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Dear Damien,

## Seagreen - Initial Transfer Value and Cost Assessment Process

### Introduction

In order to commence the Enhanced Pre-Qualification (**EPQ**) stage for the Seagreen Phase 1 Wind Farm (the **Project**) we<sup>1</sup> will publish the EPQ document and Preliminary Information Memorandum (**PIM**) (together the **EPQ Documentation**). In the EPQ Documentation we will include the Initial Transfer Value for the Project for the purposes of the bidders' EPQ submissions.

The purpose of this letter is to set out to you:

1. the Initial Transfer Value for the Project to be referred to in the EPQ Documentation; and
2. an overview of the cost assessment process.

### Initial Transfer Value

In your cost submission of 26 October 2021, you provided us with an initial forecast of costs for the development and construction of the transmission assets for the Project. We understand your forecasted costs to be approximately £633.3m, which is comprised of:

- Capital expenditure (including contingency): £514.3m
- Other costs (including transaction costs): £48.8m
- Interest During Construction (**IDC**) costs: £70.2

The Initial Transfer Value is, therefore, **£633.3m** and this is the figure that will appear in the EPQ Documentation.

These figures are based on your chosen offshore boundary point located at the 66 kV switchgear incoming circuits on the offshore substation (**OSS**) platform on the busbar side.

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<sup>1</sup> References to "Ofgem", "the Authority", "we", "us" and "our" are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

As a result of the chosen boundary point, we understand that the following assets will transfer to the Offshore Transmission Owner (**OFTO**):

- *a single offshore substation (OSS)* – including three 220/66 kV transformers, three 66/0.4kV auxiliary transformers, 220 kV gas insulated switchgear (**GIS**), 66 kV GIS incomer circuits, 66 kV bus duct interconnectors, and auxiliary systems;
- *three offshore export cables (with associated fibre optics)* – all of these circuits are 220 kV, and when combined come to a total length of 192km. Each circuit is 64km long. Each circuit is divided into near shore (0.5km) and far shore (63.5km);
- *three onshore export cables (with associated fibre optics)* – onshore 220 kV underground cables of 20.2km route length;
- *an onshore substation* – including three 275/220/29kV super grid transformers complete with 275 kV and 220 kV air insulated switchgear, two 400 kV shunt reactors, three 220 kV shunt reactors, three dynamic reactive compensation plants, six 220kV harmonic filters, and three 29/.04kV auxiliary transformers;
- *SCADA and Human-Machine Interface* – for the control and management of onshore 275 kV switchgear; 275 kV super grid transformer and controllers; 220 kV switchgear; OSP 220/66kV grid transformer and controllers; auxiliary transformer; 66kV switchgear incomers; and onshore and offshore power quality meters.

We note that this boundary point and the assets transferring may be subject to change at a later date, and that this may result in changes to the cost estimates and/or assessment described in this letter.

**You should note that the use of this information is not an endorsement by us of the basis on which you derived your estimated costs or any assumptions or methodology that you used in your calculations. It is simply being used for the purpose of commencing the tender exercise.**

### **Cost Assessment Process**

The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 (the **Regulations**) provide the legal framework for the process which Ofgem runs for the grant of offshore electricity transmission licences. The Regulations<sup>2</sup> set out the requirement for the Authority to calculate, based on all relevant information available to it at the time, the economic and efficient costs which ought to be, or ought to have been, incurred in connection with developing and constructing the offshore transmission assets in respect of a qualifying project.

Where the construction of the transmission assets has not reached the stage when those transmission assets are available for use for the transmission of electricity, this calculation will take the form of an estimate of the costs which ought to be incurred in connection with the development and construction of those transmission assets. This estimate is the Indicative Transfer Value (**ITV**) for the Project which will be included in the Invitation to Tender (**ITT**) documentation. This value will be used for the Tender Revenue Stream (**TRS**) bids submitted by bidders at the ITT stage.

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<sup>2</sup> Regulation 4(1).

Where construction has reached the stage when those transmission assets are available for the use of the transmission of electricity, the calculation of costs will take the form of an assessment of the costs which ought to have been incurred.

In our initial review of your submitted costs we note the following areas that will need further discussion, together with anything else arising from our reviews:

- £16.8m in development costs have not been broken down in the CR8 cost category;
- Some costs appear to be pro-rated estimates (for example, in CR2 the 66 kV busducts and surge arrester all appear to have the same cost, the same applies to the electrical equipment in CR5 and CR6). Explanations around this will be required;
- The inclusion of a 275kV supergrid transformer has been included in CR2 offshore. This needs clarification/further discussion;
- Costs relating to 'snagging lists' have been included in CR2 and CR5;
- The onshore transformers do not appear to be broken out in CR5. This is required for TNUoS (Transmission Network Use of System) charging purposes;
- Details of the settlement in CR5 of £3.7m will be required;
- Acceleration costs have been included in CR7;
- O&M base costs have been included in CR8. This will have to be justified, as O&M cost are not construction nor development costs and cannot be included;
- Land and fisheries costs should be reallocated to the relevant assets that they refer to; and
- The IDC cashflow – the development cost of £16.8m is included at the date of June 2020. We would expect the development of the project to have been long before that date. We would need a detailed breakdown of this figure and we would expect these values to be included at the start of the project when they were incurred.

If this project was purchased as a partly developed project, please provide details of the transaction and details of any changes in ownership of the project.

## **Data Collection**

Under Regulation 4(3) of the Regulations, we may request information from you for the purpose undertaking our cost assessment process. This will enable bidders to take into account the most accurate ITV in order to meet any requirements of a particular stage of the tender process.

Through the cost assessment process you will be required to complete cost reporting templates and cash flow schedules. These will relate to the forecast and actual costs of construction contracts, development costs, and financing costs related to the development and construction of the transmission assets being transferred to the OFTO.

You may also be required to provide supporting evidence to substantiate these cost submissions including, amongst other things, contract documentation (including completed variation orders where necessary), supplier payment lists, and asset schedules.

We remind you that if you fail to provide such information to us this could constitute an event of disqualification under the Regulations.

### **Updated Cost Estimates**

During the EPQ stage, Ofgem will review and analyse the cost information that you have provided. We may request further information from you to calculate the ITV.

In calculating the ITV we will conduct an initial forensic accounting investigation. This may require our external advisers to visit your offices and will involve checking your internal documents, contracts, and supporting information. This may also require Ofgem to visit your offices to ensure that all the relevant information is available prior to our external advisers' visit. We will contact you as part of the ITV process to discuss this further.

In conducting our analysis for the ITV we will use project information gathered from offshore transmission developers to compare costs between projects and identify any cost outliers on the Project when compared to the range of other projects. Where cost outliers are identified, we will liaise directly with you to ascertain the reason for this. In addition, we may indicate to our technical consultants that a cost outlier requires further investigation into whether the proposed cost is economic and efficient.

We will confirm the ITV to you in writing, along with an explanation of our rationale in reaching this estimate of costs. We may also provide further updates to the ITV during the Preferred Bidder (**PB**) stage for the purposes of inclusion within the PB's TRS.

### **Assessment of Costs and Final Transfer Value**

We intend to commence the process for the assessment of costs during the PB stage. This assessment of costs shall be used by Ofgem to determine the value of the transmission assets to be transferred to the successful bidder in respect of the Project (the final transfer value determined by Ofgem).

### **Next steps**

We will shortly be in contact with you to set out further details in relation to the cost assessment process.

If you have any questions regarding this letter, please contact Phill Heyden on 0207 901 0516 or via email ([Phillip.heyden@ofgem.gov.uk](mailto:Phillip.heyden@ofgem.gov.uk)) in the first instance.

Yours sincerely,



**Jourdan Edwards**

**Head of the OFTO Regime  
Networks**