for the works.

Indirect costs and risk

2.28 We were minded-to allow a total of £739,970,516 on indirect costs and risk.

2.29 We proposed not to allow £67,230,272 and £848,423 (in relation to consultancy costs and ASTI Overheads respectively)

2.30 Regarding the social value and community benefit fund, we recognised the need to ensure communities that host infrastructure obtain a benefit from doing so, and the role that good local stakeholder relations can play in successful on time delivery. On the Sustainability Innovation Fund, our view was that this funding would help drive down the project's impact on the environment. We were therefore minded-to approve both of these funding requests.

Low probability risk

2.31 We were minded-to remove £11,565,165 of funding that was requested for low probability risks (under 10% probability of the risks occurring) as we do not consider it efficient to fund specific risk with an identified very low probability of occurring.

P80 contingency and deferred risks

2.32 Our minded-to position was to allow the P50 level of funding to the JV and include the P80 contingency (the difference between P50 and P80 level of funding) and deferred risks in the COAE reopener, with a zero materiality threshold.

2.33 As a rule, Ofgem accepts project submissions at a P50 level of confidence; we judge this the most efficient level of funding for risk, providing an incentive to the TOs to proactively manage project risks and seek opportunities without providing excessive levels of comfort.

2.34 We recognised that EGL2 has a greater risk exposure than a conventional transmission project due to the challenging timescales, supply chain environment and deployment of novel technology. However, we did not accept there was an automatic requirement for a P80 level of funding, and we did not consider it efficient to fund the project at this level without further control of costs and assurance over why those costs have been incurred.

2.35 On the deferred risks, we understood that including such undefined risks in the PA would be extremely difficult to assess or agree on in a timely manner. We agreed that assessing the efficiency of these costs later in time would allow the PA assessment to progress faster (for the other parts of the proposed costs) and would ensure that the JV request a reasonable allowance based on adequate information.

2.36 Based on their explanation for requesting a P80 level of funding and the 'deferred costs', we thought it would be in the interests of consumers to include any extra costs in relation to these in a re-opener. This would ensure that we are able to get an understanding of the costs that will be passed on to consumers, and we would be able to assess the reasonableness and efficiency of any proposed costs in a timely manner. We believed that these costs should be funded when they occur, subject to efficiency checks.

2.37 Our view was that the COAE reopener was the appropriate re-opener for any extra allowance request to be assessed for P80 contingency and the deferred risks.

PAMs

2.38 In our minded-to consultation, we accepted that the supplier market in which EGL2 is delivered is one with significant commodity inflation. Although the JV has some control over the introduction and management of the PAM mechanism through its commercial leverage and ability to negotiate, they have limited means to fix prices. We therefore accepted that the PAMs could create a risk for which the JV could need further funding.

2.39 In our minded-to consultation document we set out our expectation to get further updates regarding the progress of their negotiations. We had identified an asymmetry within the PAMs that we believed could be mitigated. The asymmetry was that costs could only increase as inflation increases, but there was no opportunity for consumers to gain if inflation decreased and commodity prices went down. Following discussions with the JV in the interim since the PA submission and until the point of the minded-to position, this asymmetry has now been addressed following renegotiation with the supply chain.

2.40 Our view was that the existing ASTI mechanisms were not suitable to mitigate the uncertainty that PAMs bring. We were therefore minded-to consider PAMs under a specific and targeted new cost reopener mechanism, which would allow flexibility to adjust allowances based on commodity price movements. Such an approach would be in the benefits of consumers, as it would prevent consumers from incurring unnecessary costs. At the same time, it would provide assurance to the JV that there is a mechanism in place to request PAMs-related funding based on the progress of the project.

2.41 We also set our expectation to assess the reasonableness and efficiency of such costs, evidenced by supporting information, such as invoices, question and answer logs and relevant price indices for PAMs-related costs from EGL2's contractors.

Currency Hedging

2.42 As a rule, we encourage hedging in as transparent a manner as possible because we accept that hedging can prevent the JV incurring higher costs than anticipated and ultimately protect consumers against the cost increases that would otherwise occur.

2.43 We were minded-to consider funding costs related to currency hedging via a new reopener mechanism.

COAE threshold

2.44 In terms of COAE threshold, we stated that we accepted that for a project of this value, a 5% threshold represents a significant liability of unfunded cost risk. We considered the JV's proposed COAE threshold of 0.75% (equivalent to £25.9m) to be reasonable, and we were minded-to implement it. We believed that this represented a single risk of significant magnitude, protecting the interests of consumers whilst providing the JV with confidence that low probability and high value risks will be funded.

The minded-to consultation questions

2.45 We asked for stakeholder views on our minded-to position and feedback on the below questions:

Q1. Do you agree with our minded-to position on direct costs on EGL2?

Q2. Do you agree with our minded-to position on indirect costs and P50 level of confidence funding on EGL2?

Q3. Do you agree with our minded to position on P80 contingency funding on EGL2?

Q4. Do you agree with our minded-to position on PAM funding on EGL2?

Q5. Do you agree with our minded-to position on currency hedging funding on EGL2?

Q6. Do you agree with our minded-to position on the deferred risks on EGL2?

Q7: Do you agree with our minded-to position on the COAE threshold adjustment on EGL2?

Summary of responses

2.46 We received one response with redactions from the JV to our minded-to consultation on EGL2. We have published this on our website.[10] Overall, the JV agreed with our minded-to position and raised some further points.

Outturn costs

2.47 The JV mentioned that the EGL2 consultation did not contain any mention of Ofgem's proposals regarding amendments to SpC 9.3 of the TOs' licences on the

[10] [Eastern Green Link 2 (EGL2) project assessment consultation | Ofgem]

+/- 5% outturn cost adjustment (relative to allowances) for ASTI projects. It proposed that this work allows an alternative value to be set where appropriate for different projects.

2.48 The JV also proposed that Ofgem puts in place a mechanism within each TO's licence to ensure there is a legal/regulatory provision in place to true up regulatory allowances between the TOs where baseline allowances agreed do not reflect the final outturn expenditure. They asked that Ofgem clarifies that such a mechanism should be introduced in their licences.

P50-P80 funding and deferred risks

2.49 The JV accepted our minded to position to allow a P50 funding but stated that a greater allowance could be more appropriate for complex projects with high strategic importance. It proposed that long term planning and investment can only be achieved with suitable financial stability and predictability.

2.50 The JV's response was positive to our minded-to position to use reopener mechanisms to handle the uncertainties they identified in their submission. This includes the approach to the P80 contingency, 'deferred risks', PAMs and currency hedging. However, during subsequent engagement, the JV raised concerns around the inclusion of the P80 contingency and the 'deferred costs' in the COAE mechanism. They said that the definition of an 'event' might not necessarily be met for these costs, and they asked for further clarity on our expectations when they submit such costs.

Other feedback

2.51 On the social value and community benefits fund, the JV asked us to clarify that all the requested funding will be approved in full, as this was not explicitly stated in our consultation document. However, they noted that they could conclude that this should be the case based on the numbers of the total allowance.

2.52 The JV noted that there may be further uncertainty areas that are not associated with the PAMs. They requested inflationary protection from such uncertainty, suggesting that this could be covered through Consumer Prices Index including owner occupiers' housing costs (CPIh). In its response, the JV requested confirmation that any costs not associated with PAMs will still receive inflationary protection via the application of CPIh.

2.53 They also asked to clarify the Authority's position on seeking pass through for any foreign exchange movements that are not covered by the option.

2.54 The JV noted that the 'transmission area' definition will need to be amended in each of the TOs to allow them to carry out their activities in relation to EGL2, but although this was not in the minded-to consultation document they said they understood it will be covered when we publish the statutory consultation on the licences.

2.55 They also asked that we discharge them of the obligation to report on a Price Control Deliverable (PCD), further to the conditional FNC we published in 2022. In that document, we stated that we would be approving the FNC for the two projects related to the Eastern HVDC (see para 1.3) on the condition that they obtain the necessary planning consents.

COAE threshold

2.56 Lastly, the JV noted that they agree with the COAE threshold of 0.75%. They welcomed Ofgem's flexibility when deciding the appropriate level of COAE, and willingness to respond to market dynamics.

2.57 They also made a general comment that the similar mechanism that we have under LOTI includes a COAE threshold of 20% is no longer tenable. This is due to the shift in market dynamics and the costs escalation experienced on major transmission projects. They encourage wider flexibility in the way we approach our decisions on the COAEs.

3. Our Decision

Section summary

This section sets out our decision, including any key changes from what was proposed in the minded-to consultation, following consideration of consultation responses.

Our view

3.1 This section covers our views on the points raised by the JV in their response, and how these informed our final decision. It also covers our final decision regarding the cost allowances for the EGL2 project.

Outturn costs

3.2 We have been engaging with the TOs to discuss implementing changes to Special Condition 9.3 Price Control Deliverable assessment principles and reporting requirements to allow for cost adjustments where efficient outturn costs deviate by an amount greater than +/-5% of final project allowances. This work is currently underway and we have today published our minded-to consultation on this.

3.3 When ASTI was being developed, there were some projects that were expected to be delivered by more than one TO, such as EGL2. Each TO agreed on a percentage of the total allowance based on the area of their works, which was included in the Confidential Annex, due to commercial sensitivity. We understand that the percentage that was initially assigned to each of the TOs could change. The PA submission included a different split in the allowance percentages between the TOs from the initially agreed ones. Our decision is to split the allowances as proposed by the TOs in their PA submission.

3.4 Once a project's allowances have been set at project assessment and implemented into the TOs licences, we believe the TOs should be generally responsible for putting measures in place as part of their contractual arrangements to address cases where those allowance percentages do not match the final expenditure amongst them. However, based on further discussions with the JV, they mentioned that in order for them to be effectively reporting to the Authority, this needs to be facilitated on our end.

3.5 We understand the importance of ensuring that the reporting mechanisms are fit for purpose. They should allow the TOs to meet their obligations in a consistent and practical manner. We believe that this is not directly linked to the purposes of this decision. However, we are committing to engage with the JV to progress any further work required to provide clarity on this area.

P50-P80 funding and deferred risks

3.6 We have considered the JV's feedback in their response to the consultation and subsequent engagement, and we have decided that the COAE mechanism is not the appropriate funding route to address these uncertainties. Instead, we have decided to include P50-P80 funding and deferred risks under the new reopener, and we explain the reasons for this below.

3.7 Part E of SpC 3.41 provides for a COAE re-opener mechanism to adjust allowances and/or scope where an event happens. The definition of an ASTI COAE refers to *'events outside of the licensees' reasonable control and which the licensee could not have economically and efficiently planned a contingency for which have a material impact on the scope or cost of an ASTI Output.'*

3.8 Both the P50-P80 funding and the deferred risk have been foreseen and their costs have been estimated by the JV. As such, it is questionable whether these events could meet the definition of ASTI COAE.

3.9 The P80 contingency funding is relevant to the confidence levels for project delivery. As such, we do not believe that an 'event' is what would be required to assess an application for further funding.

3.10 Therefore, we consider that further requests for allowance that is relevant to the P80 and deferred risks will need to be addressed through a wider mechanism that does not require an 'event' to happen.

3.11 Our minded-to position was to introduce a new reopener to cover PAMs and currency hedging. We are now of the view that this reopener should also be used for the P80 contingency and deferred risks.

3.12 Our decision is to have one new reopener that covers all foreseeable uncertainties that have been raised in the PA submission, for which the TOs would have different levels of control. These will be uncertainties that can be foreseen but cannot be effectively estimated. We expect such foreseeable uncertainties will be relevant to the risks of the project, as set out in the PA submission.

3.13 We expect that such an approach should minimise the need for multiple submissions from the TOs. Also, this will provide clarity to the TOs in terms of which funding route they should be using for their requests based on the reason they are asking for funding. This should provide a clearer framework for the TOs to submit their requests for further funding, by distinguishing between unforeseeable events (handled under the COAE) and foreseeable uncertainties (handled under the new reopener).

Other feedback

3.14 We have reviewed the request for clarity from the JV on several items and we comment on these below.

3.15 Community benefits aim to ensure communities can directly benefit from hosting electricity transmission network infrastructure. The government have consulted on the scope community benefits, and we await the outcome of the consultation. In the meantime, since the funds requested from the JV on EGL2 are broadly in line with the proposed approach on community benefits, we will be approving the full sum requested for the proposed community benefits fund as part of the indirect costs and risk allowance.

3.16 Regarding the JV's request to amend the 'transmission area' definition in the TOs' licences, we accept that a change will be required to ensure the TOs are able to carry out their activities in accordance with their licences. We will be consulting on the licence changes to implement our decision on funding soon. This will cover the pertinent changes to definitions and the relevant licence conditions.

3.17 On the request to discharge the obligations of the PCD (see 2.55), we note that the TOs received pre-construction funding for EGL2 under SpC 3.15 as part of their RIIO-2 baseline allowances with an associated PCD to obtain approval of all material planning consents for EGL2. We do not believe the INC or FNC decisions affect this, and as such we have engaged further with the JV and agreed that they will report on the PCD as per the usual process.

3.18 We understand the need to seek clarity on inflationary protection (see 2.52).

3.19 All non-Price Adjustment Mechanism (PAM) costs are set ex-ante and will be indexed to CPIh. For PAM costs, we expect the JV to submit these as actual incurred costs, which will be reviewed ex post. Once reviewed and included in the total project allowance, the PAM figure will not be subject to any further inflationary protection.

3.20 We have considered whether foreign exchange currency movements could be treated via pass through. We use pass through mechanisms to address fluctuations in prices. However, we do not believe that a pass-through mechanism would be the most effective way to handle currency fluctuations for the purposes of EGL2. The JV is unable to effectively estimate the amount of costs associated with exchange currency movements at this point in time.

3.21 We understand the JV seeks protection from such costs, but we also want to get a better understanding of the impact of currency fluctuations on the total allowances and the mitigation actions the JV has taken to limit this impact. We appreciate that the category of 'currency hedging' in the way that we set it out in the minded-to position would not cover such costs.

3.22 We believe that the best way to address the uncertainty on currency fluctuations is by including this in the new reopener as well. Our expectation is that when they submit any application for extra funding, they will be able to set out what activity each cost category is relevant to.

Overview of our decision on cost allowances

3.23 Following our March 2024 consultation, we considered the response we received and engaged with the JV, to clarify aspects of their response in order to ensure that the final position which we set out in this decision is robust.

3.24 We have come to a final position on what we consider to be the economic and efficient capital costs of delivering EGL2.

3.25 The total amount of funding we have decided to give to the JV has not changed from our minded-to consultation position.

3.26 In total, we have decided to provide the JV with a capital cost allowance of £3,449,161,471 to deliver EGL2. This includes £2,709,190,955 on direct costs as well as £739,970,516 on indirect costs and risk.

3.27 The above level of funding on indirect costs and risk includes our final decision to:

- remove £848,423 for erroneously submitted consultancy costs.
- remove £67,230,272 for ASTI Overheads
- remove £11,565,165 of low probability risk costs.
- allow the P50 [redacted] to the JV.
- subject the PAMs, currency hedging, P80 contingency and deferred risks to a new reopener.

3.28 We have also decided to set the COAE threshold at 0.75%.

Summary of submitted and proposed funding

3.29 The table below summarises the final cost allowances under the ASTI Re-opener for EGL2.

ASTI Project Funding

Cost Category	**Submitted Cost (£)**	**Adjustment (£)**	**Subject to a new Uncertainty Reopener**	**Final Allowance (£)**
Indirect Costs, P50 and Risk	819,614,376 P80 contingency [redacted] Deferred Risks [redacted] PAMs [redacted] Currency Hedging	-67,230,272 -848,423 -11,565,165	P80 contingency [redacted] Deferred Risks [redacted] PAMs [redacted] Currency hedging	739,970,516 P80:Nil Deferred Risks: Nil PAMs: Nil Currency Hedging: Nil
Direct Construction Costs	2,709,190,955			2,709,190,955
Total ASTI Reopener Funding	**3,528,805,331** P80 Risk [redacted] PAMs [redacted] Deferred Risks [redacted] Currency Hedging	**-43,011,356**		**3,449,161,471** P80:Nil Deferred Risks: Nil PAMs: Nil Currency Hedging: Nil
COAE	0.75%			0.75%

Table 1: Final cost allowance under the ASTI Re-opener for the EGL2 Project (in 18/19 prices)

Next steps

3.30 We aim to publish a statutory consultation on the proposed modifications to the TOs' licence conditions that will give effect to this decision in the coming weeks. Our final decision regarding the elements covered in this consultation is subject to consideration of any further information and views submitted in response to that statutory consultation.