



Making a positive difference  
for energy consumers

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Dear Steven,

## **Indicative Transfer Value for the Beatrice Offshore Windfarm Transmission Assets**

### **Introduction**

1. The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 (the "Tender Regulations") provides the legal framework for the process which Ofgem runs for the grant of offshore electricity transmission licences. Regulation 4 of the Tender Regulations sets out the requirement for the Authority to calculate, based on all relevant information available to it, the economic and efficient costs which ought to be, or ought to have been, incurred in connection with the development and construction of the transmission assets. This process for calculating the economic and efficient costs includes a number of stages, starting with our confirmation of the initial transfer value, progressing to the Indicative Transfer Value ("ITV"), and culminating in our determination of the Final Transfer Value ("FTV") for the project.
2. We wrote to you on 21 September 2018, confirming that the £498.5m forecast of costs provided to us on 24 August 2018, for the development and construction (including financing) of the Beatrice Offshore Windfarm transmission assets (the "Project"), would be taken as its initial transfer value (the "Initial Transfer Value" or "InTV"). This value was included in the Enhanced Pre-Qualification ("EPQ") document and the preliminary information memorandum for the commencement of the EPQ stage of the Project.
3. As part of its ITV submission, Beatrice Offshore Windfarm Limited (the "Developer") submitted a cost assessment template ("CAT") on 22 November 2018, indicating a Project cost of £503.7m. Following significant changes to the Project's costs, the Developer submitted an updated version of this CAT in January 2019, the details of which are discussed in Appendix 1.
4. We have now completed the review of the CAT and ancillary cost information provided by the Developer. This letter sets out:
  - 4.1. an overview of the work that has been undertaken to estimate the ITV;
  - 4.2. our decision to calculate £448.4m as the ITV for the Project; and

4.3. the next steps in the cost assessment process.

5. We note that all costs set at this ITV stage may be revisited at the FTV stage and, unless explicitly stated that a cost item is closed, the Developer should be prepared to provide further justification for costs during discussions to set the FTV.

### Overview of work to arrive at the ITV

6. We have engaged extensively with the Developer to understand the cost data and supporting information, and used these discussions to inform our view of what constitutes the economic and efficient cost for the development and construction of the Project. We have calculated the ITV based on:

6.1. a forensic accounting review of the cost submissions;

6.2. additional information provided by the Developer to substantiate costs; and

6.3. our assessment of the efficiency of costs across relevant cost categories.

### Findings of the ITV assessment

7. Table 1 provides an overview of the cost adjustments that have been made following the Developer's ITV submission. These values include adjustments made by the Developer, our independent forensic accounting consultants, Grant Thornton ("GT"), and by ourselves.

Table 1 - Overall ITV adjustments

<b>Cost</b>	<b>Developer's submitted cost (£m)</b>	<b>Adjustment (£m)</b>	<b>ITV (£m)</b>
Capital expenditure and development costs	468.5	-51.4	417.2
Interest During Construction (IDC)	35.2	-3.9	31.2
<b>Total</b>	<b>503.7</b>	<b>-55.3</b>	<b>448.4</b>

8. The following sections provide a high-level summary of the adjustments that have been made to the individual cost categories for the Project. Appendix 1 provides further details on the adjustments, including more information on the rationale behind each individual adjustment.
9. The values within this letter have been prepared using Microsoft Excel. Therefore, this letter may contain minor rounding adjustments.

### Crosscutting issues

10. In December 2018, the Developer executed a global settlement agreement ("the Settlement") with its main EPC contractor, STDL-Nexans. We received an updated CAT from the Developer in January 2019 that reflected the financial impact of the Settlement, as well as other updated costs. The details of the Settlement are discussed in Appendix 1. Due to its timing, our review of the Settlement and its associated costs is still ongoing, and our final position on these claims will be presented and discussed with the Developer during our FTV assessment.

### *Offshore substations*

11. In its November CAT, the Developer submitted a cost of £112.3m for the design, fabrication, installation and project management of the Project's two offshore transformer modules ("OTMs").
12. Following our ITV assessment, we have made an overall reduction of £27.6m to the offshore substations cost category. This adjustment is made up of the following components:
  - 12.1. A reduction of £1.2m in relation to metering equipment and of £0.7m in relation to the OTMs' array j-tubes. These were deemed to be generation-related equipment, and hence, these values were not included in the ITV.
  - 12.2. A reduction of £3.9m in relation to a spare transformer. We do not believe that transferring a spare transformer to the OFTO is economic and efficient, and hence, this value was removed from the ITV. We note that the Developer maintains that procuring this spare transformer was economic and efficient and will provide further information for our review as part of the FTV assessment.
  - 12.3. A reduction of £4.3m in relation to the additional costs which have been incurred through the design, fabrication and installation of the OTMs as a consequence of generation equipment being incorporated on the OTMs. The Developer is currently preparing a detailed analysis of the impact of this equipment on the OTMs and will provide this for our review as part of the FTV assessment.
  - 12.4. An increase of £7.8m in relation to OTM-related costs of the Settlement. A cost of £10.3m was submitted by the developer in relation to the Settlement. We have deemed £2.5m of this value as not being economic and efficient, and hence, this value has not been included in the ITV. This Settlement will be reviewed further during our FTV assessment.
  - 12.5. A reduction of £25.0m in relation to liquidated damages retained by the Developer from STDL-Nexans.
  - 12.6. A reduction of £0.2m reflecting updates from the Developer in its updated ITV submission.
13. Based on these adjustments, a value of £84.7m has been used to reflect the cost of the OTMs within the ITV.

### *Submarine cables*

14. The Developer initially submitted a cost of £158.6m for the design, fabrication, installation and project management of the Project's submarine cables.
15. Following our ITV assessment, we have calculated an overall increase of £0.2m to the submarine cables cost category. This adjustment is made up of the following components:
  - 15.1. An increase of £2.6m in relation to the submarine cable-related costs of the Settlement. A cost of £3.4m was submitted by the developer in relation to the

Settlement. At this stage, we have deemed £0.8m of this value not to be economic and efficient, and hence, this value has not been included in the ITV. This Settlement will be reviewed further during our FTV assessment.

15.2. Reductions of £1.2m and £0.5m in relation to the procurement and delivery of spare submarine cables, respectively. This adjustment reflects costs associated with 1.7 km of spare cable not being included in the ITV. This adjustment will be reviewed during the FTV assessment, following a more detailed analysis of the Developer's spare cable strategy.

15.3. A reduction of £0.7m in relation to spare cable storage. This cost is for spare cable storage after the wind farm begins to export power. These costs are deemed to be operational costs, not construction or development costs, and hence they have not been included in the ITV.

16. Based on these adjustments, a value of £158.8m has been used to reflect the cost of the submarine cables within the ITV.

17. Our review compared the Project's submarine cable costs with those of other similar projects, and identified that the Project's submarine cable installation costs benchmark significantly higher than we would expect. At the Project's FTV assessment, we will review these costs with the Developer to ascertain any reasons for these higher than expected costs, and reduce the costs if appropriate. We communicated further details on our benchmarking methodology to the Developer during the ITV process.

#### *Onshore cables*

18. The Developer initially submitted a cost of £39.2m for the design, fabrication, installation and project management of the Project's onshore cables.

19. Following our ITV assessment, we have made an overall reduction of £0.2m to the onshore cables cost category. This adjustment is made up of the following components:

19.1. An increase of £1.0m in relation to the onshore cable-related costs of the Settlement. This Settlement will be reviewed further during our FTV assessment.

19.2. A reduction of £1.3m to reflect the removal of projected costs for the Project's 400 kV Horizontal Directional Drilling ("HDD") works, which were included as part of the Settlement negotiations.

20. Based on these adjustments, a value of £39.0m has been used within the ITV to reflect the cost of the onshore cables.

21. Our review compared the Project's onshore cable costs with those of other similar projects, and identified that the Project's costs benchmark significantly higher than what we would expect. At the Project's FTV assessment, we will review these costs with the Developer to ascertain any reasons for these higher than expected costs, and reduce the costs if appropriate.

#### *Onshore substation*

22. The Developer initially submitted a cost of £60.7m for the design, fabrication, construction and project management of the Project's onshore substation.
23. Following our ITV assessment, we have calculated an overall increase of £0.2m to the onshore substation cost category. This was in relation to onshore substation-related costs of the Settlement. This Settlement will be reviewed further during our FTV assessment.
24. Based on this adjustment, a value of £60.9m has been used within the ITV to reflect the cost of the onshore substation.

#### *Reactive substation*

25. The Developer submitted a cost of £27.1m for the Project's reactive and harmonic filtering equipment. We have not made any adjustments to this cost for the calculation of the ITV.

#### *Connection works*

26. The Developer submitted a cost of £0.9m for the connection works undertaken by SSE-Transmission.
27. We recognise that these works are necessary to the Project and we have included the full cost within the ITV.

#### *Other costs*

28. The Developer initially submitted a cost of £67.2m for 'other costs'. This cost category covers costs that are not specific to the Project's individual assets, such as end-to-end project management and insurance.
29. Following our ITV assessment, we have made an overall reduction of £24.0m to this cost category. This adjustment is made up of the following components:
- 29.1. An overall increase of £1.0m in relation to the Settlement. This Settlement will be reviewed further during our FTV assessment.
- 29.2. A reduction of £1.5m in relation to maintenance costs as these costs should not be included as part of the Project's development and construction costs.
- 29.3. A reduction of £2.5m in relation to operational insurance. This is not part of construction and development costs and cannot be included as part of the ITV.
- 29.4. An overall reduction of £19.1m proposed by the Developer to reflect a more accurate representation of the Project's incurred costs.
- 29.5. A reduction of £1.8m in relation to interest payable to the Project's shareholders. Interest during construction ("IDC") provides for all financing costs during the development and construction of the project, and hence, we do not allow additional financing costs to be included within the transfer value.

30. Based on these adjustments, a value of £43.3m was used within the ITV to reflect 'other costs'.

#### *IDC*

31. The Developer initially submitted a cost of £35.2m for its IDC.

32. Following our ITV assessment, we have made an overall reduction of £3.9m to this cost category. This adjustment is made up of the following components:

32.1. An increase of £1.1m in relation to the adjustments made to the Project's cash flow following the updated CAT received in January 2019.

32.2. A reduction of £2.6m in relation to the Project's final IDC payment being accumulated after the Project's first power date.

32.3. A reduction of £0.6m in relation to the IDC accumulated during development of the Project over a duration that we consider to be inefficient. We note that the Developer is continuing to review the methodology that we have applied to calculate this adjustment, and that we will review the Developer's comments during our FTV assessment.

32.4. A reduction of £1.9m as a consequence of the total adjustments that we have made to the Project's capex costs. We note that the Developer is continuing to review the methodology that we have applied to calculate this adjustment, and that we will review the Developer's comments during our FTV assessment.

33. Based on these adjustments, a value of £31.2m has been used within the ITV to reflect the Project's IDC.

34. Any further adjustments made to costs between the ITV being set and the conclusion of the FTV assessment may affect the Project's IDC for the FTV calculation. Therefore, we will keep the IDC under review at the FTV assessment.

#### **Next steps**

35. The cost assessment process for the Project will now proceed into the calculation of the FTV. To inform our FTV assessment we intend to work closely with the Developer and consider further updates from it on costs as the Project progresses. The process will involve the following:

35.1. an ex-post forensic review; and

35.2. a detailed review of the Project's capex and development costs – this may be assisted by independent technical consultants.

36. If you have any questions regarding this letter, please contact Gethin Morris on 020 7901 3932 (or [gethin.morris@ofgem.gov.uk](mailto:gethin.morris@ofgem.gov.uk)) in the first instance.

Yours sincerely,



**Rebecca Barnett**  
**Deputy Director, Commercial & low carbon RAB**

**Appendix 1 - redacted**