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Our Ref: ITV letter  
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Date: 24 June 2020

Dear Maria,

## **Indicative Transfer Value for the East Anglia One Offshore Windfarm Transmission assets**

### **Introduction**

1. The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 (the **Tender Regulations**) provide the legal framework for the process which Ofgem<sup>1</sup> 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 £813.6m forecast of costs provided to us on 24 August 2018, for the development and construction (including financing) of the East Anglia One Offshore Windfarm transmission assets (the **Project**),

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<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

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, East Anglia One Limited (the “**Developer**”) submitted a cost assessment template (“**CAT**”) on 05 July 2019 and subsequently uploaded onto the dataroom supporting information with the adequate level of cost detail on the 5 July 2019.
4. We have now completed the review of the CAT and ancillary cost information provided by the Developer. This letter sets out:
  - a) An overview of the work that has been undertaken to estimate the ITV;
  - b) Our decision to set £715.1m as the ITV for the Project; and
  - c) 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 may be required 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:
  - a) A forensic accounting review of the cost submissions;
  - b) Additional information provided by the Developer to substantiate costs; and
  - c) 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 we made to the Developer's costs submissions set out in the CAT. These values include adjustments made by the Developer, our independent forensic accounting consultants Grant Thornton (**GT**) and by ourselves.

*Table 1 – Overall ITV adjustment\**

<b>Cost</b>	<b>Developer's submitted cost in the CAT (£m)</b>	<b>Adjustment (£m)</b>	<b>ITV (£m)</b>
Capital expenditure and development costs	██████	██████	656.5
Interest During Construction ( <b>IDC</b> )	██████	██████	58.6
<b>Total</b>	██████	██████	<b>715.1</b>

*\*figures have been rounded and total may not sum up.*

8. The following sections provide a high-level summary of the adjustments that we made to the individual cost categories for the Project. Appendix 1 provides further details on the adjustments, covering each of them individually and including more information on the rationale behind each adjustment.
9. Please note that we derived the values within this letter from spreadsheets and the values have been rounded, therefore in some cases, the total may not sum up.

### *Crosscutting issues*

10. After the CAT was submitted for ITV analysis, the Developer re-allocated some costs related to resources. These costs, which were originally allocated to the "Other costs" category but could be attributed to a specific part of the project, were transferred to the appropriated cost categories, to reflect the cost of resources for each category. The amount re-allocated is indicated in Table 2 in the Appendix and in the paragraphs explaining the adjustments made to each cost category. These are also captured in the GT ex-ante report along with all other Developer's adjustments.

### *GT ex-ante review*

11. As a result of the investigation conducted, our financial consultants GT have applied a net positive adjustment of £██████m to the cost of the transmission assets and have highlighted a total amount of unsubstantiated costs of £██████m. These costs have been corrected to take into account cost allocation variations that Ofgem has applied during

ITV to shared costs between the East Anglia One (EA1) project and the proposed East Anglia Three (EA3) project, and to the direct and indirect cost allocation. The impact of the adjustments made to the ITV as a result of this investigation is described in the following paragraphs and in the relevant paragraphs in the appendix.

#### *Offshore substation*

12. The Developer submitted a cost of £[REDACTED]m in the CAT for the design, supply, installation, commissioning and project management of the offshore substation platform (OSP) for the Project.
13. Following our ITV review, we have reduced the OSP category by £[REDACTED]m overall, made up by the following adjustments:
  - a) A reduction of [REDACTED]m as a consequence of the [REDACTED]. This change had an impact on the [REDACTED], which incurred additional [REDACTED] and documentation related costs. The Developer recovered part of these additional costs against the [REDACTED] and added the rest to the costs in its submission. There is an [REDACTED] for this cost and this adjustment is for the difference charged by the [REDACTED];
  - b) A reduction of £[REDACTED]m for various costs related to array J-tubes that we consider generation related costs;
  - c) A reduction of £[REDACTED]m for an [REDACTED] for the [REDACTED] during transportation/installation;
  - d) A reduction of £[REDACTED] for metering costs. These are generation related costs and as such they cannot be included in the ITV;
  - e) A reduction of £[REDACTED]m for costs related to the failure of the [REDACTED]. We state in the cost assessment guidance ("**the Guidance**") that "*we do not expect the Developer to seek cost recovery through the cost assessment for costs that are either unrecovered or disputed from insurance claims*";
  - f) A reduction of £[REDACTED]m for [REDACTED] as a result of a [REDACTED], which, according to the Guidance, should be recovered through the contractor;
  - g) A reduction of £[REDACTED]m for the impact that generation related equipment has on the OSP structure. This is the value we calculated considering the information provided by the Developer. The Developer wishes to submit further analysis related to the contribution of generation related assets to the cost of the OSP. We will review any further information at the FTV;

- h) A reduction of £[REDACTED]m related to costs incurred for [REDACTED] time incurred during the installation window nominated by the Developer. The disallowed costs relate to [REDACTED] experienced during the original commissioning window, which took place between [REDACTED]. [REDACTED]. The Developer wishes to submit further evidence regarding this and we will review any further submissions at the FTV;
- i) A positive adjustment for resources costs re-allocated by the Developer to the OSP category of £[REDACTED]m; and
- j) A reduction of £[REDACTED]m for unsubstantiated costs that GT has identified in the ex-ante forensic review.

14. As a result of the above adjustments, we have estimated the value of £[REDACTED]m to reflect the cost of the OSP for the ITV.

#### *Submarine cable*

15. The Developer submitted a cost of £[REDACTED]m in the CAT for the design, fabrication, installation and project management for the submarine cables.

16. Following our ITV review, we have made an overall increase of £[REDACTED]m to the submarine cable cost category, consisting of the following adjustments:

- a) A positive adjustment of £[REDACTED]m for resources costs the Developer re-allocated to the Submarine Cable category;
- b) A reduction of £[REDACTED]m proposed by the Developer to legal costs; and
- c) A net positive adjustment of £[REDACTED]m for amounts verified and a reduction of £[REDACTED]m for unsubstantiated costs highlighted by GT as a result of the ex-ante investigation.

17. As a result of the adjustments above, we have estimated the value of £[REDACTED]m to reflect the cost of the submarine cable at ITV.

#### *Onshore cables*

18. The Developer submitted a cost of £[REDACTED]m in the CAT for the design, fabrication, installation and project management for the onshore cables.

19. Following our ITV review, we made an overall reduction of £[REDACTED]m to the onshore cables cost category. The adjustments applied consisted of:

- a) A reduction of £[REDACTED]m for costs incurred during construction of the EA1 onshore cable corridor, which included costs for the benefit of the proposed EA3 project. The Developer allocated costs related specifically to EA1 or EA3 to the respective projects and proposed a methodology for allocating the costs that were shared between projects. We discussed extensively with the Developer the criteria that should be adopted for allocating shared costs to each project and agreed a methodology based on the contract type and the actual work carried out on each project. . We concluded that the submitted onshore cable costs should be reduced by £[REDACTED]m to reflect the costs for the Project only and we applied this deduction to the ITV;
- b) A reduction of £[REDACTED]m for personnel costs (including project management) and related expenses that we considered for the benefit of the EA3 project, in which the resources were shared between EA1 and EA3 projects;
- c) A reduction of £[REDACTED]m for land use agreements costs, including agents' costs and crop compensation, relating to the period after first power. These are considered operational costs and, in accordance to the Guidance, are not included in the ITV. The Developer wishes to submit further analysis to explain the inclusion of these costs as a requirement under the DCO obligation and we will review any further information at FTV
- d) A net positive adjustment of £[REDACTED]m proposed by the Developer as a result of: the re-allocation of resources costs to this category, removal of communication sub-ducts [REDACTED] and adjustments to archaeological trenching costs based on the actual work completed; and
- e) A reduction of £[REDACTED]m for adjustments and £[REDACTED]m for unsubstantiated costs that GT has identified as a result of their investigation.

20. As a result of the above adjustments, we estimated the value of £[REDACTED]m to reflect the cost of the onshore cables for the ITV.

#### *Onshore substation*

21. The Developer submitted a cost of £[REDACTED]m in the CAT for the design, construction and project management of the onshore substation.

22. Following our ITV review, the Developer made an overall positive adjustment of £[REDACTED]m to the onshore substation cost category. This included a reduction related to a variation order for [REDACTED] work related to [REDACTED] and an increase for re-allocation of resources to this category. GT did not highlight any adjustments.

23. Based on the above adjustments, we have estimated the value of the onshore substation for the ITV at £[REDACTED]m.

*Reactive compensation equipment (RCE)*

24. The Developer submitted a cost of £[REDACTED]m in the CAT for the design, supply, installation, commissioning and project management of the RCE. Following our ITV review, we have not applied any adjustment to this category for the ITV. GT did not highlight any adjustments.

*Connection works*

25. The Developer submitted a cost of £[REDACTED]m for the connection works undertaken by National Grid. We applied a reduction of £[REDACTED]m to the Developer's submitted costs which included the Developer's adjustment for a cost not pertaining to the transmission system and unsubstantiated costs highlighted by GT. Therefore, we have estimated the cost in the Connection category for the ITV to be £[REDACTED]m.

*Other costs*

26. The Developer submitted a cost of £[REDACTED]m for the category "Other costs", including end-to-end project management and development costs.

27. Following our ITV review, we have reduced the costs of this category by £[REDACTED]m. The adjustments applied consisted of:

- a) We deducted £[REDACTED]m for resources costs that were either not classified or related to the generation assets;
- b) We reviewed the method used to apportion shared costs between the generation and transmission assets of the Project and recalculated the allocation percentages used. This resulted in a deduction of £[REDACTED]m for resources costs and related expenses;
- c) The above review impacted on some of the pre-FID development costs, resulting in a deduction of £[REDACTED]m;
- d) We deducted £[REDACTED]m for EA3 resources related costs based on a review requested by Ofgem and conducted by the Developer to determine the involvement of each role in EA3 related activities;

- e) The Developer proposed a reduction of £[REDACTED]m for costs that should not have been part of the cost assessment and a reduction of £[REDACTED]m for resources costs re-allocated to other categories; and
- f) GT highlighted unsubstantiated costs of £[REDACTED]m and calculated a correction of £[REDACTED]m to apply to these costs due to allocation percentage changes during the ITV process. We applied a net reduction of £[REDACTED]m to the submitted costs.

28. Based on the above adjustments, we estimated the value of this category for the ITV to be £[REDACTED]m.

#### *Transaction costs*

- 29. The Developer submitted a cost of £[REDACTED]m in the CAT for transaction costs.
- 30. The Developer re-allocated resources costs from other categories (resulting in an addition of £[REDACTED]m) and deducted £[REDACTED]m for legal costs. GT proposed an overall deduction of £[REDACTED]m as a result of its ex-ante investigation. We have applied these deductions to the ITV.
- 31. Transaction costs are, at this stage, not fully defined and are, in the main, an estimate of costs. We have not applied any further adjustment at this stage and these costs will be fully reviewed at the FTV stage
- 32. In view of the above adjustments, we have estimated the value of this category at the ITV to be £[REDACTED]m.

#### *IDC*

- 33. The Developer submitted a cost of £[REDACTED]m in the CAT for the Project's IDC. We made a reduction of £[REDACTED]m to the IDC submitted in the CAT to reflect the adjustment made to the project's Capex as part of the ITV process.
- 34. As with each of the costs at the ITV stage, this IDC figure is likely to be revised in response to any new adjustments or disallowances arising from the FTV assessment.
- 35. Based on these adjustments, we have included an estimated value of £[REDACTED]m for the Project's IDC.

#### **Next steps**

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



- a) An ex-post forensic review; and
- b) A detailed review of the Project's capex and development costs, including, but not limited to: [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED].

This review may be assisted by independent technical consultants.

37. If you have any questions regarding this letter, please contact Laura Gusberti on 0141 341 3997 (or [Laura.Gusberti@ofgem.gov.uk](mailto:Laura.Gusberti@ofgem.gov.uk)) in the first instance.

Yours sincerely,



**James Norman**  
**Head of New Transmission Investment**

## **Appendix 1: Redacted**