

1 INTRODUCTION

No questions.

2 OVERVIEW OF THE UPDATED PROPOSALS

No questions.

3 NATIONAL GRID ELECTRICITY TRANSMISSION (NGET)

No questions.

4 SCOTTISH HYDRO-ELECTRIC TRANSMISSION LIMITED (SHETL)

No questions.

5 SCOTTISHPOWER TRANSMISSION LIMITED (SPTL)

No questions.

6 NATIONAL GRID GAS NTS (NGG NTS)

No questions.

7 GENERAL PRICE CONTROL POLICY AND COST ASSESSMENT ISSUES

7.1 Do you agree with our proposed incentives for efficient capital expenditure, including a 25 per cent incentive rate?

To the extent that the 25 per cent incentive rate is consistent with that faced by the licensees under the current price controls (paragraph 7.3), Siemens agrees with Ofgem's proposal. We would, however, make the following comments:

- A) As we have consistently pointed out in earlier consultations, in our view the asset replacement element of non load related capex is far too low in relation to the condition of the assets.
- B) Whilst encouraging efficient use of capex, there is a significant risk that the incentive could also result in deferment of necessary asset replacement capex, with a consequent detrimental impact on network reliability and availability, ultimately impacting consumers.
- C) Whilst this may not be its primary intent, we trust that paragraph 7.7 provides for a review to prevent an occurrence of the situation noted in 7.1(B) above.
- D) Paragraph 7.4 explains the reasons for the differing incentive rates for licensees in DPCR4, and says that "this is not possible to the same extent for transmission, because of the smaller number of companies and the substantial differences between them". If the age and condition of the infrastructure assets of the four transmission licensees are different, should provision not be made for the possibility of different incentive rates?

7.2 What do you think about our proposals to address significant capex under spend? In particular:

(1) What action should we take if this happens?

For both NGET and SPTL, Ofgem is proposing non load related capex of the order of 25 per cent below that sought by the licensees; for NGG NTS the discrepancy is approximately half of that, and there is no negative discrepancy for SHETL. Short of a reversal of policy by the licensees, or a sudden or unforeseen reduction of the market's capacity to deliver this capex, it is difficult to envisage this situation arising. If, nevertheless, it does arise it would seem appropriate for Ofgem to have the authority to investigate the circumstances of the under spend and, if then deemed appropriate, to suspend the incentive arrangements. To underpin this, it would be necessary for Ofgem and the licensees to have an agreed definition of "significant capex under spend".

- (2) *At what level should we trigger this response?*

Depending upon the capex reporting arrangements required by Ofgem from the licensees, first indications of any significant under spend could be evident after the first year's reporting, thus triggering a response from Ofgem.

- (3) *Should this response apply to load related and non load related capex?*

Our responses to questions 7.1 and 7.2 have related primarily to non load related capex. There is much less of a discrepancy between Ofgem and the licensees for load related capex. The action we propose in our response to question 7.1(1) still seems to be appropriate.

- 7.3 *Do you agree with our proposed approach for dealing with uncertain costs including future input price changes, specific cost uncertainties, and wider regulatory developments?*

- A) With reference to paragraph 7.9, recent years have seen significant cost increases for materials used in transmission network construction – particularly metals – due to increasing demand globally. There is every likelihood that this will continue, and the extent of the cost increases is not easy to predict and provide for in advance.
- B) With reference to paragraphs 7.10 to 7.13, Siemens agrees with Ofgem's proposed approach.
- C) With reference to paragraphs 7.14 to 7.20, Siemens agrees with the approach proposed by Ofgem in paragraph 7.15.

- 7.4 *What do you think regarding the proposed regulatory treatment of NGG's use of affiliated LNG?*

Presumably the investment referred to in paragraph 7.32 is in assets owned by National Grid LNG Storage Limited, and these assets are not part of the NGG NTS regulated asset base. In the absence, meantime, of other providers of these services to NGG NTS, it is necessary for sufficient funds flow to the asset owner to ensure that the necessary investment is made. It appears to be more appropriate for this to happen through increasing the prices paid for the services than through a capex allowance.

8 FINANCIAL ISSUES

- 8.1 *Do you agree with the conclusions of the Smithers & Co cost of capital study, in particular the real cost of debt and equity?*

Not addressed.

- 8.2 *Do you agree with our proposed revised treatment of pensions costs?*

Not addressed.

- 8.3 *Do you agree with our proposed approach to the provision of new equity?*

Not addressed.

9 ADJUSTMENT MECHANISMS AND INCENTIVES: ELECTRICITY

- 9.1 *Do you agree with our proposal that it is appropriate for NGET to have a different form of revenue driver from SPTL and SHETL?*

Siemens agrees with Ofgem's explanation in paragraph 9.19 of the proposed different treatment of NGET from SPTL and SHETL.

- 9.2 *Do you agree with our proposed mechanism to deal with baseline and revenue driver sample risk?*

As noted in paragraph 9.9, the location – and, therefore, connection cost – of new generation is not something "that SPTL and SHETL have a great deal of control over". In the light of this it seems inappropriate to limit out-turn adjustments to "no more than 15 per cent either way", as proposed in paragraph 9.10.

- 9.3 *Do you agree with our proposed split of revenue recovery between pre-connection and completion?*

Yes – as outlined in paragraphs 9.11, 9.23 and 9.26. However, no reason is given for the 75/25 split.

- 9.4 *What are your views on the appropriate method of providing connections to the Scottish Islands?*

With reference to paragraph 9.36, whilst we could envisage competition to provide transmission links to the Scottish Island groups, given the very high construction costs we would not envisage more than

one high-capacity link to each group. As a global constructor of such links Siemens would be pleased to provide input to Ofgem in this area.

9.5 *What additional output measures do you think Ofgem should capture when considering system performance?*

Not addressed.

9.6 *Do you agree with our view that an Innovation Funding Incentive is appropriate?*

Yes. The funding levels mentioned in the Initial Proposals would, however, limit what NGET could accomplish and may be insufficient for SPTL and SHETL to accomplish anything at all. In relation to paragraph 9.38, we await the outcome of the joint work in this area between Ofgem and the ENA.

10 ADJUSTMENT MECHANISMS AND INCENTIVES: GAS

10.1 *Do you agree with our proposals for the treatment of entry and offtake capacity release obligations, and capacity substitution?*

Not addressed.

10.2 *Do you agree with our proposed approach in relation to revenue drivers?*

Not addressed.

10.3 *What are your views of our proposals on buy back incentives, in particular, in relation to investment lead times and caps on exposure?*

Not addressed.

10.4 *Is it appropriate to propose an incentive on NGG NTS to release additional incremental flexibility over and above the flexibility baseline?*

Not addressed.

10.5 *Do you agree with our view that an Innovation Funding Incentive is appropriate?*

We note that, following the Initial Proposals, Ofgem have decided to proceed with this "as a means of promoting R&D for the benefit of consumers". In relation to paragraph 10.39, we await the outcome of the joint work in this area between Ofgem and the ENA.

10.6 *What are your views on our proposals for transitional offtake incentives?*

Not addressed.

11 SUSTAINABLE DEVELOPMENT AND THE ENVIRONMENT

11.1 *Do you agree that the licensees should be incentivised to reduce leakage of SF6? Do you agree the incentive should be set for 5 years?*

"Yes" to incentivisation, and "yes" to a simple scheme which can reward the licensees at the end of the control period. In setting the SF6 emissions reduction criteria for each licensee Ofgem needs to take care to provide for an increase in the installed base of SF6 through the procurement of new equipment. However, the leakage of SF6 from new equipment is likely to be small compared with that from early gas-insulated equipment: Ofgem also need to recognise that the only effective way of reducing emissions from such equipment may be through asset replacement.

11.2 *Do you agree with our proposal not to apply the DPCR approach to transmission undergrounding? Do you have views upon how we may best factor this into our decisions?*

Yes, primarily because of the "one-off" nature and high cost of most transmission infrastructure projects. There are several candidate technologies for underground transmission circuits – oil-filled cable, XLPE cable, gas-insulated line. The amount of power to be transmitted is one factor in selecting the most appropriate technology; other factors include heat emission, the amount of electro-magnetic radiation generated, and the likelihood and consequence of the occurrence of oil and gas leakages. Ofgem could usefully bring such considerations into the decision-making process.