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*Promoting choice and value for  
all gas and electricity customers*

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Date: 16 November 2010

Dear Richard,

### **Initial transfer value and cost assessment process**

We wrote to you on the 30 September confirming that the London Array (phase 1) project had met the qualifying project requirements and we would shortly be commencing a tender for it in accordance with The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 (the Tender Regulations).

This letter sets out:

- the initial transfer value for the London Array (phase 1) project; and
- an overview of the cost assessment process.

### **Initial transfer value**

You have provided us with your initial forecast of costs for the development and construction of the transmission assets of the London Array (phase 1) project and its financing. Based on your latest submission of 4 November we understand your forecast costs to be:

Total forecast costs: £475.7m

Comprised of: £406.8m capital expenditure and development costs  
£68.9m financing costs for IDC

These figures are based on your chosen boundary point located at the incoming transformer 33kV circuit breaker cable terminations on the two offshore platforms. As a result of the chosen boundary point, you have decided at this time that the offshore substation platforms, offshore cables, onshore cables and onshore substation will transfer to the offshore transmission owner (OFTO). We acknowledge 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.

In order to commence the pre-qualification (PQ) stage in respect of the first tranche of tender exercises (which includes your project) in the second transitional tender round, we will shortly be publishing the PQ document and preliminary information memoranda for the first tranche of projects (the PQ Documentation).

We will include the cost information detailed above as the initial transfer value within the PQ Documentation for the London Array (phase 1) project for the purposes of bidders' PQ submissions.

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 Tender Regulations provide the legal framework for the process which Ofgem will run for the grant of offshore electricity transmission licences. The Tender Regulations set 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 developing and constructing the offshore transmission assets in respect of a project in the transitional regime.

Where the construction of the transmission assets has not reached the stage when those transmission assets are available for the 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.

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

### *Data collection*

Under regulation 4(3) of the Tender Regulations, we may request information from developers for the purposes of enabling bidders to take into account the most accurate estimate of costs in respect of the London Array (phase 1) project. This is in order to meet the requirements of a particular stage of the tender process.

Therefore, through the cost assessment process developers will be required to complete cost reporting templates and cash flow schedules. These will relate to the actual/forecast costs of construction contracts, development costs and financing costs related to the development and construction of the transmission assets being transferred to the successful bidders.

Developers may also be required to provide supporting evidence to substantiate their cost submissions including, amongst other things, contract documentation, supplier payment lists and asset schedules.

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

### *Cost estimate*

During the PQ Stage, Ofgem will review and analyse the cost information you have provided. We may request further information from you to calculate for the London Array (phase 1) project our estimate of the economic and efficient costs which ought to be incurred in connection with the development and construction of the relevant transmission assets. This estimate is the indicative transfer value for the London Array (phase 1) project which will be included in the qualification to tender (QTT) documentation for the purposes of bidders' QTT submissions.

In calculating this estimate we will conduct an initial forensic accounting investigation. This will require our external advisers to visit the developer's offices and will involve checking developer's internal documents, contracts and supporting information covering a proportion (as determined by Ofgem) of the total cost of developing and constructing the transmission assets. This may require Ofgem to visit the developers' offices to ensure that all the relevant information is available prior to our external adviser's visit.

We would anticipate any visits to occur in late November or early December 2010 and will contact you shortly to discuss this further.

### *Updated cost estimates*

Following commencement of the QTT stage, we will request further information from developers for the purposes of enabling bidders to take into account the most accurate estimate of costs. We may therefore update the indicative transfer value for the London Array (phase 1) project as a result of any further information provided by you and our continuing analysis. The most up-to-date indicative transfer value for the London Array (phase 1) project 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.

This up-to-date indicative transfer value for the London Array (phase 1) project is the value we will use when providing you with a letter of comfort. This sets out, subject to certain conditions, the guaranteed minimum value you will receive for the transmission assets to be transferred to the successful bidder for the London Array (phase 1) project. This guaranteed minimum will be 75 per cent of the indicative transfer value at ITT stage or 100 per cent of our assessment of costs, whichever sum is the greater. We consider that the indicative transfer value at ITT stage is a sufficiently firm value to use given the timescales between when we give you comfort and the projected financial close of the London Array (phase 1) project. We expect to provide this letter of comfort to you before the commencement of the ITT stage.

We may also provide further updates to the indicative transfer value during the preferred bidder (PB) stage for the purposes of inclusion within the preferred bidder's TRS.

### *Assessment of costs and final transfer value*

We intend to commence the process for the assessment of costs during the PB stage. The 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 a qualifying project (the final transfer value).

We expect that the assessment of costs and our determination of the final transfer value will not be concluded until after the grant of an offshore transmission licence when the developer notifies us that they can assess the outturn cost of transmission assets with reasonable certainty (i.e. within 5%). It is your obligation to notify us of the date you expect this to be so we may undertake this expediently.

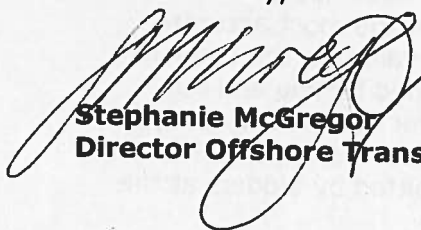
We will determine what proportion of the indicative transfer value the developer should receive on transfer of the transmission assets (which, as stated above, will not be less than 75% of the indicative transfer value included in the ITT documentation). On conclusion of our assessment, the deferred consideration (being the difference between the final transfer value and the proportion of the indicative transfer value received by the developer on transfer) will then be paid by the OFTO to the developer and the post tender revenue adjustment mechanism in the offshore electricity transmission licence will be used to reflect the final transfer value.

### **Next steps**

We will shortly be in contact with you to make arrangements for the forensic accounting investigation visit and will also write to you setting out further details in relation to the cost assessment process.

If you have any questions regarding this letter, please contact Roger Morgan on 020 7901 0525 (or [roger.morgan@ofgem.gov.uk](mailto:roger.morgan@ofgem.gov.uk)) in the first instance.

Yours sincerely,



**Stephanie McGregor**  
**Director Offshore Transmission**