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Public Funding of Penmon Fish Farm



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I have prepared this report for presentation to the National Assembly under the Government of Wales Act 2006.

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**Report presented by the Auditor General for Wales to the
National Assembly for Wales on 18 December 2013**



Photo courtesy of Anglesey Aquaculture Ltd

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Summary

- 1 In July 2001 Bluewater Flatfish Farms Ltd opened a land-based fish farm in a disused coastal quarry near Penmon, Anglesey. The farm produced turbot and created eight jobs. Bluewater Flatfish Farms' Greek parent company, Selonda SA, established a subsidiary, Selonda UK, to develop a further, larger fish farm (Penmon Fish Farm) to produce halibut in the quarry. The Penmon Fish Farm project (the Project) cost £11.9 million and received over £5.2 million of public funding.
- 2 The Project was originally due to be completed in 2003, but it experienced delays and difficulties, partly because of problems with the technology involved, and it did not become operational until 2009, producing sea bass. The Welsh Government signed off the Project as complete at the end of December 2008 because the European grant scheme, under which grant funds were provided, ended then, and the Project was assessed as achieving its objectives, which were an operating plant and 30 jobs. By early 2009 claims for all of the eligible expenditure had been submitted and the full amount of grant and match funding approved was paid by the Welsh Government.
- 3 However, key aspects of Penmon Fish Farm were not operating as originally planned, including a mains electricity power supply, a wetland filtration system and an effluent discharge pipe. In April 2010, Isle of Anglesey County Council served a noise abatement notice on the farm's operators for noise arising from diesel generators. In October 2011 Selonda UK pleaded guilty to allowing effluent and chemical waste to pollute the natural environment; and in February 2012, the former managing director was found guilty of having allowed the pollution to take place.
- 4 In late 2011 Selonda UK experienced cash flow difficulties and in January 2012 the company's assets were sold by administrators for £1.2 million to Anglesey Aquaculture Ltd. The plant's new owners continue to farm sea bass and are investing to address the technical problems and ensure the plant operates within environmental regulations.
- 5 In 2012 the Auditor General received correspondence from the Chairman of the Public Accounts Committee and another Assembly Member expressing concerns about the value for money the Welsh Government had secured from the public investment in Penmon Fish Farm. Following an initial review, the Auditor General decided to extend the scope of the review to encompass the Welsh Government's role in managing and monitoring the grants to Penmon Fish Farm, and to publish a report that would aim to answer the question:

Did the Welsh Government manage the public investment in Penmon Fish Farm in a way that maximised the benefits of the investment?



6 Overall, we concluded that:

The Welsh Government followed its procedures for approving and monitoring grant funding of the Project. However, the procedures at that time were less robust than those in place now and were unsuited to a project of this scale, complexity and risk. Although the Project achieved its main objectives, problems arose when the fish farm began operating which caused pollution and nuisance.

7 In reaching this conclusion we found that:

- a the Project offered potential economic and environmental benefits in return for considerable public and private investment, but it encountered problems that resulted in delays and increased costs;
- b the Project delivered a fish farm which has brought some benefits, and action has been taken to address problems of noise and pollution;
- c the Welsh Government identified potential risks when it approved grant funding for the Project, but did not put in place grant conditions that would have helped mitigate the risks;
- d the Welsh Government's monitoring of progress focused insufficiently on the risks identified during the Project's appraisal; and
- e the funding regime for European grants has been strengthened in recent years and, as a result, arrangements for managing complex projects have improved.

Recommendations

Building upon improvements in the Welsh Government's arrangements for grant funding projects following previous Wales Audit Office and Public Accounts Committee reports, we have identified some areas for further improvement and make the following recommendations:

- R1** To address the risk that a grant-funded project may meet the conditions of the grant whilst failing to comply with legal, fiscal and regulatory requirements or ethical standards of business conduct, the Welsh Government should:
 - Investigate the feasibility of including within grant offer letters a general condition that makes compliance with UK law, regulations, taxation and standards of conduct in business a standard condition of grant.
- R2** To address the value for money and fraud risks associated with procurement transactions between a grant recipient and a supplier that is a related company, in validating grant claims the Welsh Government should:
 - Test transactions between the related companies for reasonableness, or treat the related companies as a single entity and test the suppliers' expenditure.
- R3** To reduce the risk that complex projects involving specialist technical requirements may not be completed as required or may deliver poor value for money, in addition to accessing expertise from within the Welsh Government to assist project monitoring teams, the Welsh Government should:
 - Commission individuals with appropriate industry or technical expertise to support project monitoring teams.

R4 To improve the management of project risks and the effectiveness of enforcement action, where appropriate, the Welsh Government should:

- Strengthen communication and co-ordination between the different grants management teams within the Welsh Government and with external regulatory bodies.

Penmon Fish Farm is a land-based facility for farming sea fish



Photo courtesy of Anglesey Aquaculture Ltd



Part 1 – The Penmon Fish Farm project offered potential economic and environmental benefits in return for considerable public and private investment, but it encountered problems that resulted in delays and increased costs

Penmon Fish Farm aimed to establish an environmentally sensitive aquaculture facility in North Wales, based on innovative technology

- 1.1** The Bluewater Fish Farm was established in 2001 at Dinmoor Quarry, near Penmon in Anglesey, to produce turbot. Based on the anticipated success of Bluewater Fish Farm, its Greek parent company, Selonda SA, sought further expansion at the quarry by means of a large-scale halibut farm (Penmon Fish Farm).
- 1.2** Selonda SA established a subsidiary, Selonda UK (the Company), for the purposes of the Penmon Fish Farm project (the Project). In June 2001, Selonda UK applied to the Welsh Government¹ for public funding to support substantial private investment in the new facility. The Project was forecast to cost a total of £10.3 million, of which £6.2 million would be invested by the private sector, and 30 jobs were predicted.
- 1.3** It was expected that the facility would be the largest closed recirculation fish farm in the world. The size and complexity of the planned operation presented considerable challenges that required innovatory technological solutions. The Project involved hatching fish fry and growing them to maturity on land, in large indoor tanks containing treated seawater drawn from the sea via an inlet pipe and pumped around the tanks. Levels of oxygen, food, acidity, temperature and salinity needed to be constantly monitored and carefully managed to optimise growing conditions. Waste water and effluent were to be filtered, passed through artificial wetland reed beds and discharged back into the sea.
- 1.4** The proposed plant was to be situated in an area designated as being of outstanding natural beauty and within a region, North Wales, in which traditional fishing had declined and unemployment was relatively high. Therefore, in its funding application documents the Company stressed the Project's environmental friendliness, in terms of energy efficiency, visual impact and low emissions, as well as its potential economic benefits.
- 1.5** The Project received widespread political support at local and national levels because of its claimed benefits. The stated aim of the Project was to develop the '...first fully sustainable fish processing plant in Wales. This Project will minimise the release of organic material to the environment through the combined use of advanced recirculation technology and a recycling of nutrient wastes by the creation of a managed wetland.'²

¹ For the purposes of this report, the general term 'Welsh Government' is used unless for reasons of clarity it is appropriate to identify an individual department or team.

² Selonda UK FIFG grant application form, June 2001

1.6 The Welsh Government granted European Union (EU) Financial Instrument of Fisheries Guidance (FIFG) grant funding to the Project, along with match funding. The grant recipients and the Welsh Government envisaged the Project as the first stage in establishing a new industry in Wales. A fish processing plant, for which additional funding would be sought at a later date, was to be the second stage. The grant offer letter stated that the quantifiable outputs from the first stage, the fish farm, would be: one aquatic development supported and 30 gross jobs created. The grant application form, submitted to the Welsh European Funding Office (WEFO)³ in June 2001, along with its supporting documentation, emphasised that the Project would:

- a** deliver an aquaculture facility utilising world-leading recirculation technology and create 30 jobs;
- b** establish a new, sustainable land-based fishing industry on the island of Anglesey, in harmony with the environment;
- c** achieve a minimum production of 1,000 tonnes of halibut a year which, alongside the 600 tonnes of turbot a year anticipated from Bluewater Fish Farm, would provide enough output to initiate a fish processing facility which could have the potential to create a further 25 jobs with associated economic benefits;
- d** create a 2.5 hectare saline wetland, which would provide a habitat for wildlife, specifically wading birds, and minimise the release of effluent into coastal waters in an environmentally sensitive way; and
- e** contribute to achieving national, regional and local development and regeneration objectives.

The Project fell behind schedule, costs and demands for public funds increased, and problems culminated in the financial failure of the grant-recipient company three years after the Project was completed

1.7 The Project to build the fish farm experienced problems and delays from the outset. The Project's planned milestones, as set out in Selonda UK's original grant application of June 2001, were:

- a** site preparation to start in November 2001 and construction to start in December 2001;
- b** production and hatchery plant to be completed by April 2003; and
- c** full production by January 2006.

1.8 Grant funding of £3.6 million for the Project was not approved until July 2002. The Project's funding from private sources included £3 million from a partnership of Icelandic fishing companies, but in August 2002 the Icelandic partnership withdrew its support for the Project. In February 2003, Isle of Anglesey County Council refused an application for £50,000 of grant support because the funds for this originated from EU Objective 1, which meant that the limits on EU funding for the Project would have been exceeded. The FIFG grant offer letter states that in the event of a decrease in private funding, EU grant funding will not increase. To meet the shortfall, in January 2003 the Welsh Government agreed to increase its match funding from £464,494 to £1.5 million⁴, and in March 2003 Selonda SA increased its share of the private funding.

³ WEFO is responsible for managing various European grant schemes in Wales.

⁴ Welsh Government match funding approval and payments were managed separately from the FIFG grant, by the Fisheries Policy Unit.



- 1.9** In April 2003 a WEFO site visit identified that no work had been started on-site. Some progress was made subsequently, but in June 2004 WEFO raised concerns about the slow progress. In May 2005 WEFO wrote to Selonda UK, threatening that unless the Project was completed quickly, the FIFG grant for the Project would be cancelled and reclaimed, in order that it could be committed to another project to avoid FIFG scheme funds having to be returned to the EU. The Project made some further progress but this continued to be sporadic.
- 1.10** The variety of construction and other technical problems experienced by the Project also led to total estimated costs increasing from £10.3 million to £12.0 million. The private financing component increased from £6.2 million to £6.9 million in 2007. In March 2006 Selonda UK requested and received an exceptional payment of £622,500 from existing Welsh Government match funding to meet deposits required by construction contractors.
- 1.11** WEFO regarded Project completion as being the full amount of eligible expenditure being claimed; the end of the funding scheme; and/or, full delivery of the Project's target output indicators. Five per cent of the grant could be held back until the target indicators were delivered. The Project was classed as financially completed at the end of December 2008, when the FIFG funding scheme terminated. Selonda UK submitted the final grant claim to WEFO at the end of February 2009 and the final payment from WEFO to Selonda UK in March 2009 completed the full payment of FIFG grant to the Project. The plant began operating in early 2009.
- 1.12** Subsequently, Selonda UK requested more grant funding, in addition to the FIFG grant and Welsh Government match funding it had already received. These additional grants were £2,920 Agri-Food Development Scheme grant in March 2009 for Project marketing and branding; £43,432 European Fisheries Fund grant⁵ in August 2009 for a fish stunning and sorting plant, with £31,000 of Welsh Government match funding; and a further £27,000 grant in August 2011 for power supply.
- 1.13** In the first 11 months of 2011, Penmon Fish Farm had made a net loss of £1.9 million,⁶ and Selonda UK Ltd experienced cash flow difficulties and had insufficient working capital to pay for fish food and oxygen. Without these essential commodities; thousands of fish were at risk of death. The Welsh Government's Fisheries Policy Unit provided £40,000 to suppliers for deliveries in order to address the immediate difficulties. However, the Company was unable to raise further private funding and in January 2012 it was liquidated and its assets were sold for £1.2 million to a Dutch company, which has operated the fish farm since then, under a subsidiary company, Anglesey Aquaculture Ltd. The new owners also paid an additional £0.6 million to settle debts and secure fish food supplies. Bluewater Fish Farm had ceased operating in 2009, and was liquidated in November 2012 and its assets were sold to another subsidiary of the same Dutch company as Anglesey Aquaculture Ltd, for £165,000.

⁵ European Fisheries Fund grants were made under the successor EU scheme to FIFG.

⁶ Liquidator's Statement of Insolvency, January 2012

Part 2 – The Project delivered a fish farm which has brought some benefits, and action has been taken to address problems of noise and pollution

The Project delivered an operating fish farm, created direct jobs and encouraged the relocation of technical expertise to Wales, but some other wider benefits that were anticipated have yet to be realised

- 2.1** Although the project was completed much later than had been planned at the outset, the Welsh Government is satisfied that the Project was successful. 'In this instance WEFO and European Commission (EC) officials are satisfied that the Project, in line with EC regulations, fulfilled the terms and conditions of grant and the respective outputs which were essentially to create 1 aquaculture farm and 30 gross jobs'.⁷
- 2.2** The first of the two target outputs of the Project was achieved in early 2009 when the plant began operating. The second target output of the Project was to create 30 jobs. The Welsh Government assessed that the Project had achieved this. By the end of December 2008, when the FIG scheme ended, 17 jobs were identified; monitoring during July 2009 identified 28 jobs; and Project closure at the end of July 2009 identified 33 jobs created. The FIG programme and the grant offer did not specify whether these should be new jobs and UK law does not permit them to be specified as jobs only for local people. It is likely that
- a small number of managerial jobs went to existing Selonda staff from outside Wales, and only some of the balance of the jobs, mostly low paid, was taken by local people. It is not clear how many of the jobs at Penmon Fish Farm were taken up by former staff from the neighbouring turbot farm, which had created eight jobs but ceased operations during 2009 and has been used as a packing plant since then.
- 2.3** An economic appraisal of the Project, undertaken for WEFO in July 2001, calculated the cost per job to the public purse as £137,000 on the basis of 30 jobs and expected public funding at that time of £4.1 million. The appraisal concluded that this was exceptionally high, compared with the average cost per job of £17,500 generated by the Regional Selective Assistance Programme 1991-1995. The economic appraisal concluded that this represented poor value for money. Taking the total FIG grant and match funding together, the actual cost per job was more than £170,000. This figure does not include subsequent smaller grant payments made to Selonda UK, which would make the cost per job figure even higher.
- 2.4** Anglesey Aquaculture Ltd told us that under new ownership the fish farm currently employs 26 staff, working in shifts. This suggests that the Project has been successful in generating sustainable jobs, although at high cost. However, it is not yet clear whether, under new ownership, the Project has resulted in a viable and sustainable business. Anglesey

⁷ Correspondence from Welsh Government Department of Rural Affairs in response to a question from an Assembly Member, 5 October 2010.



Aquaculture Ltd told us that it has already made a significant investment in the plant to address technical problems which the new owners believe will enable it to operate satisfactorily and profitability within the next couple of years. To date, its total investment has been approximately £5.2 million.

2.5 Although the cost per direct job created was high, a value for money assessment should also take into account any other, wider, benefits achieved. One of the key reasons for approving the Project was its potential to position Wales at the forefront of a new technology-based aquaculture industry. Information from the Welsh Government's Project files indicates that the main supplier to the Project, IAT,⁸ established an office in Gaerwen, near Llangefni, Anglesey to service the contract with Selonda for building the plant, and in 2002 advertised for two posts to manage the construction. IAT relocated its entire operations to Llangefni in 2003, bringing 20 jobs, and currently employs 28 staff there. IAT continues to provide services to the new owners of the fish farm. IAT's website shows aquaculture projects which it is involved in worldwide, and we understand from Welsh Government officials that IAT is now a Wales-based industry leader in recirculation technology expertise.

2.6 Selonda UK abandoned its plans for a further phase of the Project, a fish processing plant, and to date no other aquaculture plants utilising recirculation technology have been developed in Wales. However, Welsh Government officials told us that they have received several inquiries from potential investors who may be interested in locating aquaculture projects in Wales, using recirculation technology, particularly if the fish farm at Penmon becomes successful.

Some components of the fish farm were not completed as originally specified, and nuisance and pollution undermined the Project's claims to be environmentally sensitive and sustainable

Problems in establishing a mains electricity supply sufficient for the fish farm's needs led to noisy diesel generators being used, creating a nuisance

2.7 In 2001 Selonda UK's application for FIG grant funding identified £487,000 of expenditure for which grant support was required to be used for power supply. This was needed because the existing mains electricity link to the quarry, used to supply the Bluewater Flatfish Farm, would be inadequate to meet the farm's continuing needs, the Project's requirements and to provide for potential expansion in the future. The environmental statement, prepared to support the grant application and the application for planning permission, stated that mains electrical power would be supplied through a new power line that would be constructed as part of the Project. This would require an upgraded 33,000 volt link to the fish farm from Beaumaris substation.

2.8 The FIG grant approval process required all relevant consents to be in place prior to application submission, but in this case the application was accepted in advance of planning consent from Isle of Anglesey County Council or a permit to abstract water and discharge waste from the Environment Agency⁹ being obtained. WEFO granted

⁸ IAT is referred to variously as International Aqua Tech (IAT) Ltd. [Selonda UK. Business Plan 2001; Selonda SA. Annual Report 2004]; International Aquaculture Technologies (IAT) Ltd. [WEFO documentation]; Intensive Aquaculture Technology (IAT) Ltd [WEFO procurement notes]; Integrated Aquaculture Technology (IAT) Ltd [Selonda UK. Environmental Statement 2001].

⁹ The Environment Agency's operations in Wales are now undertaken by Natural Resources Wales. For the purposes of this report, the name in place at the time is used.

this exception to allow the project appraisal process to commence because appraisal was expected to be a lengthy process due to the complex, technical nature of the Project.

- 2.9** Isle of Anglesey County Council granted planning consent for the fish farm in February 2002. The consent specified that a separate application would be required for a mains power supply, but obtaining this additional consent for electricity supply was not a condition of planning consent for the fish farm. The planning consent and discharge permit were both in place before the grant was approved.
- 2.10** The FIGG grant application was approved in July 2002. The grant offer letter did not specify that the power should be supplied from the National Grid, but it is clear that the £487,000 of Project expenditure eligible for grant support was for the purposes set out in the documents supporting the grant application, which specified a new mains link and estimated the cost of establishing it.
- 2.11** In June 2007, Selonda UK identified that the costs of establishing the power supply from the National Grid had increased to more than £1 million. Selonda UK had encountered difficulties in concluding agreements with 23 landowners over whose land the supply would be routed. In October 2007 Selonda UK had identified that power supply completion was likely to extend beyond the planned Project completion date of 31 August 2008 and requested an extension of the Project completion deadline to 31 December 2008. Negotiations with landowners were concluded by August 2008 and, in correspondence with WEFO, Selonda UK stated that it would proceed with planning for the installation of the power supply but would be unable to commence construction of the power lines until spring 2009, with expected completion that summer. In the meantime, the electrical power to the plant's pumps and tanks was installed, along with an electrical substation intended to link with the new mains supply, and Selonda UK submitted grant claims to WEFO for the eligible expenditure involved.
- 2.12** The Project was financially complete at the end of December 2008 and the final grant payment was made to Selonda UK in March 2009. By then all eligible expenditure in respect of the power supply had been incurred and the full grant claimed and paid. Payments were based on claims submitted by Selonda UK, supported by audit certification. At the end of the Project the power supply costs had increased above the £487,000 approved within the Project to over £1 million. Selonda was required to meet the extra costs of completing the power supply. Normally, if ineligible costs were involved in completing a project, WEFO would expect these to be incurred during the period of the project along with all eligible expenditure. However, in October 2008, WEFO accepted that all of the ineligible expenditure in relation to the power supply would not be incurred before the end of the FIGG scheme. The effect of this approval was to remove power line installation completion from the Project.
- 2.13** In March 2009 (after the end of the Project and after receipt of the final grant payment) Selonda UK made a planning application to Isle of Anglesey County Council for the mains power supply, but subsequently withdrew it. Estimates from the energy company of the cost of establishing the link and supplying mains power had risen significantly and negotiations between the energy company and Selonda UK had stalled. Since then, no further planning application for the new mains electricity link has been submitted.



2.14 The fish farm began operating in early 2009 using some mains power from the existing supply. This was supplemented by electricity generated on-site by diesel generators because the existing supply was insufficient for the plant's needs. Selonda UK kept Welsh Government officials informed about the difficulties, delays and escalating costs associated with the mains power supply and WEFO agreed to the use of generators, without which the fish farm could not have begun operating. In April 2010, following complaints from local residents, Isle of Anglesey County Council served a noise abatement notice on Selonda UK because low-frequency noise from its diesel generators was causing a nuisance. In response, Selonda UK brought in quieter diesel generators which remained in continuous use to meet the plant's needs.

2.15 In August 2011, the Welsh Government provided a further £27,000 to Selonda UK specifically for power supply¹⁰. The payment was made as part funding for an £85,000 project to provide a sustainable power supply for the fish farm, planned to be completed in March 2012. Selonda UK was to provide the balance of £58,000.

2.16 The fish farm's new owners, Anglesey Aquaculture Ltd, took over the plant in January 2012 and, in May 2012, completed the project to uprate the existing mains power supply to the quarry which had previously served Bluewater Flatfish Farm. Because Bluewater Flatfish Farm ceased operating in late 2009, the uprated supply is capable of meeting the plant's present needs, without the 33,000 volt link to Beuamaris and without the requirement for diesel generators in continuous operation, which have been removed recently. A single diesel generator remains on-site for use as a back-up supply in the event of a mains power failure.

The technological and environmentally friendly aspects of the Project were not delivered in accordance with the Project's claims, and the plant breached environmental regulations

2.17 The FIFG grant application form and supporting documentation stressed that the Project would have a minimal negative impact on the environment, and specified that effluent emissions would be controlled by using recirculation technology and by establishing an artificial wetland filtration system. The artificial wetland would comprise 2.5 hectares of saline reed beds to filter the outflow from the plant, which would then drain into the sea. According to the grant application and the supporting documentation, the wetland and reed beds would increase biodiversity and provide a habitat for wading birds and invertebrates. The wetlands were identified in the FIFG grant offer letter as an eligible cost of £513,000, against which grant could be claimed.

2.18 In March 2002 Selonda UK started the process of obtaining permits from the Environment Agency to extract water from the sea and discharge filtered effluent back into it. Permits were issued in June 2002 specifying the pipework for the intake and outflow, which was to extend to below the low-water mark. The discharge permit set out metering and monitoring requirements to ensure that the Company complied with the permit in relation to aspects of the effluent, including tidal conditions, volume, chemical composition and suspended solids. The Environment Agency also specified planting density requirements for the effective operation of the reed beds. The permits' requirements were more extensive, detailed and demanding than the descriptions in the grant application and supporting documents.

¹⁰ The documents we have seen identify that this additional funding for power supply was approved by the Business Minister and the Deputy Minister for Food and Fisheries, and was paid to the power company in August 2011.

- 2.19** A report following a monitoring visit by WEFO in June 2006 stated that the wetland was functioning satisfactorily with waste from the neighbouring Bluewater Flatfish Farm. However, problems emerged once the Penmon Fish Farm began operating and generating larger volumes and concentrations of effluent. The filtration system within the plant was failing to remove fine particles of fish waste before effluent was fed into the wetland reed beds. The reed beds were intended to remove dissolved organic waste naturally, not to filter out solids. Consequently, the artificial wetland became choked with fish faeces, the reeds died and the reed beds stagnated and became foul smelling. Thereafter, the artificial wetland filtration system in operation involved the use of filtration sacks. The additional costs of the filtration sacks were ineligible within the Project and were met by Selonda UK.
- 2.20** In August 2010, after the Project had been completed and 15 months after Penmon Fish Farm started operating, the Environment Agency received complaints from the public about pollution from the plant. The Environment Agency investigated the complaints and prosecuted Selonda UK for breaches of environmental regulations, which involved the unlawful discharge into the sea of trade effluent and chemicals. Evidence given during the prosecution identified that the wetland filtration system was not operating effectively, and systems for metering and monitoring discharges from the farm were not in place. The outflow pipe had not been constructed as specified by the Environment Agency permit; instead of a submerged discharge pipe extending from the wetland into the sea to below the low-water mark, a short pipe discharged effluent over the rocks. Selonda UK pleaded guilty in October 2010 and was fined £50,000. In February 2012, the former managing director of Selonda UK was found guilty of having allowed the pollution to take place.
- 2.21** The FIG grant application had stated that the farm's visual impact from the seaward side would be mitigated by a constructed embankment, which would also serve to safeguard against any spillages from the facility entering the sea. The embankment would be enhanced by landscaping and planting, which would comprise 'an earth bund seeded with coastal plant species' which would 'be targeted at improving foraging and breeding habitat for bird species'. However, the landscaping and planting work was not included in the application as expenditure to be eligible for grant support, and no grant funding was provided. In the event, the works were not completed as described.
- 2.22** In March 2009, Selonda UK received a grant from the Welsh Government of £2,920 towards the cost of producing marketing materials. Selonda's promotional materials included brochures stressing the Project's green credentials and referring to the wetland filtration system. The materials were produced soon after the fish farm began operating and before Selonda UK was prosecuted for breaches of environmental regulations. However, the Project's green credentials were undermined subsequently by the use of diesel generators on-site, the failure of the filtration systems and wetland to process effluent effectively, and the release of chemicals into the sea.



2.23 In September 2012, the Environment Agency issued a new discharge permit to Penmon Fish Farm's new owners, Anglesey Aquaculture Ltd. The terms of the new permit increased the permitted volume of discharge per day but reduced the permitted levels of contaminants in the discharge, compared with the original permit. The new permit also requires that improvement work is undertaken by the plant's operators which will involve constructing a discharge pipe. The Environment Agency and the Welsh Government have informed us that Anglesey Aquaculture Ltd is working with them closely

to address the problems which gave rise to the pollution incident, including improving filtration within the plant, upgrading the wetlands and installing the discharge pipe. However, the Environment Agency informs us that at present, geological issues are causing problems with constructing the submerged discharge pipe. In the meantime, effluent continues to be discharged over the rocks from a pipe above the shoreline but its content is controlled and monitored by the operators and periodically checked by the Environment Agency.

The Fish Farm utilises advanced recirculation technology to maintain optimal growing conditions



Photo courtesy of Anglesey Aquaculture Ltd

Part 3 – The Welsh Government identified potential risks when it approved grant funding for the Project, but did not put in place grant conditions that would have helped mitigate the risks

The Project application and supporting documentation met the criteria of the grant funding scheme

3.1 The EC's FIG grant application process involved checks by WEFO that all of the documentation required was completed properly, and that the Project met the criteria for the European grant funding scheme¹¹, which are linked to EU policy objectives. WEFO provided pre-application advice to potential applicants for European funding to ensure that they were directed towards the most relevant sources of funding for their project and understood the requirements of the scheme. Support was also available from WEFO to help applicants to complete application documentation appropriately. The Selonda UK grant application was made under the EU's Objective 1 programme, which aimed to increase economic output. Specifically, Selonda UK sought assistance from the FIG under Priority 5 (rural development and the sustainable use of natural resources), Measure 9 (support for fisheries and aquaculture).

3.2 Supporting documents submitted with the application form, which constitute part of the application, included a business plan with financial projections and an environmental statement. These documents contained general descriptions of the plant and how it would operate, emphasised the Project's ecological and environmental credentials, and included extracts from and references to a

range of policies to demonstrate compliance with legislation in areas such as equalities, as required by the FIG grant scheme. Neither the grant application form nor the supporting documentation contained detailed technical specifications of the plant or construction plans for the fish farm to underpin Selonda UK's assertions about the fish farm's environmental impact, and these were not required by the grant scheme. The scheme did, however, require local authority planning permission and permits from the Environment Agency to be in place, which placed more detailed requirements upon the construction and operation of the fish farm than the FIG grant conditions.

The Welsh Government's appraisal of the application identified that the Project was ambitious, costly and risky, but if successful it could establish a centre of expertise in Wales

3.3 The Welsh Government assessed the Project in July 2001. WEFO led the assessment and sought advice from other divisions and departments of the Welsh Government, including Rural Affairs and Agriculture and Fisheries, and external legal advice was obtained to determine whether the Company was eligible to receive European Structural Funds. The Project's technical assessment resulted in the highest possible score of one (on a scale from one to five) on the level of fit with the needs of the region. Other aspects of

¹¹ The aims of FIG grant, set out in appendices to the grant offer letter, were: 'helping achieve a sustainable balance between marine resources and their exploitation; modernising fishing structures to ensure the future of the industry; helping maintain a dynamic and competitive fishing industry and revitalise areas dependent on fishing; improving the supply and exploitation of fishery products'.



the Project were also scored on a one to five scale and the total of these scores was used to generate a technical assessment rating. These aspects comprised:

- a** need for the Project, including rationale, justification, problems it seeks to address, impact, and compliance with statutory requirements and state aid legislation;
 - b** management and delivery of the Project, including likelihood of the Project being well-managed and the expected impacts delivered, track record of Project delivery and/or business success, appropriate skills and experience, realistic and achievable timetable for delivery and completion, a clear and workable exit strategy, and plans for publicising and promoting success;
 - c** additionality, displacement and substitution – providing additional activity and the need for public funding, not displacing other existing businesses or activities, and integration with other established projects;
 - d** providing benefits to the wider rural economy;
 - e** addressing cross-cutting objectives relating to environmental considerations, IT and equal opportunities; and
 - f** environmental and social impact and sustainability – positive contribution to environmental quality, economic strength and social equity.
- 3.4** The Project scored nine across these other aspects, placing it in the highest priority category of H.¹² Combined with the regional needs score of one, this gave an overall technical assessment of H1, which is the highest priority for grant support. The Welsh Government strongly recommended approval of the Project because, in addition to the high

assessment score, it built on the previous investment in the Bluewater Fish Farm on the same site. It represented a major investment in recirculation technology as part of a wider strategic intention of establishing Wales as a leader in this field, with an expectation that such technology would play an important role in future food production.

- 3.5** The potential for aquaculture of the type envisaged by the Project had been recognised within the fisheries industry for some time, but development had been inhibited because of the risks involved. The Welsh Government hoped that a successful venture would encourage further investment. The technical appraisal included the comment 'It is difficult to see another project which is likely to have such a positive effect on the fisheries sector in Wales, provided it is taken to its conclusion'.
- 3.6** Public grant funding regimes accept a higher level of inherent risk associated with projects than commercial funding streams would tolerate, in order to achieve wider social and economic benefits. A criterion for grant funding is that projects would probably not proceed without grant funding to support the amount of capital investment required. Furthermore, grant-funded projects are frequently unprofitable in the short-term. To ensure that public funds are not used to generate excessive profits for the private sector, grant conditions may require that projects are not profitable for a specified period following the last grant payment.
- 3.7** In addition to these inherent risks, the appraisal led by WEFO identified a number of specific risks to the Project. These included:
- a** Technical risks associated with the proposed design and build of the facility – including the use of land-based recirculation technology untested on this

¹² The best possible aggregate score is six; the worst is 30. The total is used to generate a rating of project suitability and quality expressed as high, medium or low. The Project scored one for the aspects of satisfying needs, management and delivery, and environmental and social sustainability. The Project scored two for the other aspects.

scale; saline wetland filtration, a system in use for freshwater but not seawater; potential difficulties with fish health and disease arising from intensive farming; and the need for electrical power, to support continuous operation of the plant.

- b** Financial risks – including the high level of capital investment, particularly in the first two years of the Project, and the long payback period; the high costs of production; and the large volumes of production required to support the revenue levels set out in the business plan.
 - c** Market risks – including uncertain levels of demand for intensively farmed fish; the accuracy of demand projections; and price competitiveness.
 - d** Output risks – that any jobs created would be either technical, likely to be filled from outside Wales, or relatively unskilled, and that the overall cost per job would be extremely high.
 - e** Outcome risks – that profits and expertise would not stay in Wales, and that a future processing plant may not be sited locally.
 - f** Procurement risk – arising from single tender procurement from the main supplier.
- 3.8** The grant offer letter included provisions that cover shortfalls in private funding and cost escalation, which help to mitigate some of these risks. However, the risks arising from the supplier (IAT) being closely related to Selonda UK were not identified. Also, although the Welsh Government had noted that the large amount of grant funding being invested in one project represented another significant weakness, this risk was not included in the appraisal. In addition, not all the risks that were identified were adequately reflected in the scoring criteria. For example, the unit cost of project outputs, such as cost per job, is a

key element in assessing value for money. Although recognised as a project risk, the unit cost of outputs was not part of the scoring criteria used to appraise the Project.

- 3.9** In September 2003, after it had been approved, WEFO undertook a routine internal review of the Project. The review report summarised the Project's position at that time, including the application process, changes to funding, economic and technical appraisals, and also value for money considerations. The section on value for money included the following: 'This Project could be viewed as a straightforward grant support to a commercial enterprise... On those kinds of grounds this Project would represent a very low value for money score... The aim here is to support the development of a new high technology industry that could attract further inward investment... With that aim in mind the conventional measures for value for money no longer apply... a comprehensive measure of the risk has been made and the conclusion reached that the Project did represent value for money – at the time of the decision to give full approval.'

As the largest project within the grant scheme, the decision to award grant funding to Penmon Fish Farm reduced the risk that available EU funds would not be spent

- 3.10** The risk that the FIG grant programme for 2000-2006 would be undersubscribed, and potential EU funding lost, was a consideration in the decision to approve grant funding to the Project. The initial FIG allocation of European grant funding to Wales was £9 million. During the course of the FIG programme, a further £7 million of European funding



was made available. At the time that WEFO was considering Selonda UK's application in respect of Penmon Fish Farm, there were concerns that the FIG programme would be undersubscribed because of the low number and value of grant applications coming in. Any unused funds would have had to be returned to the EU at the end of the programme. A paper to the Welsh Government's Agri-Food Partnership¹³ meeting dated 10 July 2001, the month after Selonda UK made their application, included the statement '...there is a very real risk that the FIG programme will be under subscribed. The under spending of the Fund at the end of the programme should be avoided at all costs.'

3.11 The programme monitoring report for December 2001 identified that '...nearly all of the budget...was uncommitted due to a slow start with the FIG programme. WEFO plans to catch up on commitments in 2002 and there are project applications in the pipeline requesting grants totalling £6.8 million.'¹⁴ In the 12 months following approval of the grant for Penmon Fish Farm in July 2002, there were eight other awards, totalling £1.74 million. Eventually, £16.3 million of grants was allocated across 46 approved projects, of which the grant of £3.6 million for Penmon Fish Farm was the largest.

3.12 Within the overall 2000-2006 European Structural Funds programme, of which FIG was a part, WEFO gave particular care to monitoring the performance of FIG because it recognised that '...any slippage on one or two of the large projects drawing on those funds has the potential to have a

disproportionate effect'.¹⁵ The National Audit Office's report on Structural Funds of 2002 stated that WEFO was depending on '...a handful of aquaculture projects' to proceed quickly 'to avoid de-commitment of £1.4 million of grant on 31 December 2002'.¹⁶

Grant approval was subject to the general conditions of the funding scheme, which were not specific enough to reflect the Project's particular risks and technical complexity

3.13 Under the FIG grant scheme, the private sector was required to contribute a minimum of 40 per cent of eligible expenditure, FIG could contribute a maximum grant of 35 per cent, and a minimum of five per cent had to be provided by other public sector match funding. The Rural Assets Strategy Partnership evaluated the grant application in February 2002¹⁷ and a FIG grant of £3.6 million was approved by WEFO in July 2002. The grant represented 35 per cent of the £10.3 million project expenditure eligible under the scheme. The grant offer letter stated that the grant awarded was calculated as the minimum necessary for the Project to succeed. Initially, additional public support would come from a £50,000 grant from Isle of Anglesey County Council and £464,000 in match funding from the Welsh Government, which had been approved by the Fisheries Policy Unit. Private finance of £6.2 million would be required to make up the balance.

¹³ Paper by the Fisheries Subgroup of the Agri-Food Partnership, prepared for the Agri-Food Partnership meeting of 10 July 2001. The partnership exercised oversight of the FIG programme but was not involved in approving grants to individual projects.

¹⁴ National Assembly quarterly progress report on Structural Funds programmes, December 2001. The 'pipeline' projects included the £3.6 million of FIG grant which was subsequently awarded to the Penmon Fish Farm project, in July 2002.

¹⁵ National Assembly quarterly progress report on Structural Funds programmes, March 2002

¹⁶ National Audit Office national report, *European Union Structural Funds – Maximising the Benefits for Wales*, 2002

¹⁷ The Rural Assets Strategy Partnership provided advice to WEFO on the strategic fit between the proposed project and the objectives of the funding scheme, as part of the grant application evaluation process. WEFO took the final decision on FIG grant funding.

3.14 The grant offer letter set out the amount of the grant and the conditions attached to it, which were nearly all generic to grants awarded under the FIG scheme. One special condition relating to limits on profitability was included. This special condition was not always applied to FIG projects, particularly to smaller projects. Apart from this special condition, the conditions of the FIG grant for Penmon Fish Farm were not tailored to address the scale or technical complexity of the Project or the particular risks identified during the appraisal process. The main grant conditions were:

- a** the grant must be used for the purposes of the Project for which it is approved;
- b** for capital investment projects the proposed investment in buildings and equipment should be in accordance with the schedule of expenditure in the grant offer letter, and must be completed in full;
- c** for a five-year asset retention period, assets must be kept in good repair and used for the purposes for which the grant was given (for Penmon Fish Farm this period ran to 31 December 2013);
- d** records for all eligible expenditure must be kept for three years after final payment;
- e** the scheme must meet EC publicity requirements, and acknowledge support of the EU and the Welsh Government, for example on plaques and billboards, in publicity and information materials, and in press releases; and

f the special condition that the grant recipient must not make a profit until the fourth year of operation, and thereafter profit must be limited to a specified percentage of turnover, above which the Welsh Government would be able to recover grant equivalent to 35 per cent of the excess profit.

3.15 The 'target outputs' for the Project were expressed in the grant offer letter as an aquatic development and 30 gross jobs created. The final version of the grant offer letter, dated 30 August 2007¹⁸ states 'Specifically, grant is offered on condition that the Project delivers its aims and produces the agreed quantified targets and pattern of expenditure...' and that 'WEFO is under no obligation to pay more than 95% of the FIG grant specified until the project has been completed to its satisfaction...'.¹⁹

Annex B to the offer letter included the general conditions and the special condition (relating to profitability) of grant, and stated that grant could be withheld or repaid, wholly or in part, if:

- a** it is not used for the purposes of the Project;
- b** WEFO considers the future of the Project to be in jeopardy;
- c** any information provided in the application or in subsequent or supporting correspondence is found to be substantially incorrect or incomplete; and
- d** there is unsatisfactory progress towards completing the Project or meeting the target outputs.

¹⁸ During the project, new versions of the grant application form and grant offer letter were required because of changes in the funding arrangements, expenditure profile, completion timescale, business plan and project costs. The key outputs and technical specification remained unchanged.

¹⁹ Grant offer letter from WEFO to Selonda UK, 30 August 2007, paragraphs 2 and 7



3.16 The grant offer letter stated that the Project should be completed on the basis of the details set out in the application. However, the general descriptions of the plant, wetland and landscaping in the grant application and supporting documents were not detailed technical specifications, and the grant conditions did not bind the applicant to deliver the Project in line with their claims and assertions. In addition, the application documentation included statements about aspects of the fish farm which were not included within the approved expenditure for the Project, such as landscaping and planting. Therefore, completing these works was not a condition of the FIFG grant.

3.17 Selonda UK's ecological and environmental claims in relation to the fish farm were influential in securing grant funding for the Project because they contributed to the high score the environmental aspects received in the technical appraisal of the grant application. Including all of the significant and environmentally sensitive aspects of the fish farm within the Project, specifying them in

grant conditions and monitoring them would have reduced the likelihood of the problems that subsequently arose.

3.18 The grant conditions required all necessary permits and consents to be in place but did not require the Project to be completed in accordance with the detailed regulatory requirements. The FIFG grant application contained sections that required the applicant to demonstrate how they would comply with legal requirements in areas such as equalities. However, in common with other funding schemes, the grant offer letter did not include any general requirement for the grant recipient to comply with UK law, regulations, taxation or any standards of conduct in business. If the Welsh Government was able to develop an enforceable condition that covered such requirements, its inclusion would help to safeguard public funds used for grant-funded projects. It would also mitigate potential risks to the Welsh Government's reputation, through association with companies which did not meet the requirements of such a condition.

Fish are grown to maturity in indoor seawater tanks



Photo courtesy of Anglesey Aquaculture Ltd

Part 4 – The Welsh Government’s monitoring of progress focused insufficiently on the risks identified during the Project’s appraisal

The Welsh Government’s structures and processes for grant-funded projects did not support the effective management of complex projects

- 4.1** WEFO was established in 2000 as an executive agency of the National Assembly and in 2003 was reorganised to become a division within the Welsh Government’s Department for Economic Development and Transport. In 2013, WEFO was moved to become part of the Department of Finance and Corporate Services. WEFO was (and is) responsible for managing various European grant schemes in Wales. Within WEFO, different teams were responsible for managing aspects of FIFG grants and there was a clear separation of duties between them. The Programme Management Team managed the application and appraisal; the Claims Management Team handled claims and payments; and the Monitoring and Evaluation Team managed site visits, inspections and output monitoring.
- 4.2** Welsh Government match funding approval and payments were managed separately by the Fisheries Policy Unit, which at that time was part of the Welsh Government’s Department for Environment, Planning and Countryside. To support its management of the match funding, the Fisheries Policy Unit placed reliance upon the project appraisal and financial monitoring undertaken by WEFO.
- 4.3** The Welsh Government did not have an integrated, IT-supported project management system in place and the various teams, which were not co-located, held their own paper files. Consequently, the teams undertook their functions largely in isolation from each other. In the case of Penmon Fish Farm, WEFO’s Monitoring and Evaluation Team told us that it was not aware of the project risks that had been identified by WEFO’s Programme Management Team during the Project’s appraisal.
- 4.4** In addition, Welsh Government officials have told us that effective arrangements for communication and co-ordination between the Welsh Government and external regulatory bodies, such as planning authorities and the Environment Agency, were not in place, which could have strengthened risk management and enforcement action if project monitoring had identified problems with a project. Where permits and consents are required, WEFO checks that these are in place before the project is formally approved. However, grants are not conditional upon compliance with the specific requirements of other regulatory bodies. Monitoring and enforcement of such requirements are the responsibility of the relevant bodies and WEFO does not routinely receive relevant information from them.



The main supplier contract was awarded to a related company without a competitive tendering process, and no controls to mitigate the associated risks were put in place

- 4.5** To demonstrate that good value for money is achieved from grant funding, EC requirements for the FIG grant scheme stated that EC rules should apply to procurement in respect of grant-funded projects. This requires contracts above a certain limit to be advertised in the Official Journal of the European Union (OJEU). Although commercial, private sector bodies are not covered by EC procurement rules, they are expected to use fair and open practices, including competitive tendering, when letting contracts supported by Structural Funds grants.
- 4.6** The major supplier to the Project, IAT, was part of the same group of companies (Selonda SA) as the grant recipient, Selonda UK; which also held a minority share in IAT²⁰. The value of the contract with IAT was £10.3 million, representing the entire eligible cost of the Project and including project management, design, manufacture and installation. Selonda UK awarded the contract to IAT without going out to competitive tender.
- 4.7** IAT was also the main supplier to the Bluewater Fish Farm project, in which it had a 12.5 per cent share. IAT's experience of developing the recirculation systems for the Bluewater Fish Farm project was a positive factor in WEFO's appraisal of the level of Project delivery risk in relation to the Penmon Fish Farm project, which utilised the same technology although on a much larger scale.
- 4.8** Selonda UK identified in its grant application that IAT would be the only supplier. Following a financial controls check in April 2003, WEFO raised concerns in relation to compliance with EC procurement requirements. To address such concerns, in July 2002 Selonda UK had commissioned a report from an independent consultant to justify its assertion that a single tender was appropriate because of the technically complex nature of the Project. WEFO accepted the report's conclusion that only IAT could provide the specialist technical expertise required, thereby making a competitive tendering process unnecessary. A competitive process had not been followed for awarding the Bluewater Fish Farm contract to IAT for the same reason. The absence of competitive tendering raises the risks of a lack of transparency and poor value for money, even if the supplier is an unrelated company. The likelihood of these risks increases where the supplier is a related company.
- 4.9** The controls exercised by WEFO reflected the requirements of the scheme in place at the time, but they provided little assurance in relation to compliance with specification, value for money, price manipulation, excessive profits and financial regularity or fraud risks. These risks increase where there is only one contract covering all eligible expenditure, and where the contractor is a related company. The relationship between Selonda UK, as the grant recipient, and IAT, as the contractor, was recognised during the Project appraisal. However, no specific conditions of grant or controls to mitigate the risks arising from procurement by single tender from a related company were put in place. Checks by WEFO or by the grant recipient's external auditors on payments did not extend beyond IAT's invoices to Selonda UK. Transactions between IAT and its suppliers were not checked, and IAT's invoices to Selonda UK did not include a detailed breakdown of what the invoices covered.

²⁰ Selonda SA's Annual Report 2004 identifies relationships between its subsidiaries, including Selonda UK's ownership of 25 per cent of IAT Ltd.

WEFO's verification of grant claims focused primarily on checking that Project expenditure figures were accurate and as agreed, rather than on risk management or value for money

4.10 WEFO has responsibility, on behalf of the Welsh Government, for managing grant payments to the recipient and verifying that project expenditure is incurred in accordance with the agreed profile and the purposes for which the grant was made. The Project was funded under the 2000-2006 FIG scheme, which closed in 2009. The Project was subject to the inspection regime that applied to the 2000-2006 EU Structural Funding programmes, whereby all grant claims were subject to basic checking by WEFO staff to ensure that they were complete and not obviously misstated. WEFO's checks in relation to payment of FIG grant instalments focused on eligibility of the expenditure funded by the grant, provision of private match funding, compliance with EU procurement regulations, and financial completeness (that the full amount of grant agreed was claimed during the project).

4.11 WEFO had three key mechanisms to confirm that projects complied fully with regulations and that the correct amount of grant was being claimed:

- a** an annual audit of each project by an independent reporting accountant, engaged by the grant recipient, to confirm that expenditure claimed during the period was eligible, valid and correctly stated;

- b** monitoring visits to a sample of projects to confirm that the grant recipient had adequate financial and management controls in place, and (as required by EU regulations) to confirm that expenditure claimed related to goods and services delivered;²¹ and
- c** audits of a sample of projects, by officials of the Welsh Government on behalf of the EC, to check that the projects comply with EU regulations on eligibility of activities, match funding, expenditure, publicity and procurement.

4.12 These controls focused on the risk of claims containing financial error or on identifying non-compliance with EU regulations. Such errors or non-compliance would have resulted in the claw back of grant if discovered by the EC's own auditors. WEFO's instructions for reporting accountants (responsible for providing audit certificates to support grant claims) did include a test to confirm that 'the project carried out is the same as that originally approved', but there was no further guidance on the extent of the work needed to confirm whether or not this condition was met.

4.13 Grant recipients were expected to submit quarterly grant claims against eligible project expenditure incurred, in line with a profile agreed and specified in the grant offer. WEFO's FIG grant claims verification was based on certification, usually by the grant recipient's external auditors, that the eligible expenditure had been incurred. A grant recipient would submit a claim form to WEFO identifying the amounts of eligible expenditure incurred. WEFO would check that the claims were under the headings of eligible expenditure, within the amounts agreed and fitted the expected profile of expenditure. Then, the grant recipient's appointed auditors

²¹ At present, within WEFO, these checks are financially focused but in order to strengthen the evaluation and monitoring of projects' technical aspects, better access to technical expertise is being established.



would match invoices from contractors and suppliers to payments in bank statements, and issue an annual audit certificate. The audit certificate was intended to give assurance that claims reflected actual expenditure incurred, within amounts and categories set out in the grant offer. The verification of grant claims and audit certification did not involve specific checks that goods and services had been delivered or physical assets had been constructed, nor that projects were being completed in line with the agreed descriptions in the application and supporting documents.

- 4.14** WEFO officials made quarterly site visits to monitor progress with the fish farm project. The purpose of the site visits was to:
- a** check that the project was carried out in accordance with the approval letter;
 - b** check that management and financial systems were sound;
 - c** verify the eligibility of expenditure and confirm the outputs achieved;
 - d** check compliance with contract procurement procedures;
 - e** check that publicity had been undertaken in accordance with EC guidelines; and
 - f** check that any variations to the Project were necessary and were within the grant scheme's requirements.²²

4.15 These visits identified some problems with financial records keeping; the absence of an equalities policy; and that disabled access to the facility had not been constructed. Visits also identified that progress with the Project was behind schedule and WEFO became concerned that the full amount of grant may not be claimed within the period of the funding scheme. In response to slow progress against the agreed expenditure and claim profile, the frequency of monitoring visits increased from quarterly to monthly.

4.16 WEFO project files include documents that record discussions between Selonda UK and WEFO officials during site visits about filtration trials and problems with the power supply. There was also frequent correspondence between Selonda UK and WEFO in relation to project progress, funding arrangements, difficulties during construction and testing of the plant and artificial wetland, and problems with the power supply. During the technical appraisal of the grant application, risks were identified in relation to recirculation technology, the saline wetland and the plant's demand for electrical power. However, these risks were not reflected specifically in grant conditions. The WEFO officials undertaking the site visits were not aware of the risks identified during technical appraisal of the application; and their focus was on the financial checks required by the grant scheme, rather than risk management or value for money.

²² These functions were spread amongst different teams within WEFO.

WEFO agreed variations to the Project's funding sources and completion timescale and was responsible for monitoring progress, but checking compliance with specific regulatory requirements was not within its remit

- 4.17** Notifying WEFO of substantial changes to the Project is a requirement within the grant offer letter. Where a significant variation to the Project was proposed, in relation to funding, completion date, approved costs and claims, a revised grant application was required for approval.
- 4.18** Between June 2001 and August 2007 Selonda UK submitted seven versions of the grant application form. In September 2002 the Company had advised WEFO that initial plans for the Project to produce halibut would be changed to the production of sea bass. In February 2005 Selonda UK submitted a revised business plan to WEFO, reflecting the change from the farming of halibut to sea bass and providing updated financial projections showing the Project's increased costs, changes to financing arrangements and improved cash flow arising from the shorter growing cycle of sea bass compared with halibut (12 months instead of 36 months).
- 4.19** WEFO's approach is to work with grant recipients wherever possible to address any problems which arise during project delivery. In the case of the Penmon Fish Farm, to avoid precipitating Project failure and the potential loss of public and private investment in the plant, WEFO approved changes to the Project's completion date, claims schedule,

funding sources and costs, which were reflected in changes to the grant application and approval letter. WEFO also agreed the change from producing halibut to sea bass. However, the main text in the application form and supporting documents remained unchanged; including descriptions of the plant, wetland and landscaping and also references to producing halibut. The Project's objectives were also unchanged.

- 4.20** The Project's objectives were described as 'target outputs' in the grant offer letter. They were the delivery of an aquaculture development (a fish farm) and 30 gross jobs. The Welsh Government told us that WEFO did not usually regard achieving target outputs as a 'condition' of grant funding and so would not normally recover grant if, for example, the target number of jobs was not achieved. Where projects have reached a late stage before problems come to light, WEFO's enforcement options are limited. They can withhold payment of existing claims, stop further payments or, in serious cases where the recipient has not acted in good faith or has been fraudulent, they can cancel the project altogether and seek repayment of the grant. WEFO is satisfied that the fish farm achieved its target outputs and that the essential elements of the Project were delivered.
- 4.21** Most projects funded under the 2000-2006 EU Structural Funds programmes received grants of less than £1 million. The relatively small amounts of grant funding meant that projects were not usually tested in any depth against their specifications. WEFO's focus was on ensuring compliance with the EU's regulatory framework, which is demanding, that EU spending targets were met and that outputs were fully recorded and on target. The grant offer letter set out categories of expenditure eligible for funding, such as 'power supply' and 'wetlands', but on their own



the categories were too broad to provide a basis for monitoring completion according to the descriptions contained in the application and supporting documents.

4.22 Where variations arose within categories of approved expenditure, WEFO did not regard these as significant enough to require a revised application and approval and a more informal approach was adopted. Letters, emails and notes from site visits show that WEFO was kept informed when tests and operational use of the recirculation and filtration systems revealed problems. Selonda UK was able to modify these systems and to supplement the reed beds with filtration sacks but WEFO did not formally document approvals to these changes.

4.23 Monitoring and enforcing compliance with the regulatory requirements of the planning authority and Environment Agency are responsibilities of the relevant bodies and does not form part of grant monitoring. Because of the fish farm's location in an area of outstanding natural beauty, various concerns were raised during the consultation phase of the process for obtaining planning permission. These included concerns about electricity supply, visual impact, noise, odours and pollution. The planning consent required Selonda UK to provide detailed plans for landscaping and of the coastal embankment, which was to be undertaken in accordance with the plans. To date, this work, which was not part of the grant-funded Project, has not been completed. The planning consent for the fish farm noted that a separate consent would be necessary for the electricity supply but this was not made a condition of the consent. No specific conditions were attached to planning consent to address potential issues of noise or nuisance, despite the industrial scale of the fish farm operation and its location in a conservation area.

4.24 The Environment Agency permits for the fish farm specified clear requirements to address risks of pollution. These included aspects of the intake and outflow pipe construction, discharge monitoring requirements and permitted levels of pollutants. Evidence given in court during the Environment Agency's successful prosecution of Selonda UK established that key elements of the fish farm, including the outflow pipe, wetland reed beds and filtration system, were not completed as specified or were not operating effectively and these factors, along with failures to meet the specific requirements of the discharge permit, had contributed to the pollution.

Part 5 – The funding regime for European grants has been strengthened in recent years and, as a result, arrangements for managing complex projects have improved

Some of the weaknesses we have identified in the Welsh Government's management of the public investment in Penmon Fish Farm illustrate some of the more widespread shortcomings in grants management that existed at the time

- 5.1** Grant making by public bodies is covered by administrative law, which governs the actions of public bodies in exercising their functions. A grant represents a gift or donation, and is less enforceable than a contract. A funder has no right to receive anything in return for a grant, but the grant agreement may include terms and conditions specifying how the grant is to be spent.
- 5.2** In 2002 the National Audit Office examined the management of grants in Wales funded by the EU.²³ The report concluded that WEFO's project appraisal procedures were basically sound, but could be made more sophisticated in terms of assessing project need, added value, risk and value for money. The report recommended that WEFO should do more to:
- a** assess added value (the additional benefits offered by projects) by focusing on areas of risk and ensuring that all parties are aware of what is required of them;
 - b** re-examine its arrangements for satisfying itself about the value for money of projects, including requiring improvements in the adequacy of the information in applications on which judgements are made;
 - c** ensure applicants identify the risks in projects and how they will be managed; and
 - d** incorporate a more detailed assessment of project need and quality into the criteria for selecting projects.
- 5.3** Many of the shortcomings identified by the National Audit Office can be found in the Project. The National Audit Office report also identified weaknesses in WEFO's assessment of project outputs, including cost per job. The report noted that Wales compared unfavourably against other areas of the UK which benefit from EU Structural Funds, such as Cornwall, where indicators, such as unit costs and job creation levels, were used more extensively in assessing projects.
- 5.4** A follow-up report by the National Audit Office in 2004 identified some improvements in WEFO's management of grants. However, weaknesses identified in subsequent reports by the Wales Audit Office suggest that the improvements were not sufficient to address all of the problems which arose with the public funding of Penmon Fish Farm.

²³ National Audit Office report, *European Union Structural Funds – Maximising the Benefits for Wales, 2002*

²⁴ *Grants Management in Wales*, November 2011



5.5 In 2011 the Wales Audit Office examined grants management in Wales.²⁴ The report drew on the findings from 18 reports on grant-related matters published by the Wales Audit Office between 2005 and 2011. The report found that the costs of administering grants in Wales were high and identified common weaknesses in the management of grants, in learning from experience, and in addressing the poor performance of grant recipients in delivering grant-funded projects. In particular, the report found:

- a** weaknesses in the ways in which grant funders defined the objectives of their support for projects;
- b** failures to establish, as part of the conditions of grant, clear quality standards in respect of how projects should be delivered; and
- c** failures to link clearly defined outcome objectives with a clear understanding as to how the programme or Project will deliver those objectives and a robust analysis of the resources needed.

5.6 In 2012, the Wales Audit Office's report on the Welsh Government's relationship with the All Wales Ethnic Minority Association (AWEMA)²⁵ highlighted continuing weaknesses in grants management, including in relation to WEFO. To address these, the report recommended that:

- a** the Welsh Government should establish due diligence protocols to be built into processes for awarding and monitoring grant funding, proportionate to the scale of funding and type of recipient body;

- b** WEFO should ensure all project officers are aware of the purpose and importance of monitoring and verifying that projects are proceeding satisfactorily and delivering intended outcomes; and
- c** WEFO should review all special conditions and take any necessary follow-up action promptly.

5.7 At present, the Welsh Government is responding to these issues, particularly in relation to grant funding of public organisations and third sector bodies. The National Assembly's Public Accounts Committee published its own interim report on grants management in August 2012.

The funding regime for European-funded grants has been strengthened

5.8 There have been significant changes in procedures for the current (2007-2013) programming period, although the basic purpose and structure of controls remain unchanged. The FIFG has been replaced by the European Fisheries Fund and is administered by a single unit (currently known as the Scheme Management Unit), which is within the Welsh Government but outside WEFO. WEFO retains responsibility for the larger European Regional Development Fund (ERDF) and the European Social Fund (ESF).

²⁵ *The Welsh Government's relationship with the All Wales Ethnic Minority Association*, Wales Audit Office, October 2012

5.9 We examined European Fisheries Fund procedures which have been tightened in a several respects:

- a** Each claim for grant payment must be accompanied by detailed schedules showing how the money has been spent and copies of all relevant supplier invoices. Grant claimants in the 2000-2006 programmes did not need to supply any schedules or invoices to support their claims and WEFO used to rely on certifying auditors to verify claims.
- b** All grant claims are subject to an inspection before the claim is paid. The inspection covers financial aspects of the claim and includes a physical inspection to check that goods and/or services have been delivered in accordance with the claim. Inspections are carried out by fisheries enforcement officers who are part of the recently created Fisheries and Marine Division. In contrast, for the 2000-2006 programmes WEFO undertook monitoring visits for a sample of projects and did not necessarily physically inspect the work done. Monitoring officers covered a wide range of Structural Funds activity and did not necessarily have experience or expertise in fisheries work.
- c** Every project is subject to a full technical inspection before the final grant payment is made. The aim is to confirm that the project has been delivered in line with the project application and will meet the project's original aims and objectives. The content of the inspection will depend on the nature of the project, and the Scheme Management Unit has access to technical specialists in the Welsh Government, such as surveyors or engineers, if required.

There was no requirement for such a technical inspection in the 2000-2006 programmes. Each project's external auditor was required to check that the project was being delivered as approved, but it is highly unlikely that this would have involved a detailed assessment against the original application or any approved changes.

- d** The Scheme Management Unit's procedures for requesting, agreeing and documenting variations to European Fisheries Fund projects in progress have been strengthened compared to the procedures used for the 2000-2006 FIG programme. A grant recipient is required to submit a formal Project Variation Form which gives clear details of the most recent approved costs, the proposed changes and the rationale for them. This information is then subject to an appropriate appraisal, which could include updated financial and technical assessments, before progressing to the approvals processes. If approved, a revised grant offer letter is issued. These variation procedures are followed where costs are more or less than originally forecast or where there are changes to elements of the project as originally approved.

5.10 These changes, if fully implemented, will strengthen controls significantly compared with the 2000-2006 programming round. The extent and depth of monitoring is substantially greater, and the physical and technical inspections make it more likely that any significant deviations from the agreed project plan would be picked up at an early stage, although the extent of the technical checks will depend on the judgement of the inspector in any given case.



- 5.11** The Welsh Government considers that the revised administrative arrangements, under which the Welsh European Fisheries Fund programme is managed by a single unit, has a number of benefits that would reduce the risk of important issues not being detected and acted on in a timely fashion. Monitoring and payments staff work solely on fisheries projects and therefore develop significant experience and expertise, and the small size of the unit relative to WEFO means that the links between these staff are closer than they were.
- 5.12** The risks arising from Selonda UK contracting with a related company to deliver most of the capital works would not be addressed by the standard questions in the inspection checklists used for the current fisheries programme. Risks such as these, which relate to the particular circumstances of a project, should be identified and mitigated through special conditions in the offer letter and related monitoring. A special condition highlights the importance of a particular issue for both the grant recipient and the Welsh Government's monitoring staff, and helps ensure that the issue is managed robustly. WEFO now uses special conditions frequently to ensure that project-specific risks are identified and monitored through regular project reviews. The Scheme Management Unit makes less use of special conditions than WEFO, but it does require those which are set to be monitored as part of the inspection process.
- 5.13** To facilitate more robust monitoring of project expenditure in relation to clearer, more specific requirements, categories of approved costs are more narrowly defined in grant offer letters in the current European Fisheries Fund programme than they were for the FIGG programme, which included the grant to the fish farm. Now, more categories of approved expenditure are likely to be specified and a breakdown of costs within categories is also included.
- 5.14** Overall, the Welsh Government has progressively strengthened its arrangements for managing grant funding. Improvements made since the Project mean that it is more likely now that significant risks would be identified during the project appraisal and evaluation process, that special conditions would be used and monitored to address risks which are identified, and that more robust controls would identify problems as they arise and lead to timely enforcement action, if appropriate.

Appendix 1 – Sources of public funding for Penmon Fish Farm

The following public funding streams have been identified:

Public funding source	£
FIFG grant	£3,601,454
Welsh Government match funding for FIFG grant	£1,514,494
Agri-Food Development Scheme: Project Marketing and Branding – 2009	£2,920
European Fisheries Fund grant (fish sorting and stunning plant) – 2009	£43,431
Welsh Government match funding for European Fisheries Fund grant – 2009	£31,000
Welsh Government revenue support for fish food and oxygen – 2011	£40,000
Welsh Government funding for power supply – 2011	£27,000
Total	£5,260,299



Appendix 2 – Penmon Fish Farm – Project timeline

Key dates	Grant application and approval	Financing	Project progress
2001			
June	FIFG grant application submitted to WEFO, supported by business plan and environmental statement.	Eligible Project costs £10,300,755. Private £6,180,453. Application for FIFG grant of £4,120,302.	Forecast completion April 2003.
July	WEFO technical assessment results in highest rating score. Revised FIFG application form reflecting changes to costs and funding.	Eligible Project costs £10,289,870. Private £6,172,922. Welsh Government match funding £514,493. Application for FIFG grant of £3,601,454.	
2002			
February	Rural Assets Strategy Partnership evaluate application.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £514,494. FIFG grant £3,601,454.	Planning consent granted by Isle of Anglesey County Council.
March	Revised FIFG application form, reflecting changes to costs, funding and completion date.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £464,496. Application for Anglesey County Council grant of £50,000. Application for FIFG grant of £3,601,456.	Forecast completion March 2004.

Key dates	Grant application and approval	Financing	Project progress
2002			
June			Environment Agency approve permit to discharge treated waste into sea.
July	WEFO approve FIG grant and issue grant offer letter (dated 25 June) to Selonda UK.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £464,494. Application for Anglesey County Council grant of £50,000. Approval for FIG grant £3,601,454.	Forecast completion March 2004.
August		Icelandic partners (FISKEY) withdraw £3 million of private funding.	
September			Selonda UK notify WEFO of switch from halibut to sea bass.
2003			
January		Welsh Government Ministerial decision to increase match funding to £1.51 million.	
February		Anglesey County Council refuse application for £50,000 of match funding grant support because the funding for this originates from EU.	



Key dates	Grant application and approval	Financing	Project progress
2003			
March	Revised FIG application form reflecting changes to project funding.	Private funding decreased from £4,973,922 to £3,944,936. Welsh Government match funding increased from £464,494 to £1,543,481.	
April			Site visit identifies no physical works done on-site.
May	WEFO identify procurement risks with single tender procurement from related company as main contractor.		
June	Revised FIG application form reflecting changes to project funding.	Eligible Project costs £10,289,870. Private funding increased to £5,144,935. Welsh Government match funding £1,543,481. FIG grant £3,601,454.	Forecast completion June 2004.
September	Project review by WEFO highlights risks, justifications for proceeding with project, value for money concerns and high cost per job. Technical appraisals and concerns are summarised.	Project review recognises major new power supply costing £1,316,000 is needed to 'build the Farm at Penmon and leave capacity for future expansion'.	WEFO review notes that IAT has relocated to Wales bringing 20 jobs.

Key dates	Grant application and approval	Financing	Project progress
2004			
June			Scheduled grant claim not submitted by Selonda UK to WEFO for payment as project running behind plan.
December			Selonda SA write to WEFO explaining delays to the project arising from problems with the recirculation technology in use in the Bluewater Farm requiring changes to the design of recirculation systems for the Penmon Plant.
2005			
February	Selonda UK write to WEFO enclosing a revised business plan reflecting change from halibut to sea bass in financial projections although the text in the application form continues to refer to halibut.	Grant funding unchanged.	
May			WEFO writes to Selonda UK expressing concerns about project progress, threatening to cancel project and reclaim grant.
September			Selonda UK write to WEFO identifying completion date of December 2006, which requires re-approval.



Key dates	Grant application and approval	Financing	Project progress
2006			
March		Selonda UK write to Welsh Government Fisheries Policy Unit requesting an exceptional payment of £622,500 from Welsh Government match funding to meet additional deposits requested by contractors against construction costs. The request is approved and payment is made.	
June			During a site visit Selonda informs WEFO of expected completion by March 2007. Delays are due to improvements required to the recirculation system specification. There are also difficulties reaching agreements with neighbouring landowners about the electricity supply. Site visit notes that the wetland is processing waste from the Bluewater Flatfish Farm.
December			Site visit notes construction of tanks and buildings is progressing. Costs escalating due to increases in construction costs, technical requirements and electricity supply issues.

Key dates	Grant application and approval	Financing	Project progress
2007			
June	Selonda UK writes to WEFO expressing intention of siting a fish processing plant on Anglesey once fish farm production reaches the required volumes.	Selonda notifies WEFO that costs of establishing power supply increased to £1,035,000.	WEFO site visit identifies buildings nearing completion. System test on installed tanks expected in August 2007.
July			Grant claim form states eight jobs created.
August	Revised FIG application form and offer letter due to increased project spend to £11,978,803. Private funding increased to fund ineligible expenditure. FIG grant funding and Welsh Government match funding unchanged.	Eligible Project cost £10,289,870. Private £6,862,855. Welsh Government match funding £1,514,494. Approved FIG grant of £3,601,454.	95 per cent of total FIG grant paid to date. Planned completion May 2008. Total forecast Project cost, including ineligible expenditure £11,978,803.
October			Selonda UK informs WEFO that power supply issues involving agreements with landowners and construction costs are likely to extend beyond Project completion date of August 2008.



Key dates	Grant application and approval	Financing	Project progress
2008			
August	Revised FIG application form submitted and agreed. Form text unchanged and still refers to halibut.	Costs unchanged from August 2007.	
October		On 20 October WEFO agrees that all ineligible expenditure associated with the Project will not be incurred by the end date of 31 December 2008. This approval removed ineligible costs associated with completing the power line from the Project.	Formal agreement by letter from WEFO to Selonda UK of revised FIG Project completion date 31 December 2008. Final claim to be received by end of February 2009.
December			Project completion date Grant claim form states 17 jobs created.

Key dates	Grant application and approval	Financing	Project progress
2009			
January			Penmon Fish Farm begins operating. Tanks stocked with fish fry.
February	Final FIFG claim form submitted. All eligible expenditure claimed.	Email from Selonda UK to WEFO identifies that cost of wetland has risen above the forecast cost of £513,000, approved as eligible expenditure, to £600,046. The ineligible additional costs are to be met by Selonda UK from other sources.	
March	Selonda UK applies for a grant under the Welsh Government's Agri-Food Development Scheme: Project Marketing and Branding. Agri-Food grant is approved.	Project cost £5,840. Grant £2,920. Final FIFG grant payment made (£180,073) to total £3,601,454.	Selonda UK applies for planning consent for mains power supply, but application is withdrawn before being considered by the council.
July			WEFO monitoring identifies 28 jobs.
August	Selonda UK apply for European Fisheries Fund grant for fish sorting and killing plant.	Project cost £124,088. Grant £43,431.	Planned European Fisheries Fund project completion July 2010. WEFO monitoring identifies 33 jobs.
November	Welsh Government Fisheries Unit approves European Fisheries Fund grant and match funding.	Project cost £124,088. Grant £43,431. Welsh Government match funding £32,022.	



Key dates	Grant application and approval	Financing	Project progress
2009			
December			Bluewater Flatfish Farm, which had been operating at below its planned capacity due to technical problems with the recirculation and filtration systems, ceased operating. The facility was then used for packing fish from Penmon Fish Farm.
2010			
April			Isle of Anglesey County Council serves noise abatement notice on Selonda UK for low-frequency noise arising from diesel generators. Quieter generators are brought in to reduce noise.
August			Environment Agency investigates a chemical spillage and discharges of effluent into the sea.
2011			
August	Welsh Government funding to Selonda UK to develop a sustainable power supply approved.	£27,000 grant to Selonda UK for power supply, payment is made direct to the power company. Total project cost is £85,000 with Selonda UK providing £58,000.	Power supply project due for completion in March 2012.

Key dates	Grant application and approval	Financing	Project progress
2011			
October			Selonda UK pleads guilty to allowing trade effluent and chemical waste to pollute the natural environment.
November		Selonda UK experience cash flow problems. The Welsh Government provides interim assistance of £40,000 by purchasing supplies of fish food and oxygen.	
2012			
January		Selonda UK liquidated and assets sold for £1.2 million. New operator is Anglesey Aquaculture Ltd (AAL).	
May			New operator, Anglesey Aquaculture Ltd, completes the additional project to improve the existing power supply to the quarry.