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Dear Duncan,

Westermost Rough - Initial Transfer Value and Cost Assessment Process

Introduction

Our¹ letter of 30 January 2014 notified you that based on our assessment of the information you provided, you had satisfied the tender entry conditions which we specify must be met before we commence a tender exercise for the Westermost Rough wind farm (the Project). It also stated that the tender exercise for the Project is expected to commence in March 2014.

In order to commence the Enhanced Pre-Qualification (EPQ) stage we will publish the EPQ document and Preliminary Information Memorandum (PIM) for the Project (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 22 October 2013, you provided us with an initial forecast of costs for the development and construction of the transmission assets for the Project. We understand your forecast costs to be £199.5m, which is comprised of:

- Capital expenditure (CAPEX): £158.8m;
- Development costs (including transaction costs): £8.8m
- Contingency costs: £19.5m; and

¹ The Gas and Electricity Markets Authority (the Authority) is the regulator of gas and electricity markets in Great Britain. Ofgem is the office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. Whilst the terms "Ofgem", "the Authority", "we", "our" and "us" are used interchangeably in this letter it is the Authority which is responsible for exercising the relevant statutory powers.

Protect, Commercial

- Interest During Construction (IDC) costs: £12.4m.

The Initial Transfer Value is £199.5m and this figure will appear in the EPQ Documentation.

These figures are based on your chosen boundary point located at the incoming 34kV transformer Low Voltage terminals. As a result of the chosen boundary point, we understand that the following assets will transfer to the offshore transmission owner (OFTO):

- 1 Offshore platform - 2x140MVA, 150/34kV transformers, 2x170kV Gas Insulated Switchgear (GIS), 34/0.4kV auxiliary and earthing transformers, natural earthing resistors;
- 1 Export cable - 1x12km 170kV subsea cable;
- 1 Land cable - 1x14km 150kV underground cable;
- 1 Onshore substation - 2x275/150kV transformers, 170kV GIS, two auxiliary transformers, associated shunt reactor, reactive compensation and harmonic filtration equipment; and
- SCADA - OFTO station and protection system.

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.

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 2013 (the 2013 Regulations) provide the legal framework for the process which Ofgem runs for the grant of offshore electricity transmission licences. The Regulations² 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 the connection with the development and construction of those transmission assets. This estimate is the Indicative Transfer Value 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.

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.

² Regulation 4(1).

Data Collection

Under Regulation 4(3) of the 2013 Regulations, we may request information from you for the purposes of enabling bidders to take into account the most accurate Indicative Transfer Value 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 may 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 Indicative Transfer Value.

In calculating the Indicative Transfer Value we will conduct an initial forensic accounting investigation. This will require our external advisers to visit your offices and will involve checking your 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 developer's offices to ensure that all the relevant information is available prior to our external adviser's visit.

We would anticipate any visit to occur in March 2014 and will contact you shortly to discuss this further.

In conducting our analysis for the Indicative Transfer Value we will use project information gathered from offshore transmission developers to compare CAPEX costs between projects and identify projects that are cost outliers 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 the cost outlier requires further investigation into whether the proposed cost is economic and efficient.

We will confirm the Indicative Transfer Value 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 Indicative Transfer Value 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 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) in the first instance.

Yours sincerely,



Min Zhu
Associate Director, Offshore Transmission