

Mr Colin Green  
Senior Manager - NGC price control extension project  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

Name	Ron Smith
Department	Power Transmission & Distribution
Division	SPTD, Manchester
Telephone	+44(0) 161 446 5400
Fax	+44(0) 161 446 5989
Email	ron.smith@siemens.com
Date	19 August 05

Dear Colin

### **Response from Siemens to Ofgem's Open Letter Dated 22 July 2005**

In relation to the **Capital expenditure allowance for 2006/07**, in its 22 July 2005 letter Ofgem states that it is minded to:

- A) Explore further the establishment of an allowance based upon two of the available options - either PB Power's Low scenario (£420.6M), or the average of NGC's average expenditure over the period 2001/02 to 2005/06 (£386.3M).
- B) Carry out further work to consider whether these options provide strong incentives for investment deferral.

The options in A) need to be seen in the context of NGC's projection of £614.1M, PB Power's initial projection of £521.3M, and PB Power's High scenario of £567.9M.

Ofgem also states that it considers that it might be appropriate to incorporate a mechanism to pass on the benefits of a capital expenditure underspend to users of the transmission system.

Siemens would comment on these and related issues as follows:

- 1) Whilst recognising that there is always a degree of uncertainty surrounding load-related system "entry" and "exit" expenditure, we are very concerned that the highest allowance Ofgem is minded to explore further is PB Power's Low scenario.
- 2) Although the letter states that "PB Power's projections are based on a substantially higher volume of asset replacement work than NGC is planning to undertake", according to Annex A even the PB Power High scenario asset replacement figure is substantially less than the NGC projection. We cannot reconcile these statements.
- 3) From our experience of carrying out construction work on the system we recognise the age profile of the transmission assets, and NGC's efforts to ensure a timely and manageable programme of asset replacement. Accordingly, and in the light of PB Power's asset replacement projections, we would have expected Ofgem to be exploring an allowance in the region of PB Power's High scenario (£567.9M), even making allowance for the uncertainty (please see point 1) surrounding some load-related expenditure projections.

- 4) In our opinion, responsible asset stewardship should result in a continuing planned programme of asset replacement. Although a high proportion of NGC's transmission assets were installed in the 1960s, an appropriate asset stewardship regime would allow their replacement to be programmed over a longer period of time than their original installation.
- 5) In relation to asset replacement, we cannot reconcile Ofgem's "... strong incentives for investment deferral ... " with our view of "responsible asset stewardship" in point 4).
- 6) Particularly in relation to asset replacement, the projections of NGC and PB Power need to be viewed in the context of the overall needs of the GB electricity industry for construction work during the coming decades. Point 4) also applies to the other GB Transmission Owners, and to the DNOs. Further, achievement of the Government's targets in relation to renewable generation will result in a significant amount of additional construction work.
- 7) The electricity industry's construction and asset replacement needs are met through a number of qualified Suppliers working with the TOs and DNOs. Whilst these Suppliers will be able to increase their capacity to manage the foreseen increase in workload, in our view it is not appropriate to allow a situation to develop where very significant peaks in activity occur over a period of a few years.
- 8) Drawing together points 4) to 7), it is our view that asset replacement work – which is more amenable to programming than the load-related work referred to in point 1) – can and should be spread over as long a period of time as is practicable. As a consequence, this would allow NGC and its Suppliers better to manage the less predictable load-related work.
- 9) Summarising the key points from our response:
  - a) The recognition by both NGC and PB Power of the need for substantial and early investment in asset replacement suggests that Ofgem should explore an allowance in the region of the PB Power High scenario of £567.9M.
  - b) Recognising the age profile of NGC's transmission assets, deferment of asset replacement, (whether incentivised or not), is inappropriate, and could put at risk the required levels of system availability.
  - c) NGC's asset stewardship approach allows the planning of a long-term programme of asset replacement; in contrast, it is not possible to plan other investment with this degree of certainty.
  - d) Provided the majority of asset replacement investment is programmed in this way, NGC and its qualified Suppliers will be able to meet the challenge of substantial 1960's asset replacement during the next decades, coupled with the more volatile mix of load-related and renewable-related investment.

Siemens would request Ofgem to take these points into consideration following this consultation period. We will be pleased to respond again as appropriate during the next four-week consultation period, scheduled to follow the publication of Ofgem's initial proposals in September 2005.

Yours sincerely,

Ron Smith  
Managing Director