

Our ref: CG/FD/ajt

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Mr Colin Green
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Office of Gas & Electricity Markets
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Dear Sir

Open Letter on Extending National Grid Company's Transmission Owner Price Control 2006/07

Ofgem letter of 22 July 2005 invites views from respondents on any aspect of the issues set out in its letter.

The letter summarises Ofgem's view of NGC expenditure for 2005/06 and 2006/07, and is therefore a clear indicator of the levels of business likely to be available from NGC over the next two years.

As a major supplier to NGC for transmission infrastructure works, the outcome of this price control extension will have significant implications for Balfour Beatty's future business. We would, therefore, like to comment in particular about the level of Capex allowance proposed by Ofgem. This is the first time that Balfour Beatty has commented directly to Ofgem and so we have also taken the opportunity to express some more general views.

Background

It is recognised by all relevant parties that the ageing of the UK transmission and distribution assets is a major issue and that the price control reviews should take full account of this. The recent distribution price control review clearly recognised the issue and reflected this in Capex allowances which exceeded the previous price control allowances by 48%.

The Trade and Industry Select Committee, in its 2004 report on the electricity distribution networks, expressed the view that "just to enable ageing equipment to be replaced, investment in the electricity infrastructure will have to be significantly higher than in recent years and over an extended period, probably about 20 years."

Capital Expenditure 05/06 and 06/07

Ofgem states that uncertainty about the level of non-load related expenditure leads it to the view that PB Power low case figures should be used.

To respond to the degree of uncertainty by allowing an arbitrary 80% of the NGT projections for NLRE seems unduly pessimistic, and even more so in the case of overhead lines, where the allowance proposed is just over 50% of NGC projections.

If there is uncertainty about the basis for the projections, the less risky approach would be to do more work to improve the level of confidence. Clearly it is prudent to have an option to make adjustments to the level of allowed NLRE at the next full price review. In the interim, however, accepting NGC current projections would seem to be a safer option than to insist on significantly lower expenditure, with the obvious increased risk to the network.

The proposal to allow NLRE significantly below the NGC projections would result in a number of schemes being deferred. This does not align with the outcome of the latest distribution price control review, which recognises a need to substantially increase Capex to cater for asset ageing.

In our view, the NGC process of Pre Sanction Engineering to assess line condition prior to refurbishment is a good example of a best in class approach to maintaining the integrity of the asset. Balfour Beatty is finding from many detailed tower condition surveys that significant quantities of tower steelwork should be replaced which leads us to conclude that there is a need to significantly increase the rates of line refurbishment to keep within the design life of the asset.

Recent increasing trends in EHV cable fault and repair work also lead us to conclude that there is a genuine case for increasing expenditure on the refurbishment or, where necessary, the replacement of these assets .

Industry Capacity

Balfour Beatty's view is that the entire industry must work together to tackle the issue of ageing asset replacement.

NGC sees the need to engage with the suppliers in new and innovative ways to deliver their projected increased Capex volumes, and their supplier workshops are designed to investigate how these volumes can be substantially increased. NGC and the supplier base work together to identify the needs of the asset and the industry resource required to support it. As a supplier in the transmission arena, Balfour Beatty has invested heavily in plant and equipment, and recruitment and training to support a significant increase in volume in the coming years. This is a lengthy process founded on the premise that supplier investment will be matched to projected expenditure. Having committed to the investment, it is important to ensure that the resource is used as intended and not diverted into other markets, which could result in the resource not being available when needed.

NGC recent alliances with suppliers, including Balfour Beatty, to deliver the gas mains replacement programme indicate clearly their willingness to work

with the supplier base to adopt innovative measures to deliver major volumes of work.

Conclusion

Our views on this interim review exercise extend to the forthcoming price review and lead us to the conclusion that the current five year regulatory cycle could usefully be extended to ten years or more for transmission assets. We note the PB Power projected asset replacement figures for the next price review period and conclude that they imply rates which will fail to adequately address the asset ageing issue.

In our view, efficiently incurred expenditure involves not only spending wisely to get best value for the money spent on achieving network targets, but also spending at the right time, so that the customer is not asked for more money later on to restore even older assets.

Yours sincerely

For and on behalf of

Balfour Beatty Power Networks Limited

Frank Duffy

Director of Network Strategy