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Our Ref: ITV letter  
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Date: 02 July 2021

Dear Matthias,

## **Indicative Transfer Value for the Triton Knoll 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 15 October 2020, confirming that the £612.5m forecast of costs provided to us on 8 September 2020, for the development and construction (including financing) of the Triton Knoll 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, Triton Knoll Offshore Windfarm Limited (the "**Developer**") submitted a cost assessment template ("**CAT**") on 19 November 2020 and subsequently provided an updated version on 23 December 2020 ("**CAT RevA**") and a further update ("**CAT RevB**") on 1 February 2021. CAT RevA was used both for the Ofgem analysis of submitted costs and the forensic analysis by our forensic independent accounting consultants Grant Thornton ("**GT**"). CAT RevB was not used for the analysis. However, the costs that the Developer updated in this version, were picked up by GT during their forensic review and included into their recommendations.
4. We have now completed the review of the CAT RevA 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 £576.8m 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 costs submitted 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 review

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, 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	537.6	-8.2	529.4
Interest During Construction ( <b>IDC</b> )	63.2	-15.7	47.5
<b>Total</b>	<b>600.7</b>	<b>-23.9</b>	<b>576.8</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. We have observed issues that are constant across all categories and called them 'crosscutting'. We reviewed the personnel costs submitted by Triton Knoll ('**TK**') and noted that resources were supplied by external contractors and also provided by RWE to TK under a management service agreement. We will review at the FTV stage the rates applied to internal resources to ensure no profit element has been included as, according to the Cost Assessment Guidance<sup>2</sup> (the "**Guidance**"), these should be included at cost.

### *GT ex-ante review*

11. As a result of the investigation conducted, GT have applied an adjustment of £2.3m to the cost of the transmission assets and have highlighted a total amount of unsubstantiated costs of £1.9m. We have included these adjustments into the ITV, with

<sup>2</sup> [Offshore Transmission: Guidance for Cost Assessment](#)

the exception of £1.7m related to transaction costs, which we will review fully at the FTV stage. 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 platform (OSP)*

12. Following our ITV review, we have applied a net positive adjustment to the OSP category by £0.4m, made up by the following adjustments:

- a) A reduction of £0.0m (£8k) for costs of communications related to the generation portion of the project. Although low in value, these costs have not been included as a matter of principle, as no generation related costs can be included into the ITV;
- b) A positive adjustment of £0.4m identified by GT for costs based on the updated re-measurable bill of quantities instead of costs based upon milestone payment amounts; and
- c) a reduction of £0.0m (£40k) for unsubstantiated costs that GT has identified in the ex-ante forensic review.

13. As a result of the above adjustments, we have estimated the value of £98.1m to reflect the cost of the OSP for the ITV.

#### *Submarine cable*

14. Following our ITV review, we have made an overall reduction of £0.6m to the submarine cable cost category, consisting of the following adjustments:

- a) a reduction of £0.0m (£6k) for fibre optic cables used by the generator. We consider the costs not included in the ITV to reflect the use of the fibres for generation purposes. We have therefore apportioned the cost shown here between the transmission and generator. These costs will be reviewed at the FTV stage;
- b) a reduction of £0.1m related to a variation for a delay caused by the Developer's decision on how to manage access to the OSP by the pull-in teams. We do not consider delays of this sort, economic and efficient and therefore we have not included this cost;
- c) a reduction of £0.0m (£42k) for a desktop engineering exercise in the event that a late topside delivery required the installed export cables to be wet stored.

Although the Developer may have acted prudently in order to avoid a larger risk, we cannot expect the consumer to bear these risks. We have therefore not included this cost in the ITV;

- d) a reduction of £0.1m for costs related to consultancy services that TK have advised to be a cost pertinent to the generator part of the project as related to the wind farm;
- e) a reduction of £0.1m for cables type testing, which should be recovered from the contractor, as it was their decision to change the cable supplier, resulting in the need for additional type testing. The Developer has advised it will provide further information regarding this cost at the FTV stage, to demonstrate that this cost was already deducted from the contract. We will review any new information the Developer may provide at FTV;
- f) a reduction of £ 0.2m for forecasted costs unlikely to be incurred that we removed following GT's ex-ante review.

15. As a result of the adjustments above, we have estimated the value of £129.9m to reflect the cost of the submarine cable at ITV.

#### *Onshore cables*

16. The Developer submitted costs in the CAT for the design, fabrication, installation and project management for the onshore cables.

17. Following our ITV review, we made an overall reduction of £0.3m to the Developer's onshore cable cost category. The adjustments applied consisted of:

- a) Two reductions of £0.1m each, for standby costs, related to delays in obtaining permission in advance of starting works, from National Grid (NG) and Rail Network respectively. The information provided so far does not explain why permission was not obtained in advance of work commencing and that it was the contractor's responsibility to check permission in advance of conducting the works. We do not consider these costs economic and efficient and we consider these were incurred as a result of inefficient contractor interface management;
- b) A reduction of £0.1m for costs related to post-construction crop compensation. According to the cost assessment guidance: *'Developers [...] need to compensate land owners for disruption caused by construction activities. We can consider including these costs up to the point of construction being complete, but not beyond that point into the operational period'*; therefore we have not included these costs;

- c) A reduction £0.2m for fibre optic cables that are used for the benefit of the generator. The reasons for this reduction are the same as discussed under paragraph 16 a);
- d) GT highlighted a positive adjustment of £0.3m and we incorporated a negative adjustment of £0.1m for unsubstantiated costs.

18. As a result of the above adjustments, we estimated the value of £133.4m to reflect the cost of the onshore cables for the ITV.

#### *Onshore substation*

19. The Developer submitted costs in the CAT for the design, construction and project management of the onshore substation.

20. Following our ITV review, the Developer made an overall adjustment of £0.6m, made up by the following reductions:

- a) £0.2m for costs related to tariff metering and other generation-related costs;
- b) £0.2m for the area of the onshore substation occupied by generation-related equipment. The Developer provided an estimate of costs for which we have applied an adjustment. We may review this information at FTV to ensure all elements of costs have been taken into account;
- c) £0.1m for costs to accelerate the access track construction to avoid delaying National Grid (NG) from commencing the Unlicensed Works<sup>3</sup>. From the information provided by the Developer, we consider that the acceleration measures were taken in order to keep generation related targets on track and therefore have not been included in the ITV;
- d) £0.0m (£33k) in relation to costs for a wind turbine generator model needed for onshore substation commissioning that contained errors and inconsistencies. We regard the costs for this ineffective work as not being economic and efficient and have not included them in the ITV;
- e) As part of their review, GT have highlighted £0.0m (£25k) of unsubstantiated costs which we have not included in the ITV.

21. Based on the above adjustments, we have estimated the value of the onshore substation for the ITV at £64.7m.

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<sup>3</sup> Unlicensed Works are works needed to connect a transmission project to a NG substation and that NG is not required, under its transmission licence, to carry out itself.

### *Reactive compensation equipment (RCE)*

22. The Developer submitted costs in the CAT for the design, supply, installation, commissioning and project management of the RCE. Following our ITV review, we have only adjusted this category for £0.0m (£15k) for unsubstantiated costs highlighted by GT, therefore the estimated value at ITV for the reactive compensation equipment is £39.6m.

### *Connection works*

23. The Developer submitted costs for the connection works undertaken by National Grid. We applied a reduction of £0.1m to the Developer's submitted costs for various items related to:

- a) interface issues between the Developer and the contractor;
- b) additional costs not specified at the time of contract; and
- c) Covid-related costs. However the Developer did not provide sufficient details to demonstrated how Covid did affect this cost.

24. As a consequence, we have estimated the cost in the Connection category for the ITV to be £3.3m.

### *Other costs*

25. The Developer submitted costs, including end-to-end project management and development costs, into the category "Other costs",

26. Following our ITV review, we have reduced the costs of this category by £7.0m. The adjustments applied consisted of:

- a) A reduction of £4.3m due to our review of the devex costs and the allocation method applied to the shared costs (between the generation and transmission assets). The Developer used Cost Allocation Keys (CAKs) to apportion costs that could not be attributed directly to either the generation or the transmission parts of the project. We do not agree on how some CAKs have been applied and reverted to the capex split in accordance to the Guidance: *'In the event that a Developer is unable to provide a metric and has based allocations on an estimate, or we do not consider that a clear, transparent and appropriate allocation methodology has been used, we may: allocate these costs based on*

*an estimate of the percentage of Transmission Assets' cost versus the total costs of the project'; and*

- b) All other costs that were not included in this category are the result of the ex-ante review conducted by GT, which resulted in a reduction of £2.8m.

27. Based on the above adjustments, we estimated the value of this category for the ITV to be £57.8m.

#### *Transaction costs*

28. The Developer submitted transaction costs into the CAT.

29. Transaction costs are, at this stage, not fully defined and are, in the main, an estimate of costs. We have not applied any adjustment at this stage and these costs will be fully reviewed at the FTV stage.

#### *IDC*

30. The Developer submitted costs in the CAT for the Project's IDC. We have made an overall reduction of £15.7m to the IDC, including a reduction of £6.1m for adjusting the duration of the pre-FID period in line with other projects under the Development Consent Order (DCO) regime. The pre-FID duration includes a period where the onshore substation location had to be defined and the project was not progressing. We will review at the FTV stage any further information the Developer may submit regarding this issue.

31. We applied a reduction of £8.9m to account for the point in time when IDC should cease. We will review at the FTV stage the time when IDC should stop, in line with the Guidance, once we will obtain full information of energisation and commissioning activities,

32. Finally, the IDC was adjusted by a further £0.7m, proportionate to the reduction in capex caused by costs not being included in the ITV.

33. 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.

34. Based on these adjustments, we have included an estimated value of £47.5m for the Project's IDC.



## **Next steps**

35. 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 will consider further updates from the Developer on costs as the Project progresses and any new information that is submitted, including those related to certain costs disallowed at ITV. 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:
  - i. sea cable supply
  - ii. onshore cable;
  - iii. fibre optic cables;
  - iv. resource costs
  - v. allocation of shared capex and development costs to the transmission assets; and
  - vi. review of the period and duration in which IDC is applicable.

36. This review may be assisted by independent technical consultants.

37. If you have any questions regarding this letter, please contact Sean Conway on 0141 341 3989 ([Sean.Conway@ofgem.gov.uk](mailto:Sean.Conway@ofgem.gov.uk)) in the first instance.

Yours sincerely,

**Jourdan Edwards**  
**Head of the OFTO Regime**

## **Appendix 1: Reconciliation of costs (all redacted)**