

National Grid Transmission R10-T1: Initial Proposals consultation response Supplementary information – Business Support

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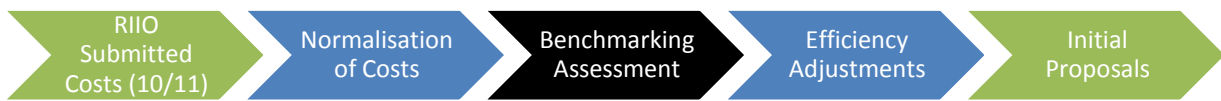
Executive summary

Benchmarking of Business Support costs

- 1 Benchmarking of business support costs purely on 2010/11 costs and metrics such as FTEs and revenue represents a material departure from Ofgem's published RIIO principles which favoured benchmarking future, not historical costs. The analysis underestimates the impact of Transmission workload growth over the next decade giving rise to inappropriately low allowances. Errors in the calculations and unsound logic in the assessment compound this position, leaving untenable targets which will inhibit areas such as IS innovation and skills development.
- 2 Reversing the analysis and logic errors in the benchmarking would increase combined allowances for Transmission and Distribution by approximately £94.1m, this is before adjusting the benchmarking to refer to Networks' levels of performance due to lack of comparability with the Hackett data.
- 3 As they stand we have concerns around the suitability of the initial proposals in the these key areas:
 - (a) **Future benchmarking:** The lack of benchmarking based on future metrics contradicts Ofgem's published RIIO principles, with Ofgem stating: *"We will place much more emphasis on the benchmarking of forecasts (as opposed to historic costs) as these are likely to be more relevant in the context of our sustainable development duties and the introduction of new output measures."* We have been unable to ascertain whether any such benchmarking has taken place. But are aware that our costs have been benchmarked based solely on 2010/11 metrics such as FTEs or revenue, rather than considering the impact of forecast increases in these over the RIIO-T1 period reflecting growth. This is inconsistent and demonstrates a departure from the RIIO core principles.
 - (b) **Ignoring our benchmarking and market testing evidence:** We agree that including efficiency additions based on the strength of independent benchmarking in the business plans is a positive step. However several of the benchmarking results and market testing evidence submitted by us have been ignored by Ofgem's own admission, creating artificially low allowances.
 - (c) **Non-normalisation of costs:** Regulation costs have been benchmarked against a comparator set of data which contains no regulated entities. Hackett data has been used to set a target in several activities despite specific guidance from Hackett not to do this. In addition, there has been no account taken of the benefit of us having more automated (and hence more IT led) processes than those we have been benchmarked against, despite Hackett themselves stating this needs to be performed.
- 4 The resulting impact of these errors and inadequate analysis is a set of allowances which do not reflect an accurate assessment of the costs in this area.

Benchmarking methodology

- 5 The Initial Proposals used cross network benchmarking for business support costs with reference to data from Hackett to produce a reference point outside of the utility sector. As stated in our submission if costs are adequately normalised and the methods used are applied consistently, the use of such benchmarking for business support costs is a valid assessment method. The issue with the use of such benchmarking in Initial Proposals is that neither of these conditions have been adhered to, giving rise to flaws in the methodology used and a deflated resulting allowance.
- 6 In this response we highlight some errors in data and methods employed to benchmark our business support costs over the RIIO period. The response is structured to focus on and suggests the methods that should be used to rectify the errors and omissions. It should be noted that we have been unable to disaggregate the initial proposals submissions into forms of control, this document therefore is focussed at the National Grid cost level.
- 7 We understand the benchmarking process to be as follows:



- 8 The next sections discuss the issues we have found with this assessment.

Future benchmarking

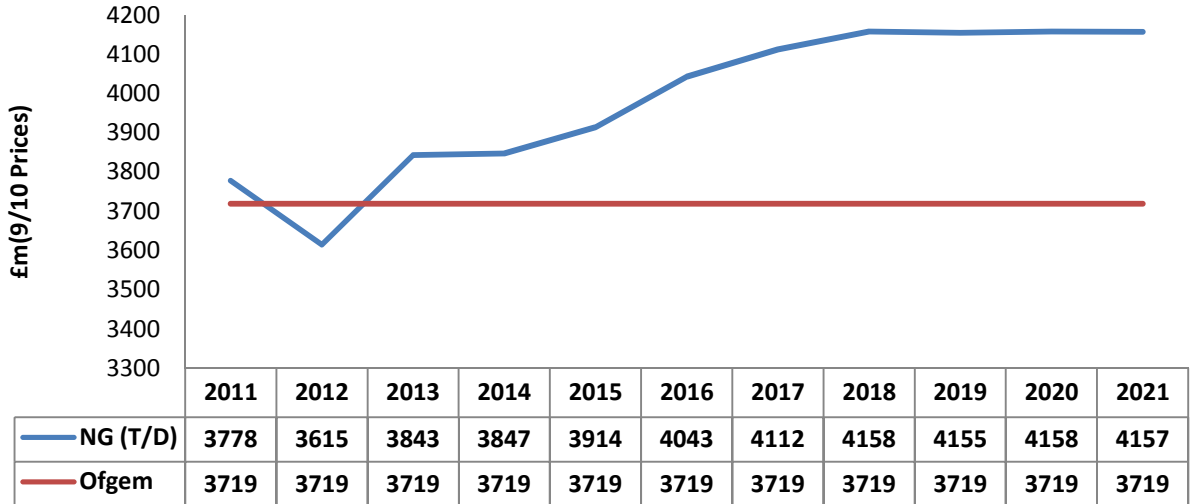
Area	Issue	Action required
Future benchmarking	Costs benchmarked using 2010/11 metrics, ignoring impact of future growth	Projections for FTEs and revenue applied to the benchmark Upper Quartile (UQ)

- 9 Within this assessment our future costs have been assessed based on 2010/11 expenditure and metrics such as FTEs and revenue from the same year. This ignores the cost impact of future growth in both of these metrics and directly contradicts the RIIO guidance at the start of the price control where Ofgem stated that *“We will place much more emphasis on the benchmarking of forecasts (as opposed to historic costs) as these are likely to be more relevant in the context of our sustainable development duties and the introduction of new output measures.”*
- 10 We are unable to ascertain whether any such benchmarking has taken place. Our costs have been benchmarked based solely on 2010/11 metrics such as FTEs or revenue, rather than considering the impact of forecast increases in these over the RIIO-T1 period reflecting growth. This is inconsistent and demonstrates a departure away from the RIIO core principles. Future benchmarking (or benchmarking of forecasts as stated in the consultation) has not been adhered to despite us highlighting the impact of such drivers on business support costs in our initial and updated business plan submissions.
- 11 The table below shows the activities impacted by the use of historical as opposed to future benchmarking and the metrics used:

Metric	Activity
Revenue	Finance, CEO and Property
End Users	IT and Telecoms
FTE	HR

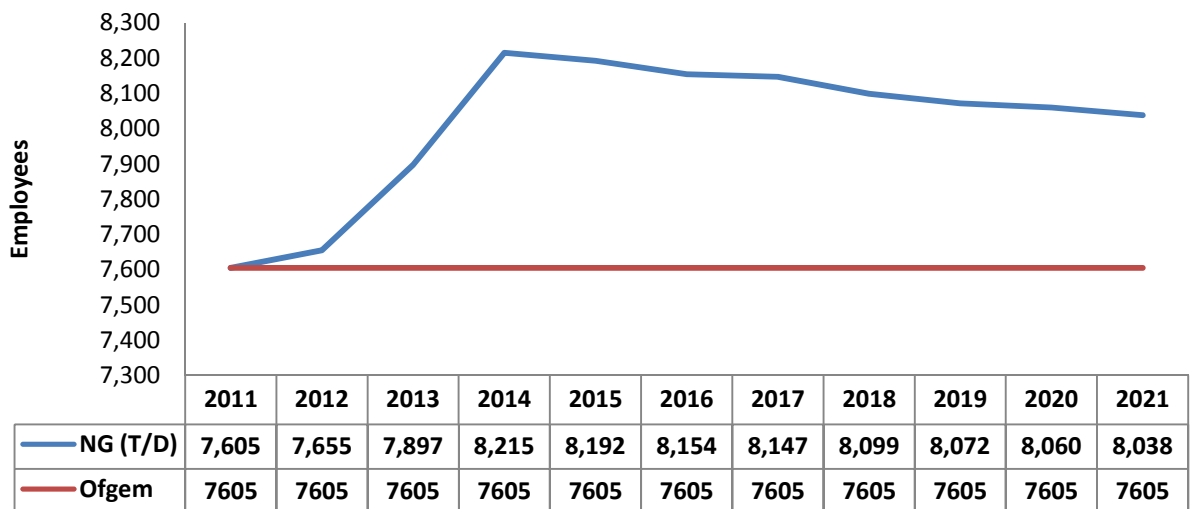
- 12 The below graph/table shows the forecast revenue from Initial Proposals (across Transmission and Distribution) versus the figure used in the assessment:

Revenue differences in benchmarking modelling



- 13 In the table above it can be seen that the underlying revenue is growing over the RIIO period across Transmission and Distribution.
- (a) Any one year selected as a base year is not a reflection of future growth.
 - (b) The Transmission business is in an organic growth phase and needs to have sufficient opex throughout RIIO otherwise key activities such as IS innovation and skills development will be inhibited
- 14 The same presentation for FTEs shows the following comparison (across Transmission and Distribution) versus the figure used in the assessment:

FTE differences in benchmarking modelling

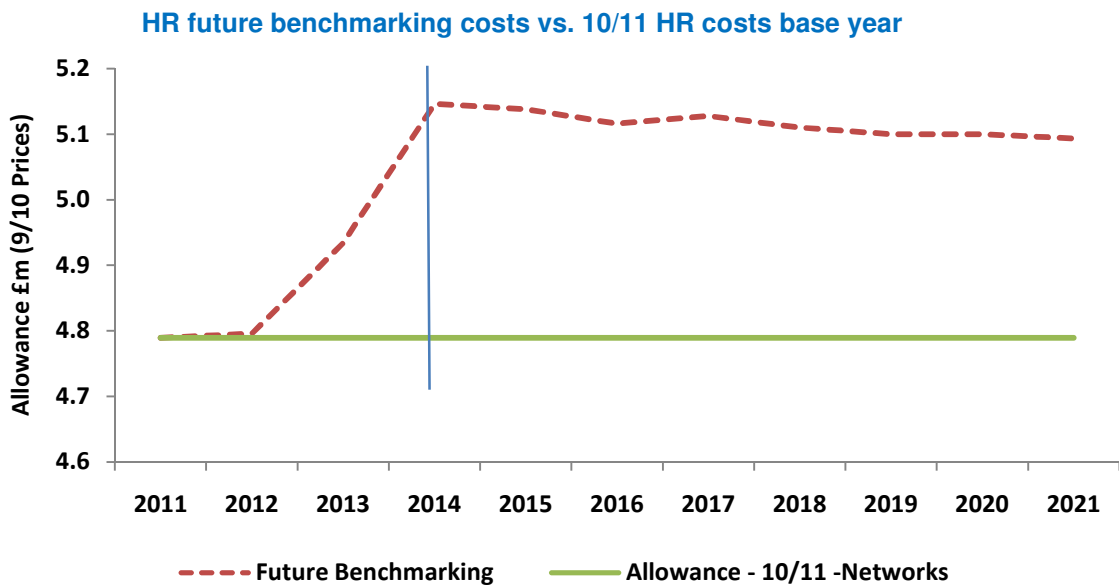


- 15 Again significant growth in the cost driver is ignored in the assessment. Similar differences appear in the user metrics used for IS as these are based on the FTE data.

- 16 Our estimates show that factoring in this growth increases the allowances for business support across Transmission and Distribution by approximately £94.1million, as shown in the table below:

Area	[Text Removed]	[Text Removed]
Finance, Audit and Regulation	[Text Removed]	[Text Removed]
HR	[Text Removed]	[Text Removed]
CEO	[Text Removed]	[Text Removed]
IS	[Text Removed]	[Text Removed]
Property	[Text Removed]e	[Text Removed]
Total	[Text Removed]	[Text Removed]

- 17 The graph below shows this example in practice for HR costs with the green line illustrating our allowance as defined in the Initial Proposals, and the red line the adjusted allowances based on the growth in FTEs over the period (using within year FTE numbers and multiplying this by the UQ).



- 18 Overall this represents an increase of approximately [Text Removed] across Transmission and Distribution; it still leaves us with a substantial efficiency challenge, but takes account of underlying growth in our plan. This method allows for some alignment of our forecasts and the associated benchmarking, whilst appreciating the underlying cost drivers.

Efficiency Additions

- 19 The initial proposals highlight the efficiency addition mechanism as a process which rewards network companies for demonstrating good benchmarking practice and having business plans which demonstrate that benchmarking feedback is being incorporated into future forecasts. We agree that the inclusion of this mechanism is fair, however, a number of benchmarking and market testing evidence we submitted has been ignored or understated in this assessment.

Area	Issue	Action required
Benchmarking evidence ignored	Our benchmarking reports for IS, HR and Property have not been assessed using the 'efficiency addition' methodology.	Apply approach to all submitted reports, reducing the gap to the UQ
Market testing evidence ignored	Market testing evidence does not currently impact the efficiency assessment despite this being a more accurate reflection of what the market can bear	Include market testing evidence, especially for IS in the assessment
Scoring methodology inconsistencies	The scoring to assess benchmarking reports is inconsistent across Networks using identical benchmarks with our addition for TOCS benchmarking less than another Network	Apply the same method of assessment to both ours and third party networks and hence the same efficiency addition
Exclusion of Transmission costs	Transmission costs are excluded from the efficiency addition modelling	Transmission costs should be included, giving a more accurate figure for the total efficiency addition

- 20 Our analysis and conversation with Ofgem staff suggests that benchmarking reports that were submitted as part of the RIIO-T1 submission have not been evaluated or assessed in the efficiency addition factor model. In addition we disagree with the statement made in the support files documentation that *'It should be noted that because NGGD submitted more substantial efficiency evidence than NGET and NGGT, our assessment of NGGD's efficiency was applied as National Grid's overall efficiency evidence factor'*
- 21 We find this statement without merit, and factually inaccurate due to a number of reasons:
- NGET and NGGT submitted evidence for Transmission only with regards to a number of key areas, such as HR, CEO and IS
 - This evidence complemented rather than replaced evidence our Gas Distribution colleagues submitted, and emphasised that our costs were benchmarking well
 - NGGD made reference in their submission that their individual benchmarking evidence was made as complementary to what had already been submitted by Transmission
- 22 In the table below we highlight the key areas where our benchmarking has been overlooked¹.

¹For detailed benchmarking please see our Efficiency and Value for Money Annex Page - 56

Area	Benchmark	Organisation	Date	Submitted by	Assessed
IT	Benchmarked	McKinsey	2009	T & GD	GD Only
	Benchmarked	Gartner	2010	T Only	Not Assessed
	Market tested	Markets	2011	T & GD	Not Assessed
Property	Benchmarked	TOCS ²	2010	T & GD	GD Only
	Benchmarked	IPD ³	2011	T Only	Not Assessed
Finance ⁴	Market tested	TCS	2009	T Only	Not Assessed
Insurance	Market tested	Millers & AGRC ⁵	2011	T and GD	Excluded from Benchmarking
HR	Benchmarked	Saratoga	2011	T Only	Not assessed
Procurement	Benchmarked	Hackett	2009	T & GD	Not Assessed
CEO	Market tested	National Grid	2012	T Only	Not Assessed
Support Costs	Marginal cost analysis	National Grid	2012	T Only	Not Assessed

- 23 In our efficiency assessment of IT and finance costs (included in Appendix A) we gave evidence of the value of market testing, to ascertain the best market price for the business scope. This supported the findings of our benchmarking analysis. In the current efficiency addition analysis, this analysis does not carry any weight. This is despite market testing offering an assessment of what the market can bear in this area, rather than being a desktop benchmarking assessment which is divorced from reality. This is despite Ofgem's comments in the RIIO strategy documents which suggested that tender prices were evidence of efficiency. In addition, we submitted a specific Transmission benchmarking report from Gartner which showed our costs to be well below average but this assessment appears to have been overlooked.
- 24 HR benchmarking was conducted for us by Saratoga PwC, and Hackett also benchmarked Procurement. Both gave positive reports, provided at the time of submission, but again these have been omitted from the benchmarking assessment.
- 25 Following clarification questions from Ofgem and their consultants we undertook two pieces of additional work to highlight the link between direct and indirect costs, as well as to disaggregating and analysing corporate centre costs and their relative efficiency. These reports were included as part of our final Transmission submission and evidence suggests that they remain unconsidered by Ofgem in their assessment of our plans.
- 26 Our analysis also highlighted differences in assessment methods within the efficiency additions modelling on identical data from the same external provider. The TOCS data was used by ourselves and Wales and the West Utilities (WWU) but when assessed we achieved different assessment marks.
- 27 We expected the results to be identical given the nature of the TOCS dataset.
- 28 The TOCS dataset is based upon available data gathered in the market place provided by a number of studies across industries with survey results across a number key metric areas:
- (a) Total cost of occupation

² TOCS – Total Office Cost Survey via Actium consulting

³ IPD – Investment Property Databank

⁴ This was the shared services finance function rather than the activity called finance within the detailed data tables

⁵ AGRC - Aon Global Risk Consulting

- (b) Cost for old and new buildings
- (c) Net effective rents analysis
- (d) Analysis of costs, workstations and wider benchmarks

29 TOCS is an open system and has a uniform data set. Hence its use by us should not be seen any differently or assessed with greater prejudice than any of the other network companies, one such example being Wales and the West Utilities (WWU), who used the ‘Litmus Partnership’ to calculate the TOCS via Actium Consulting. We bypassed this consultancy and went to Actium directly (owners of TOCS).

[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]
[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]
[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]	[Text Removed]

30 In the above table we summarise the analysis done by the benchmarking model for property cost assessments. We cannot see justification for the difference in total score. We are disappointed at the failure of consistent process across this area and flawed analysis, because:

- (a) There is nothing different about the data set – so the verifiability score should be identical, we are challenging the robustness of the analysis considering the data custodian is the same.
- (b) [Text Removed]
- (c) The methodology score is further evidence of poor assessment. The TOCS methodology would have not been explained by WWU, in our analysis and in reading their plans we cannot reference any area where the ‘TOCS methodology’ is explained, we can only assume [Text Removed]. We explained our methodology fully⁶ and we urged that Ofgem approach Actium directly for any further clarification of benchmarks.

31 In addition, our analysis highlights a factual error in the calculation tables; the average costs for RIIO-T1/GD1 omit Transmission costs. In the calculation summary the average costs are for National Grid Distribution only. With the addition of Transmission the total score is reflected with greater accuracy and increases to [Text Removed]currently calculated (although should increase further once the other errors are adjusted).

Normalisation of data

32 Benchmarking at this level of aggregation is only effective if a significant amount of analysis is undertaken (with guidance) about which costs should be normalised. This is an important step in any benchmarking assessment to ensure comparability of data. The largest pitfall of any benchmark is that of non-comparable data giving rise to unrealistic targets. Network companies will each incur legitimate costs which are not comparable to others - for example, not all networks will have outsourcing contracts and therefore need to re-tender – and the Hackett data set will not include other costs which are key components of networks’ business support costs (for example regulation costs). Whilst the benchmarking process involved a number of normalisations these were all adding costs into the assessment rather than reducing them – we have highlighted the key normalisation errors below:

⁶ National Grid ‘Efficiency and Value for Money – March 2012 – Pages 59-62

Area	Issue	Action required
Higher utility costs for IS	There is a proven requirement for more automation in the utility sector which is ignored	Adjust efficiency addition scores appropriately and use the Networks UQ rather than Hackett
Finance, Audit and Regulation	Regulation costs are included in an assessment against a data set with no regulated entities included	Either separately assess regulation costs or adjust UQ to be based on Networks UQ, not Hackett
Finance, Audit and Regulation	Costs of re-tendering outsourcing contract have been included in assessment	Separately assess the requirement for re-tendering costs
HR	Agency costs are subtracted twice from the Transmission FTE metric used	Rectify the error, then recalculate

33 The issues with these are as follows:

- (a) **IS automation costs** – In guidance issued to Ofgem, Hackett warn against assuming higher IS costs than their benchmark figures is due to inefficiency. This is due to the process efficiencies created by automation. This issue is highlighted further by evidence (included in Appendix A) that there is a proven requirement for utilities to require more technology compared to many other sectors. The benchmarking of IS should therefore use the Networks UQ, not Hackett.
- (b) **Regulation costs** - The finance, audit and regulation activity has a UQ based on the Hackett data set. This data set does not include any regulated entities yet regulation costs are not normalised out of the assessment. This could be rectified by either separately assessing regulation costs (including price control review costs) in all networks or reverting to using the networks UQ instead, as all of the networks will have regulation costs.
- (c) **Re-tendering costs:** A significant proportion of our finance costs are outsourced, with the contract expiring in 2016. Under European law we have to undertake a number of steps to ensure that the necessary re-tender is fully competitive. This creates a one-off cost [Text Removed] within our plan across Transmission and Distribution which should be assessed separately.
- (d) **Agency error:** HR costs are benchmarked on costs per FTE using non-agency FTEs for 2010/11. The calculation for this figure includes an error which removes the agency figures twice from the 'including agency' FTE number. This should be adjusted.

Hackett data set comparability

- 34 The use of an independent benchmarking commentator (Hackett) builds some impartiality into the benchmarking analysis and gives a reference point outside the utility sector. While we support the use of Hackett for reference the data should not be used to set the allowances – something that Hackett themselves, agree with when they say in guidance sent to Ofgem that the metrics should not be used as a direct target, we have concerns around two key areas of the Hackett dataset.

Area	Issue	Action required
Non-comparability of Hackett data metrics	In many instances the companies which fall into the metrics defined for the assessment are not comparable to National Grid or the iDNs	Hackett benchmark should only be used as a reference point, not to set the UQ and the Networks UQ should be used instead
Cherry picked upper quartile	Benchmarking cherry picks the 'best of the best' network that cannot exist in reality	

- 35 Whilst Ofgem suggest that the data is not skewed or overly influenced by any one type of industry or company, it remains unverifiable. This is a departure from the transparency principles of RIIO. We expect that the exclusion of Government, non-profit organisations and utilities will have had a significant effect on the overall benchmark.
- 36 It would have been advantageous for Ofgem and ourselves if we were involved with shaping the benchmarking metrics and methodology from the start of RIIO for a number of reasons:
- Firstly, this is a large step change away from 'regression' benchmarking that has been done in the past when networks were only compared against each other – whilst we understand that this type of benchmarking has been applied to Distribution networks, this is the first instance of this type of benchmarking used in Transmission, yet no discussion on design has taken place.
 - Secondly, we believe that some of the important normalisations between network companies and current errors in the modelling would have been identified. For example, we would have been able to have provided the level of end users within Transmission if requested (see next section).
 - Finally, we would have expected that, as part of the RIIO process, greater emphasis would have been placed on the transparency of regulatory assessments, their outputs and the relative level of information that would have been required for a comprehensive assessment of our plans. The strength of the methodology in any benchmarking assessment is reliant on sound and reconcilable data. We have found it difficult to reconcile the data in the information provided by Ofgem – which may have been avoided if we were part of the process.
- 37 We understand that the benchmark modelling that was conducted by Hackett and Ofgem had the following specifications, resulting in the comparability issues identified below:
- Revenue size which is set to less than £2bn per annum** – this is unsuitable for the assessment for National Grid as our revenue is greater than £2bn (our revenue in National Grid (UK) is greater than £3bn per annum).
 - FTE numbers greater than 5,000, but less than 20,000** – this is unsuitable for comparing National Grid against IDN networks as some Networks have FTE numbers less than 5,000 per network.
 - Exclusion of Government and non-profit organisations** – this group included utilities and the basis for excluding these entities is not justified – a regulated utility

company cannot be benchmarked against such an incomparable group – ideally this decision should be reversed.

- 38 These comparability issues mean that the Hackett data set cannot be comparable to our cost base and the Networks UQ should be used instead, using Hackett to calibrate and check against.
- 39 In addition, use of bottom up UQs produces a phantom network of the ‘best of the best’ in all activities. Such a network does not exist in reality – a concept that was accepted by Ofgem in GDPCR1.
- 40 Within the models we have been given, we can see a clear example of this UQ cherry picking effect as illustrated in the following table where Hackett looked at the make up of the CEO function. Interestingly, it is within the Network UQ that the most significant cherry-picking effect can be seen.

Total Cost as a % of revenue	Hackett UQ	Network UQ
Executive Office & Group Strategy	0.081%	0.466%
Corporate Communications	0.019%	0.038%
Legal	0.080%	0.066%
Sum of Bottom-Up	0.180%	0.571%
CEO in total	0.185%	0.902%

- 41 Again, this means that the Hackett data set cannot be used to set the allowances and, in addition, this identifies issues with the CEO benchmark which are explored further in the next section.

Other issues

- 42 In our analysis we also identified a number of other errors, these are listed in the table below:

Area	Issue	Action required
Insurance error	Initial Proposals state that insurance is funded in full but there is a £3m per annum shortfall in allowances versus submission	Correction of the 10/11 base year actual cost
Composite CEO UQ	The composite UQ is cherry picked rather than using comparable Networks UQ	Adjust benchmark to Networks UQ
IS user numbers for Transmission	We were not asked for Transmission user numbers which are higher than those currently used	Adjust to the updated National Grid figures of 1.53 versus 1.23 currently used

- 43 Hackett provided benchmarking figures for all our regulated activities with Ofgem making the decision to separately assess insurance and construct a composite value for CEO activities.
- 44 We welcome the separate assessment of insurance; however the resulting allowances exclude £3m per annum of cost (across Transmission and Distribution) despite the Initial Proposals stating all insurance increases are allowed. This seems to be because of the incorrect figure used for 2010/11 costs. This error needs to be rectified in the modelling.
- 45 The insurance figure used for 2010/11 is [Text Removed], to which the ‘justified movements’ are added back for UK Transmission - however it is this value [Text Removed] which we are unable to reconcile back to our RRP or subsequent submissions – however we are aware of an ‘insurance benchmark reversal’ model which was absent from the benchmarking modelling.

- 46 As shown above the CEO composite cherry picks costs which are not based on a realistic company. This cherry picking should be removed and the Networks UQ for total CEO costs [Text Removed] should set the benchmark.
- 47 The benchmarking assessment uses the number of end users to assess IT and telecoms costs for the RIIO period. The end user number is generated using a 'multiplier' derived from a set of user numbers submitted by UK Distribution as part of their submission for RIIO. We were not asked to provide Transmission information for IS users at the time of submission, nor were we asked as part of the formal Q&A process that followed both the initial and final submissions.
- 48 This has led to an error in the calculation of end users in our submission. In the modelling Ofgem have used the multiplier value of 1.23 to calculate user numbers for Transmission based on the Gas Distribution figures. This is incorrect when applied to Transmission.
- 49 The number of users in Distribution is quite different to that of Transmission. Given the differences between device usage across Distribution and Transmission we have conducted a piece of supporting analysis to calculate the equivalent ratio within Transmission. We highlight the outcome of this in the table below, it should be noted that:
- (a) The updated Transmission figure increases the average across National Grid
 - (b) We have used Distribution RIGS to define user numbers in Transmission.

Network	Ratio
Transmission	[Text Removed]
Distribution	[Text Removed]
Transmission and Distribution	[Text Removed]

- 50 The Ratio of [Text Removed] represents a number of key differences between the Transmission use of devices and that of Distribution, namely:
- (a) Transmission engineers will usually have a number of devices depending on their role and the assets they are responsible for – this would usually mean they would have a:
 - (i) Standard office laptop – for office based activities such as email
 - (ii) Transmission Test Laptop (TTL) to configure critical on site equipment (including a number of CNI installations), as well as multiple Office in The Hand (OiTH) laptops for administrative functions, work scheduling and reporting.
 - (iii) Dedicated hardware to do network analysis
 - (b) In addition, hardware above our standard allocation is usually required by directorates for specific requirements, e.g. trading support.

Appendix A – IT and Telecoms

- 51 IS costs have been assessed using the Hackett benchmark, using cost per user as the driver, both Transmission and Distribution have been given a (device:user) ratio adjustment [Text Removed], which was calculated from our submission.
- 52 We have calculated revised numbers for Transmission and National Grid, we agree that the method used to calculate the Distribution multiplier is correct (see earlier).
- 53 IT and Telecoms represents over [Text Removed] of the indirect business support cost base and is tasked with delivering a range of activities across both Transmission and Distribution, as with any of our activities in Business Support we are minded to ensure that these activities are delivered at the most efficient and economic levels.
- 54 For this reason we conducted several benchmarking exercises to complement our RIIO submission across both Transmission and Distribution. It is therefore surprising that these were not assessed as part of the overall efficiency addition element of the benchmarking process.
- 55 In the efficiency additions assessment of benchmarking reports, Ofgem have commented that not all assumptions were validated and the data was not explained. In our April Gas Distribution submission we provided further information about this benchmarking study, including an explanation of the assumptions made and how the data was validated. This is repeated below for information:
- (a) In 2009, our IS directorate used McKinsey to carry out a benchmarking study into our IS operations, which used 26 gas and electricity utility companies from across Europe with an average annual revenue of [Text Removed] as comparators. The study looked at each business area within an organisation (Distribution and Metering, Trading, Generation, Transmission, etc.). We divided National Grid in the UK into Gas Distribution (including Metering), Gas Transmission and Electricity Transmission. The results presented here are for Gas Distribution and Metering only. They exclude system operation costs for the distribution networks due to the complexities of SOMSA exit which was ongoing at the time of the study. As this represents only a small proportion of our expenditure, we do not believe this exclusion has had a material impact on the outcome of the study. To normalise the results of the study, all costs have been presented per distribution connection [Text Removed] Data for the study was a mixture of financial information taken from our audited accounts from the preceding year (2008/09) on a Totex basis and responses to a multiple choice questionnaire. Shared costs were allocated to each business area in the same way as for our regulatory accounts. The questionnaire provided the input to a qualitative analysis of how effectively our UK Gas Distribution organisation utilises IT to drive value.
 - (b) Data collection was primarily performed by National Grid staff, we were supported in this by McKinsey who ensured that we answered the benchmarking questions in a manner that was consistent with their database definitions. The data was validated by McKinsey against their model to flag and resolve any inconsistencies before producing the final report.
- 56 We acknowledge the comparison was to other utilities companies. In our experience this provides the most appropriate comparison as the activities carried out are similar. The

graph below produced by Gartner from their regular benchmarking process⁷ illustrates the variability across industries (IT Spending by employee, by industry 2011):

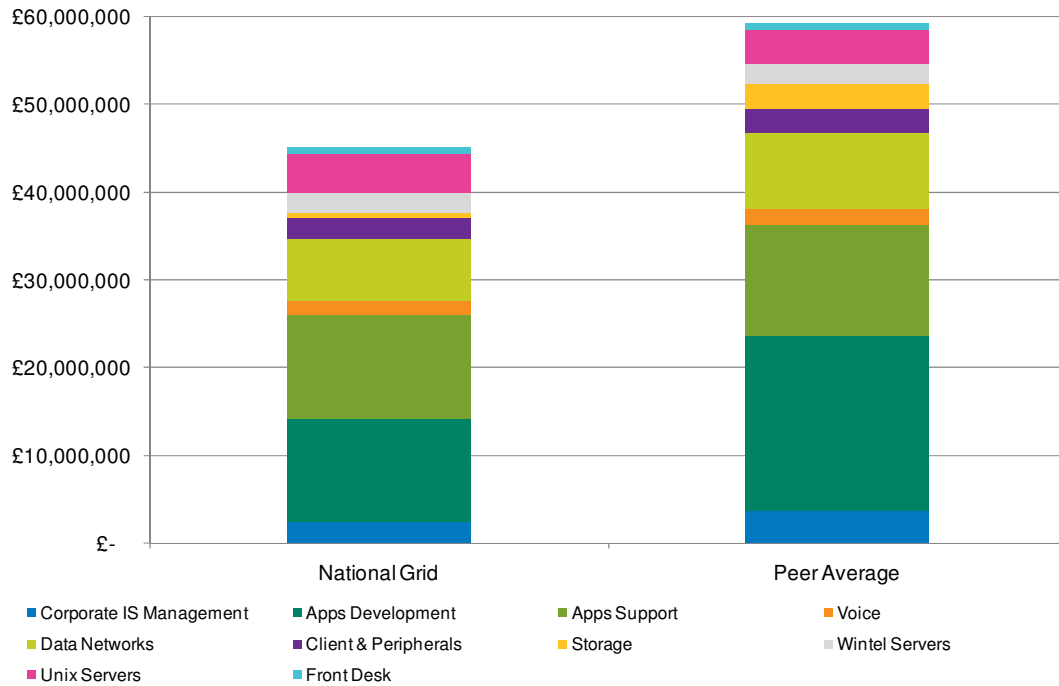


57 We have also carried out a second benchmarking study with respect to our IT costs for Transmission. It was described in both our 'IS Strategy' and 'Efficiency and Value for Money' annexes to our March 2012 submission and a copy of the report was included with the latter in Appendix A. The text provided is repeated below for information.

- (a) The study was carried out by Gartner⁸ and compared UK Transmission to 21 similar worldwide organisations based on data from the 2009/10 financial year looking at our 'commodity' IT costs (e.g. servers, helpdesk).
- (b) After taking into account the adjustment, our actual spend on software development is [Text Removed] rather than the [Text Removed] submitted at the outset. This [Text Removed] compares favourably with a peer average of [Text Removed]. For the avoidance of doubt, the hardware cost [Text Removed] is not absent from elsewhere in the report as Gartner's methodology for reflecting infrastructure investment includes a component of depreciation. An email from Gartner which was attached in Appendix A of the 'Efficiency and Value for Money' annex clarifies their position with respect to this and our revised understanding.
- (c) A summary of the findings in other areas is included in the graph below and shows our costs are [Text Removed] less than those of our peers:

⁷ Source Gartner: IT Spending and Metrics Report 2012, 16 January 2012

⁸ Gartner, Inc. (NYSE: IT) is the world's leading information technology research and advisory company



- 58 This study should be included in Ofgem's post benchmark addition assessments.
- 59 We were surprised that Ofgem have not made any allowance for the results of market testing as this is reflective of what the market will bear and is also a forward looking consideration of what costs will be, while benchmarking, by its nature, is backward looking. Market testing offers the opportunity to test the market for the latest techniques and prices as well as giving us access to wider expertise and additional capacity. Whilst the majority of our expenditure is market tested it is not possible to test all of our expenditure. If there is no active market for the services we require, then we cannot use this method to test for value for money.
- 60 We explained in both our Transmission and Distribution submissions the processes we follow to procure systems. In order to ensure we achieve the best price, we use procurement and tendering processes to drive value through our negotiations. These take the form of:
- Combining contracts under one supplier to drive value from economies of scale
 - Using standard terms and conditions to reduce administration overheads
 - Extending contract periods to provide certainty and enable close working with key suppliers whilst still ensuring that costs are competitive in the market
 - Benchmarking contracts and suppliers to increase levels of competition
 - The introduction of a technical weighting factor to tender programmes to ensure cost is not the only element considered in negotiations
- 61 We explained in both our Transmission and Distribution submissions the processes we follow to procure systems. In order to ensure we achieve the most economically advantageous results we use a formal procurement process to ensure that sourcing events are tightly managed and the contracts that are awarded deliver maximum value to National Grid.
- 62 We have advanced our procurement processes and procedures within the current price control period and now adhere to a seven stage category management process that has been designed to deliver cost effective and innovative procurement solutions, while ensuring

compliance with National Grid's policies, as well as legislation. The process governs the end to end sourcing delivery from requirements gathering through to contract award and management. Governance is built into the category management process in the form of 'Gate reviews' and 'Peer reviews'. Management controls and reporting then ensure progress is monitored and processes adhered to, with internal audits to provide further assurance. The category management process was reviewed by Efficio⁹ during 2009 and considered by them to be best practice. Since then it has been subject to continuous improvement.

- 63 We are subject to European procurement legislation (Utilities Contract Regulations) which is designed to ensure utilities create fair competition in the market place by ensuring fair, objective and transparent tender processes.
- 64 85% of our IT and Telecoms costs have been market tested and the costs included in our submission reflect this. We consider that an allowance should be made above and beyond the benchmarking for this.

⁹ Efficio is a leading edge management consultancy focused entirely on procurement and supply chain optimisation