



Walney 1 Offshore Transmission Assets
Ex Post Financial Cost Review

19 October 2011

Ernst & Young LLP

Private and confidential

The Office of the Gas and Electricity Markets Authority
9 Millbank
London
SW1P 3GE

19 October 2011

Dear Sir

Walney 1 Offshore Transmission Assets – Ex Post Financial Cost Review**Introduction**

Further to the Contract Task Order dated 4 February 2010 (Task Order Number 62/023A) we have undertaken an Ex Post Financial Cost Review (“the Review”) in respect of the Walney 1 Offshore Transmission Assets (“the Walney 1 Transmission Assets”).

Work performed

In undertaking the Review our work comprised the review procedures as prescribed by Ofgem and set out in Appendix A to this report (“the Review Procedures”). Details of the results from the Review Procedures are set out in the body of this report.

Purpose of our report and restrictions on its use

This report has been prepared solely for the benefit of The Office of the Gas and Electricity Markets Authority (“Ofgem”).

We understand that Ofgem will disclose this report to the developer of the Walney 1 Transmission Assets and to the preferred bidder for the Walney 1 Transmission Assets. We consent to that disclosure on the basis that Ernst & Young LLP assumes no responsibility to any user of this report other than Ofgem and any other person that chooses to rely on it does so entirely at their own risk.

Statement of independence

Ernst & Young LLP has been appointed by DONG Energy A/S and its subsidiary undertakings in the past in relation to a number of matters. In order to maintain our independence in undertaking the Review confidentiality and ring fencing procedures were put in place. We therefore do not consider that our independence is impaired in relation to the Review.

Yours faithfully

Ernst & Young LLP

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1. Introduction and executive summary

1.1 Introduction

1.1.1 Background

Under a new regulatory regime governing the ownership and operation of offshore electricity transmission certain offshore transmission assets that were either in the course of construction or which had been constructed are to be sold by the developer/generator and purchased via a competitive tender process by an Offshore Transmission Operator.

As part of the tender process Ofgem has undertaken an exercise to calculate the economic and efficient costs of construction of the offshore transmission assets (“the Estimated Transfer Value”). The Estimated Transfer Value is the summation of the estimated costs to complete and commission the offshore transmission asset including capital costs, interest costs, developments costs and costs associated with the tender process. Potential acquirers of the offshore transmission assets are required to use the Estimated Transfer Value as the basis for their bids.

In July 2009 Ofgem and RBC Capital Markets issued a preliminary information memorandum in relation to each relevant offshore transmission asset (“the PIM”). Each PIM contained an initial view of the Estimated Transfer Value. This initial view was updated by Ofgem following the receipt of additional information from the developers and an updated Estimated Transfer Value was set out in the First Transitional Tender Information Memorandum (“the FTTIM”) issued by Ofgem and RBC Capital Markets in September 2009.

Following completion of the construction of each offshore transmission asset Ofgem will undertake a final assessment of the total costs (“the Final Transfer Value”). The developers have provided further information to enable Ofgem to undertake this assessment.

As part of the tender process Ofgem requires independent verification of the costs incurred by the developers which are to be taken into account in the assessment of the Final Transfer Value.

1.1.2 Project costs

The total project costs of the Walney 1 Transmission Assets can be summarised as follows:

- ▶ Estimated Transfer Value per the PIM: £99.4 million (including financing costs of £9.1 million).
- ▶ Updated Estimated Transfer Value per the FTTIM: £101.8 million (including financing costs of £12.7 million).
- ▶ The latest estimate of total costs (“the Cash Flow Schedule¹”) by the developer²: £106.9 million (including financing costs of £8.2 million and transaction costs of £1.7 million).
- ▶ We understand that a technical assessment will be undertaken, in particular on the cable installation and associated work. This technical assessment may result in a recommendation that, if accepted by Ofgem, could lead to a restriction on the developer’s costs set out in this report.

¹ The Cash Flow Schedule is set out at Appendix B. Subsequent to the preparation of the Cash Flow Schedule the Developer has reallocated certain costs between ‘development costs and ‘transaction costs’ (as noted in Appendix B).

² Based on actual costs and accruals recorded in SAP as at 04/02/2011

1.1.3 Content of this report

To verify the costs incurred by the developer which are to be included in the Final Transfer Value we have been instructed by Ofgem to undertake certain Review Procedures. This report sets out the Review Procedures that have been undertaken and their results in the following sections:

- ▶ This section gives an overview of the relevant offshore transmission assets, an outline of the Review Procedures that we have performed and an executive summary of our findings.
- ▶ Section 2 summarises the way in which the developer has recorded the costs that it has incurred, a detailed description of the Review Procedures performed and their results.
- ▶ Section 3 sets out changes in the costs included in the Estimated Transfer Value between the PIM and the FTTIM and between the FTTIM and the Cash Flow Schedule.
- ▶ Section 4 summarises the Cash Flow Schedule in total and then by the principal asset categories and identifies accrued amounts which have been not yet been paid by the developer.

The report contains a number of appendices which include supporting information.

1.2 The Walney 1 Transmission Assets

1.2.1 Location

The Walney 1 Transmission Assets connect the Walney 1 Wind Farm Assets³ ('The Walney 1 Wind Farm Assets'), to the 400/132kV National Grid substation at Heysham, Cumbria. The Walney 1 Transmission Assets and Walney 1 Wind Farm Assets are located off the Cumbrian coast in northwest England. The onshore transmission licensee is National Grid Electricity Transmission ("NGET").

1.2.2 History

The Walney 1 Wind Farm Assets and the Walney 1 Transmission Assets are owned by Walney (UK) Offshore Windfarms Limited ("the Developer"). Walney (UK) Offshore Windfarms Limited is owned by DONG Wind (UK) Limited (50.1%), SSE Renewables Holdings (UK) Limited (25.1%), and a consortium of PGGM and Dutch Ampere Equity Fund, which is managed by Triodos Investment Management (24.8%).

Key events in the history of the Walney 1 Wind Farm Assets and the Walney 1 Transmission Assets are as follows:

- ▶ 2004: Walney (UK) Offshore Windfarms Limited was incorporated under the then name of DONG Walney (UK) Limited. All of the share capital was owned by DONG Wind (UK) Limited with the ultimate parent company being DONG Energy A/S.
- ▶ 2008: Construction of the Walney 1 Wind Farm Assets and Walney 1 Transmission Assets commenced.
- ▶ 2009: SSE Renewables Holdings (UK) Limited acquired 25.1% of the share capital of DONG Walney (UK) Limited from DONG Wind (UK) Limited.
- ▶ 2009: DONG Walney (UK) Limited was renamed Walney (UK) Offshore Windfarms Limited and a new board of directors was put in place.

³ We note that the Walney 1 Wind Farm Assets do not form part of the Walney 1 Transmission Assets that are the subject of this report.

- ▶ 2010: A consortium of PGGM and Dutch Ampere Equity Fund, which is managed by Triodos Investment Management, acquired 24.8% of the share capital of Walney (UK) Offshore Windfarms Limited from DONG Wind (UK) Limited.
- ▶ 2011: Commissioning of Walney 1 Wind Farm Assets and Walney 1 Transmission Assets commenced and is expected to be completed in April 2011.
- ▶ 2011: The first operational wind turbine was connected on 13 January 2011.

1.2.3 Project assets

The Walney 1 Transmission Assets comprise:

- ▶ An offshore substation.
- ▶ A subsea cable approximately 45.3 km in length.
- ▶ Three onshore cables each approximately 2.7 km in length.
- ▶ An onshore substation.

The boundary points, set out in the PIM are:

- ▶ Offshore: Located at the transformer cable sealing end of the 33kV cables connected to the 132/33kV transformer.
- ▶ Onshore: Located within the onshore substation at NGET's 132kV busbars, with the busbars in the line bay itself being the interface between NGET and the Walney 1 Transmission Assets.

1.3 Scope of the Review Procedures

1.3.1 Principles

The Review Procedures have been performed on the cash expenditure that has been incurred by the Developer in constructing the Walney 1 Transmission Assets, in accordance with the developers compensation principles consulted upon by Ofgem with the offshore wind industry.

Taxation and non-cash items including depreciation are not included in the Cash Flow Schedule and are therefore not within the scope of the Review Procedures.

Financing costs (also referred to as 'interest during construction') and transaction costs are included within this report in the calculation of total project value. The calculation of financing costs and transaction costs has been subject to a separate review by Ofgem and is not within the scope of the Review Procedures.

1.3.2 Procedures

The Review Procedures that we have undertaken are set out in Appendix A to this report.

The Developer has provided the Cash Flow Schedule setting out the latest estimate of total capital and development costs which it has incurred; this schedule is attached at Appendix B.

The objective of the Review Procedures is to verify the costs included by the Developer in the Cash Flow Schedule by tracing a sample of costs to the Developer's accounting systems and to source documentation e.g. purchase invoices and bank statements.

The Review Procedures do not constitute an assessment as to whether the costs of construction were incurred in an economic and efficient manner. As a generality Ofgem's

expectation is that developers will procure in an economic and efficient manner in order to seek to obtain a return on investment in a competitive generation market.

1.3.3 Information

Based on the Cash Flow Schedule prepared by the Developer Ofgem has selected a sample of costs upon which we have undertaken the Review Procedures.

In order to perform the Review Procedures we visited the Developer's premises and were provided with information and explanations as described in sections 2 to 4 of this report.

Our work is based on the Cash Flow Schedule contained within the spreadsheet 110311_WOW1OFTO ex-post_total budget_with OFTO new categories _KEMA_submission.xlsx provided by the Developer to us on 11 March 2011.

1.4 Executive summary

The costs included in relation to the construction of the Walney 1 Transmission Assets, as set out in the Cash Flow Schedule, can be summarised as follows:

Cost category	Directly incurred cost	Indirectly incurred cost	Total cost	Sample tested
Offshore substation	£████████	-	£████████	£████████
Offshore cable supply and install	£████████	-	£████████	£████████
Land cable	£████████	-	£████████	£████████
Onshore substation	£████████	-	£████████	-
Connection contract costs	£████████	-	£████████	-
Development costs	£████████	£████████	£████████	-
Contingency	£████████	-	£████████	-
Foreign currency hedging loss	£████████	-	£████████	-
Total direct and indirect costs	£████████	£████████	£████████	£████████
Interest during construction	£████████	-	£████████	-
Transaction costs	£████████	-	£████████	-
Total project value	£████████	£████████	£████████	£████████

We performed the Review Procedures set out in Appendix A on a sample of the costs incurred by the Developer, as selected by Ofgem. That sample represents 67% of the total direct and indirect costs.

The following exceptions were noted in the results of the Review Procedures:

- ▶ The Cash Flow Schedule includes amounts of £████████ (Bladt), £████████ (Visser & Smit) and £████████ (Prysmian) which have been processed for payment but not recorded on a bank statement by the date of the Review Procedures. We are therefore unable to agree the amounts to bank statements.
- ▶ The Cash Flow Schedule includes a number of accruals which relate to the contracts selected for review by Ofgem. As these accruals have not yet been invoiced, we are unable to agree the amounts to invoices or bank statements.

- ▶ The Cash Flow Schedule includes an amount for a Visser & Smit invoice of € [REDACTED] (£ [REDACTED]). The value per the invoice is € [REDACTED] (£ [REDACTED]). The Cash Flow Schedule is therefore understated by £ [REDACTED].

In addition, in undertaking the Review Procedures we noted the following:

- ▶ The Cash Flow Schedule includes an amount of £ [REDACTED] in relation to the Prysmian contract. As this amount related to both land and sea cable, the Developer has split the costs between 'Offshore cable supply' (£ [REDACTED]) and 'Land cable' (£ [REDACTED]). We understand that this allocation is based upon the respective lengths of each cable⁴.
- ▶ The Developer has allocated certain costs between the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets using various methods including management judgement.
- ▶ Indirectly incurred costs relate to the Developer's own staff time spent project managing construction of the Walney 1 Transmission Assets and include an allocation of group overheads and a profit margin.
- ▶ The Cash Flow Schedule includes a foreign exchange hedging loss of £ [REDACTED] million. This hedging loss represents an allocation of total hedging losses recorded in 2009. The losses relating to the Walney 1 Transmission Assets are in regard of Euro to Sterling hedge contracts entered into by the Developer against forecast contract commitments as a whole and are not allocated to individual contracts or assets. Given the movement in the Euro to Sterling exchange rate over the period covered by the hedging contracts we would expect that the hedging contracts would result in losses.
- ▶ The total value of the Walney 1 Transmission Assets per the Cash Flow Schedule, excluding financing costs and transaction costs has increased by £ [REDACTED]m in comparison to the total value per the FTTIM. We understand that the main reason for this increase is primarily additional variation orders between the date of the FTTIM and the Cash Flow Schedule.

Of the total direct and indirect costs included in the Cash Flow Schedule provided by the Developer, £ [REDACTED]m ([REDACTED]%) is represented by accrued amounts, these amounts are expected to be paid once the commissioning phase is completed and contractors have submitted their final statements of account.

⁴ We note that the Developer has calculated this allocation between categories based on a ratio of [REDACTED]km/[REDACTED]km. The correct ratio should have been ([REDACTED]km)/([REDACTED]km + [REDACTED]km) as per section 1.2.3. As the ratio is only used to allocate costs between categories in the Cash Flow Schedule this miscalculation does not affect the total project value.

2. Review procedures

2.1 Introduction

In order to verify the costs included on the Cash Flow Schedule we have performed the Review Procedures detailed in Appendix A in relation to a sample of cost items selected by Ofgem.

This section of the report contains:

- ▶ An overview of the way in which the Developer has prepared the Cash Flow Schedule from their underlying accounting systems.
- ▶ The results of the Review Procedures in relation to:
 - ▶ Directly incurred costs: Costs incurred by the Developer in relation to third party suppliers which were incurred in construction of the Walney 1 Transmission Assets.
 - ▶ Indirectly incurred costs: Project management costs incurred by the Developer, a proportion of which has been allocated to the Walney 1 Transmission Assets in the Cash Flow Schedule.

2.2 Preparation of the final Cash Flow Schedule

2.2.1 Accounting records

The Cash Flow Schedule was prepared by the Developer's project accountant based upon the accounting records of Walney (UK) Windfarms Offshore Limited.

The main components of the process for compiling the final Cash Flow Schedule were:

- ▶ The Developer and contractors entered into contracts for the provision of construction work.
- ▶ A separate general ledger code structure was set up in SAP to record the costs of constructing the Walney 1 Transmission Assets.
- ▶ A purchase order for the full value of each contract/variation was created within SAP.
- ▶ The contractor periodically issued applications for payment, which the Developer agreed, prior to an invoice being issued.
- ▶ Invoices were automatically matched against the relevant purchase order, coded to the relevant SAP codes and paid.
- ▶ Staff costs were coded to the project by SAP on a daily/monthly basis as set out in section 2.4.2.
- ▶ Accruals were calculated each quarter using a SAP report which showed the total value of purchase orders created less invoices allocated against the purchase orders at that date, effectively calculating costs which were committed to, but not invoiced. The report was sense checked and further amended for amounts not subject to purchase orders and accruals relating to indirectly incurred costs.
- ▶ Each quarter, a report was generated from SAP which showed actual costs compared to budget for the whole of the Walney 1 project. This report was discussed and agreed with lead engineers before being presented to the project manager for approval.

The accounting records maintained in SAP explicitly separate amounts relating to the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets via the general ledger account code structure. However, certain costs were allocated between the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets as set out below.

The accounting records maintained by the Developer provide an adequate record of the costs incurred and which are included in the Cash Flow Schedule.

2.2.2 Allocation of costs

Certain costs in the Cash Flow Schedule have been allocated between the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets by the Developer. This allocation has been performed on the following basis:

- ▶ The Developer has allocated █% of landowner costs to the Walney 1 Transmission Assets based on management estimate. It is understood that the majority of such costs relate to construction of onshore assets.
- ▶ The Developer has allocated █% of site costs to the Walney 1 Transmission Assets based on management estimate. We understand that site costs relate to costs such as legal, travel and consents costs.
- ▶ The Developer has allocated █% of insurance costs using a calculation based on the proportion of the total costs of the Walney 1 Transmission Assets in comparison to the total estimated costs of both the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets.
- ▶ Within offshore substation costs, the Developer has included █% of the total cost of constructing foundations based on the number of offshore foundations as a proportion of total number of foundations.
- ▶ Project management costs have been allocated to the Walney 1 Transmission Assets using a proportion of █% of the total project management costs incurred by the Developer. The █% allocation is based on the Developer's estimate of costs relating specifically to the Walney 1 Transmission Assets. In October 2010, the Developer performed a review of all project management costs charged to SAP. As part of the review costs were analysed between transmission, generation and indirect costs. Transmission costs represented █% of the total value.

2.3 Directly incurred costs

2.3.1 Work performed

The sample of directly incurred costs selected by Ofgem in relation to the Walney 1 Transmission Assets is set out in section 2.3.2, below.

The work performed in relation to these costs is set out in steps 1 to 6 of section 2 of the Review Procedures set out in Appendix A.

2.3.2 Results

The results of the Review Procedures are summarised below and set out in detail at Appendix C to Appendix F.

	Total value included in Walney 1 Transmission Assets	Value agreed to Purchase Invoices	Value agreed to Bank Statements	Value agreed to Accounting Ledgers
Bladt (Offshore substation)	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Scaldis (Offshore substation)	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Visser & Smit (Offshore cable supply and install)	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Export cables Supply – Prysmian (Offshore cable supply and install and land cable)	£ [REDACTED]	[REDACTED]	£ [REDACTED]	£ [REDACTED]
TOTAL	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]

The following exceptions were noted in the results of the Review Procedures:

- ▶ The Cash Flow Schedule includes amounts of £ [REDACTED] (Bladt), £ [REDACTED] (Visser & Smit) and £ [REDACTED] (Prysmian) which have been processed for payment but not recorded on a bank statement by the date of the Review Procedures. We are therefore unable to agree the amounts to bank statements.
- ▶ The Cash Flow Schedule includes a number of accruals which relate to the contracts selected for review by Ofgem. As these accruals have not yet been invoiced, we are unable to agree the amounts to invoices or bank statements.
- ▶ The Cash Flow Schedule includes an amount for a Visser & Smit invoice of € [REDACTED] (£ [REDACTED]). The value per the invoice is € [REDACTED] (£ [REDACTED]). The Cash Flow Schedule is therefore understated by £ [REDACTED].

In addition, in undertaking the Review Procedures we noted the following:

- ▶ The Cash Flow Schedule includes an amount of £ [REDACTED] in relation to the Prysmian contract. As this amount related to both land and sea cable, the Developer has split the costs between 'Offshore cable supply' (£ [REDACTED]) and 'Land cable' (£ [REDACTED]). We understand that this allocation is based upon the respective lengths of each cable.⁵
- ▶ The Developer has allocated certain costs between the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets using various methods including management judgement.
- ▶ Of the total direct and indirect costs included in the Cash Flow Schedule provided by the Developer, £ [REDACTED]m ([REDACTED]%) is represented by accrued amounts, these amounts are expected to be paid once the commissioning phase is completed and contractors have submitted their final statements of account.

⁵ We note that the Developer has calculated this allocation between categories based on a ratio of [REDACTED]. The correct ratio should have been ([REDACTED]) as per section 1.2.3. As the ratio is only used to allocate costs between categories in the Cash Flow Schedule this miscalculation does not affect the total project value.

2.4 Indirectly incurred costs

2.4.1 Work performed

The sample selected by Ofgem did not include any indirectly incurred costs in relation to the Walney 1 Transmission Assets. However, we discussed the basis of inclusion of indirectly incurred costs with the Developer.

2.4.2 Results

The Developer has allocated an element of its own staff costs to the Walney 1 Transmission Assets to account for internal project management as set out below:

- ▶ Staff time is automatically analysed and allocated to the Walney 1 project each day within SAP.
- ▶ The initial staff cost is calculated on the basis of hours multiplied by a predetermined rate. We understand that the initial rate covers direct production related costs (eg. Wages, pension, holiday etc) and indirect production costs (eg. Managerial costs, HR, IT etc.).
- ▶ A further journal is processed each month to increase the value of the staff cost allocation at a predetermined rate per hour to account for non-production group costs (support functions, marketing department costs etc.) and profit margin. The mark-up is intended to reflect the market rate for the relevant grade of employee. This mark-up which varies from █% for a senior manager to █% for a technician is not analysed into its constituent elements.
- ▶ Of the total internal staff cost incurred in managing the entire Walney 1 project, █% has been allocated to the Walney 1 Transmission Assets in the Cash Flow Schedule based on the Developer's estimate of the internal staff time spent managing construction of the Walney 1 Transmission Assets.

2.5 Hedging losses

The Cash Flow Schedule includes a foreign exchange hedging loss of £█ million. The hedging loss represents an allocation of the total hedging losses recorded by the Developer in relation to all Euro to Sterling hedge contracts entered into in 2009 in relation to the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets.

The Developer has provided us with spreadsheet information supporting the calculation of the hedging loss. The spreadsheet information includes details of the individual hedge contracts entered into by the Developer. We have not reviewed the source documentation for the hedging contracts as part of the Review Procedures.

In summary the approach adopted by the Developer is as follows:

- ▶ The Developer identified all hedging contracts entered into in respect of the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets and calculated a total hedging loss of DKK █ million (equivalent to £█ million).
- ▶ The total DKK losses were divided between Euro to Sterling hedges (DKK █ million) and DKK to Sterling hedges (DKK █ million). As only the Euro to Sterling hedges are relevant to the Walney 1 Transmission Assets these were calculated as representing █% of the total hedging losses (equivalent to £█ million of the £█ million loss).
- ▶ In order to allocate the Euro to Sterling hedging losses to the Walney 1 Transmission Assets the Developer identified all forecast contract commitments from 2009 which were denominated in Euros and which would have been covered by the hedging arrangements, totalling €█ million. Of these forecast contract commitments the

Developer has identified €■ million of contracts which are attributable to the Walney 1 Transmission Assets (■%).

- ▶ Applying the factor of ■% to the Euro to Sterling hedging losses of £■ million results in an allocation of £■ million to the Walney 1 Transmission Assets.

We understand that the hedging undertaken by the Developer was based on the overall forecast contract commitments and not in relation to specific contracts associated with the Walney 1 Transmission Assets. As a result the hedging losses are not allocated to the individual assets or categories of asset which make up the Walney 1 Transmission Assets.

We note that each of the sample of contracts which were subject to the Review Procedures were denominated in Euros and that, in total, these four contracts represented ■% of the total direct and indirect costs of the Walney 1 Transmission Assets. The contract values subject to the Review Procedures had a total value of €■ million after variation orders.

The information provided by the Developer shows that the Euro to Sterling hedging contracts were entered into in September 2009 and November 2009 with maturity dates ranging from January 2010 to October 2011. Payments made under the sample of contracts subject to the Review Procedures took place from mid-2009 to the date of our review with payments under some contracts yet to be made. The periods covered by the hedging contracts are therefore consistent with the timing of payments made under the contracts subject to the Review Procedures.

We have reviewed the movements in the Euro to Sterling exchange rate in the period covered by the hedging contracts:

- ▶ The Euro to Sterling spot exchange rate at the dates the hedging contracts were entered into was approximately €1.094:£1.
- ▶ Over the course of 2010 the Euro weakened against Sterling, the average month end spot rates for 2010 was €1.169:£1.

Accordingly the Sterling equivalent value of the Euro contracts would have decreased and therefore we would expect that the hedging contracts would result in losses over the period.

3. Variance analysis

3.1 Introduction

The total project value as set out on the Cash Flow Schedule is £97.0 million excluding financing costs and transaction costs. Changes in the total project value including financing costs over time can be summarised as follows:

- ▶ Per the PIM: £99.4 million (including financing costs of £9.1 million).
- ▶ Per the FTTIM: £101.8 million (including financing costs of £12.7 million).
- ▶ Per the Cash Flow Schedule: £106.9 million (including financing costs of £8.2 million and transaction costs of £1.7 million).
- ▶ We understand that a technical assessment will be undertaken, in particular on the cable installation and associated work. This technical assessment may result in a recommendation that, if accepted by Ofgem, could lead to a restriction on the developer's costs set out in this report.

This section contains the results of the Review Procedures described in Appendix A⁶.

3.2 Reconciliation between the PIM and the FTTIM

The reconciliation between the PIM and the FTTIM can be summarised as follows:

	£m
Estimated Transfer Value per the PIM	99.4
Add:	
Increase in financing costs	3.6
Less:	
Decrease in capital costs due to revision of contract prices	(1.2)
Estimated Transfer Value per the FTTIM	101.8

As stated in section 1.3.1, the calculation of financing costs has been subject to a separate review by Ofgem and is not within the scope of the Review Procedures.

⁶ Appendix A, step 7 of section 2 and step 5 of section 3.

3.3 Comparison of project value per the FTTIM to the Cash Flow Schedule

The table below sets out a comparison of the total costs included in the FTTIM and the final Cash Flow Schedule:

Cost category	Total cost	Total cost	Variance
	(FTTIM)	(Cash Flow Schedule)	
Offshore substation	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Offshore cable supply and install	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Land cable	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Onshore substation	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Connection contract costs	-	£ [REDACTED]	£ [REDACTED]
Development costs	£ [REDACTED]	£ [REDACTED]	£ ([REDACTED])
Contingency	£ [REDACTED]	£ [REDACTED]	£ ([REDACTED])
Foreign currency hedging loss	-	£ [REDACTED]	£ [REDACTED]
Total direct and indirect costs	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]
Interest during construction	£ [REDACTED]	£ [REDACTED]	£ ([REDACTED])
Transaction costs	-	£ [REDACTED]	£ [REDACTED]
Total project value	£ [REDACTED]	£ [REDACTED]	£ [REDACTED]

As stated in section 1.3.1, the calculation of financing costs has been subject to a separate review by Ofgem and is not within the scope of the Review Procedures.

The variances in costs between the FTTIM and the Cash Flow Schedule are set out below:

Offshore substation

Offshore substation costs have increased by £ [REDACTED]. We understand that the majority of the increase relates to a reclassification of costs from development costs.

Offshore cable supply and install

Offshore cable supply and install costs have increased by £ [REDACTED]. We understand that approximately £ [REDACTED] million of this increase relates to revised variation orders associated with the installation of offshore cable. The Developer has told us that the variation orders fall into the categories set out below (in euros):

	Value
Delayed start up due to delayed export cable	€■■■m
Cable damages	€■■■m
Rock cutting	€■■■m
Soil condition	€■■■m
Survey of entire export cable route	€■■■m
Additional weather and stand-by costs	€■■■m
TOTAL	€■■■m

Onshore substation

Onshore substation costs have increased by £■■■■■. We understand that the majority of this increase relates to an increase in the expected cost of harmonic filters.

Development costs

The decrease of £■■■■■ in development costs is primarily due to a reclassification of costs to other categories.

Contingency

The contingency provision has been reduced by £■■■■■ to £■■■■■ following a review of expected costs to completion. The following table sets out an analysis of the £■■■■■:

Contingency	Basis	Value
Rock dumping	Survey	£■■■■■
Overvoltage protection for offshore substation	Management estimate	£■■■■■
Resource cost until finalisation	Management estimate	£■■■■■
Total		£■■■■■

We understand that these costs have not been finalised.

Foreign currency hedging loss

The Cash Flow Schedule includes a foreign exchange hedging loss of £0.8 million. This hedging loss represents an allocation of total hedging losses recorded in 2009. The losses relating to the Walney 1 Transmission Assets are in regard of Euro to Sterling hedge contracts entered into by the Developer against forecast contract commitments as a whole and are not allocated to individual contracts or assets. Given the movement in the Euro to Sterling exchange rate over the period covered by the hedging contracts we would expect that the hedging contracts would result in losses.

Interest during construction

As stated in section 1.3.1, the calculation of financing costs has been subject to a separate review by Ofgem and is not within the scope of the Review Procedures.

Transaction costs

The Developer has included £1.7 million of costs within the cash flow schedule relating to 'Transaction costs'. We understand that these amounts represent an estimate of direct and indirect costs the Developer has incurred and expects to incur in relation to the sale of the Walney 1 Transmission Assets, the process of which is summarised in section 1.1.1.

4. Project value

4.1 Total project value

The total value of the Walney 1 Transmission Assets calculated by the Developer is £[REDACTED] million excluding interest during construction and transaction costs. The total direct and indirect costs equates to [REDACTED]% of the total cost of the Walney 1 Transmission Assets and the Walney 1 Wind Farm Assets which are currently estimated to be around £[REDACTED] million.

The total project value for the Walney 1 Transmission Assets is made up of the following costs:

Expense category	Total cost
Offshore substation	£[REDACTED]
Offshore cable supply and install	£[REDACTED]
Land cable	£[REDACTED]
Onshore substation	£[REDACTED]
Connection contract costs	£[REDACTED]
Development costs	£[REDACTED]
Contingency	£[REDACTED]
Foreign currency hedging loss	£[REDACTED]
Total direct and indirect costs	£[REDACTED]
Interest during construction	£[REDACTED]
Transaction costs	£[REDACTED]
Total project value	£[REDACTED]

4.2 Payments made by the Developer

Total direct and indirect costs comprise amounts which have been invoiced and amounts yet to be invoiced and paid. Excluding financing costs these amounts can be summarised as follows:

Cost category	Settled amounts	Accrued amounts	Project value
Direct costs (section 2.3)	£[REDACTED]	£[REDACTED]	£[REDACTED]
Indirect costs (section 2.4)	£[REDACTED]	£[REDACTED]	£[REDACTED]
Total direct and indirect costs	£[REDACTED]	£[REDACTED]	£[REDACTED]

The above table shows that [REDACTED]% of the total direct and indirect costs included in the project value is represented by accrued amounts.

Appendix A Review Procedures

1. Background Work

1. Ascertain the processes and policies undertaken by the developer for making payments to suppliers for all direct costs incurred for the project.
2. Ascertain the processes and policies and metrics used by the developer by which shared costs (e.g. overheads and other indirect costs which may be split between transmission and generation) have been allocated to the project.

2. Review Work – Directly Incurred Costs

1. For a selected sample contract trace expenditure from the cash flow schedule to the relevant contract or other source record.
2. From the contract trace to an invoice(s) or journal.
3. From the transaction selected in (2) trace through the purchasing systems (from Purchase Day Book or equivalent to Purchase ledger or equivalent)
4. For same transaction trace through to the payment system (from the purchase ledger through to the general / nominal ledger). Confirmation includes verification of the payment summary with the supplier and ensuring calculations are arithmetically correct and free from error.
5. For the same transaction trace the payments made from the general ledger through such that the payment can be agreed to a debit entry on the bank account (debit entry being from the companies perspective and for avoidance of doubt represents a cash expense i.e. cash outlay from the business).
6. Prepare a report detailing the contractual payments made or due their cause (ie main contract or variations or claims, and the extent to which the contract provide warranties or ongoing support and the work undertaken with an appendix for copies of the support documentation on the selected contract and allocation.
7. Compare total costs at Project Close with Project Value at August 2009. Obtain supporting information and explanations for variances between the two dates.

3. Review Work – Indirectly Incurred Costs

1. For a sample of transactions trace from the asset schedule to journal entries made on the accounting system
2. Confirm the amount allocated has been determined as prescribed in the cost allocation methodology the Developer has indicated using

appropriate metrics in respect of the allocation of such costs between transmission and generation.

3. Confirmation includes ensuring calculations are arithmetically correct and free from error.
4. Prepare a report detailing the work undertaken with an appendix for copies of the support documentation on the selected contract and allocation.
5. Compare total costs at Project Close with Project Value at August 2009. Obtain supporting information and explanations for variances between the two dates.

Appendices B, C, D, E, F redacted