



Wales & West Utilities

Support Services Review
Indirect Operating Expenditure

13th July 2007

BACKGROUND

- Wales and West Utilities (“WWU”) is currently participating in The Office for Gas and Electricity Markets’ (“Ofgem”) Gas Distribution Price Control Review (“GDPCR”) 2008-2013.
- Ofgem originally engaged LECG, a consultant, to benchmark business support operating costs in order to estimate savings potential that should be achievable by WWU during the price control period. These were published in the fourth consultation document¹.
- In response to this document, WWU and other GDNs objected that Ofgem had adopted a frontier approach, rather than a top quartile approach, and that the total operating cost benchmark based on disaggregated data is currently not achieved by any GDN and therefore represents a "frontier shift" for all companies. Ofgem have increased the proposed allowances by 5.6 per cent², so that, on average, they are equivalent to a frontier approach if top-down benchmarking was used.
- WWU and other GDNs also objected that the mix of internal and external benchmarks which were chosen reflected inappropriate "cherry-picking"³. In the context of this price control review, Ofgem consider that the level of benchmarking and use of internal or external benchmarks carried out is appropriate and have determined allowances on this basis.
- Ofgem have now issued a document to set out their initial proposals on operating, capital and replacement expenditure allowances and allowed revenues to take effect from 1 April 2008⁴. Indirect Operating expenditure allowances will be reviewed in this report.

1. LECG draft report, February 2006 - Benchmarking Wales and West Utilities business support services
2. GDPCR Initial Proposals Document, Main Supplementary Appendices, page 6
3. GDPCR Initial Proposals Document, Consultation, 29 May 2007, page 23
4. GDPCR Initial Proposals Document, Consultation, 29 May 2007



PREVIOUS SUBMISSION TO OFGEM

- WWU originally engaged Third Horizon Consulting Partners (“Third Horizon”) to review LECG’s analysis to ascertain the appropriateness of the methodology and approach undertaken and the reasonableness of the findings. This analysis was submitted to Ofgem.
- The key findings of this analysis were¹:
 - The methodology and approach adopted by LECG is fundamentally flawed and the efficiency targets implied in the report lack justification and credibility. Consequently it is considered extremely unlikely that the level of cost reductions indicated are actually achievable
 - WWU’s support cost level in 2006/7 amounted to some £23.9 million after certain adjustments made by LECG to “normalise” them for comparison between GDNs and to conform to Ofgem policy. No detailed validation has been made in this study as to the appropriateness or otherwise of these adjustments. Of this total cost base some £19.2 m (about 80%) has been subject to analysis and comparison with meaningful and industry recognised benchmarks by Third Horizon.
 - Economies of scale play a major part in the overall efficiency of support costs in the Utility sector but the impact of these has been ignored by LECG. Analyses in this report examine the relationship between support cost and overall size using data from: the Australian Gas Distribution sector; the UK Water Industry, and the UK Electricity Industry. The existence of scale economies is robustly demonstrated by these examples and needs to be taken into account in any comparison between GDNs of different sizes.
 - When these scale economies are properly recognised it becomes clear that WWU’s efficiency compares well with other sectors/companies

1. Third Horizon Review of LECG draft report, February 2006 “Benchmarking Wales and West Utilities’s business support services”, 19 February 2007



PREVIOUS SUBMISSION TO OFGEM Cont.

- Using a more appropriate approach, and industry recognised tailored benchmarks, WWU's performance is shown to be significantly better than that shown by the LECG report. In all comparisons WWU is seen to be a strong performer and in many it is a frontier company.

- WWU operates in a challenging geographic environment with characteristics which include:
 - A large territorial area with a commensurately extended physical network
 - An exceptional shape and form which adds significantly to the difficulty and cost of servicing outlying bases
 - A low customer density which requires relatively high resources to meet agreed service levels to isolated and fragmented consumers and assets

- The impact of this is that additional support costs are incurred, over and above those which would be incurred by a network of similar size operating in a more condensed and compact physical area. Details of the analysis which supports this are contained in a report entitled “ Network Cost Drivers – a Bottom up Approach” - by John Spiller Associates.

- These additional costs have been referred to as “penalty costs”. When these additional costs are taken into account WWU's performance is even stronger



METHODOLOGY

- The 06/07 cost base of £24.7m¹ has been adjusted to reflect 05/06 prices in accordance with Ofgem requirements reducing the 06/07 cost base used in this analysis to £24.05m².
- Ofgem allowances commence on 07/08 therefore we have used the concept of other cost base to meet proposed Ofgem allowances. The other cost base excludes compliance, regulatory and contractually fixed expenditures (See page 6 definitions).
- A bottom up cost analysis has been used to identify any costs currently under contract or any costs relating to regulatory or compliance activity and the resulting other cost base.
- In some cases a top quartile comparison has also been used to show WWU current performance and implied performance following Ofgem proposed reductions against best practice benchmarks.
- FTE reductions implied in this analysis have been determined based on the average labour cost per FTE in each of the functional areas.
- The original Ofgem allowance of £16.4m was adjusted to reflect a 5.6% uplift revising total allowance to £17.3m³. This uplift has been applied equally to each functional area for the purpose of this analysis.



1. £0.3m revenue due to profit from sale of asset in has been removed from this analysis. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. In 05/06 prices
2. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. In 05/06 prices
3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.

KEY FINDINGS

- The adjusted 06/07 indirect OPEX expenditure was £24.05m¹ against an average proposed allowance of £17.3m² (£6.7m or 28% reduction).
- Roughly 65% of the cost base is due to regulatory or compliance related activity or currently under contract with external service providers. This translates to an other cost base of approximately £8.51m³
- In order to meet Ofgem targets, WWU would have to remove 97% of support services labour (93.7 FTE)⁴ and further reduce external expenditure by 41%.
- In many functional areas Ofgems reductions exceed the non contracted and regulatory and compliance costs currently incurred, resulting in contract violations and a fall in regulatory and compliance activity.

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. In 05/06 prices
2. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment
3. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. In 05/06 prices
4. Average cost per FTE derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance



The adjusted 06/07 indirect OPEX expenditure was £24.05m against an average proposed allowance of £17.3m (£6.7m or 28% reduction).

Comments

| Function | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | 06/07 Total OPEX (£m) ¹ | Implied Cost Reduction (£m) | Ofgem Proposed Allowance (£m) ² |
|-----------------------------|--|-----------------------------|-----------------------|------------------------------------|-----------------------------|--|
| Information Systems | 0.00 | 7.39 | 0.36 | 7.75 | 1.95 | 5.81 |
| Audit, Finance & Regulation | 0.57 | 0.00 | 3.42 | 3.99 | 1.87 | 2.11 |
| Insurance | 0.00 | 2.71 | 0.06 | 2.77 | -0.39 | 3.16 |
| Property Management | 0.00 | 3.94 | 0.20 | 4.14 | 1.92 | 2.22 |
| Corporate Centre and Comm | 0.11 | 0.00 | 1.89 | 1.99 | 0.41 | 1.58 |
| Human Resources | 0.53 | 0.18 | 0.51 | 1.22 | 0.80 | 0.42 |
| Legal | 0.00 | 0.00 | 0.60 | 0.60 | 0.07 | 0.53 |
| Procurement and Logistics | 0.00 | 0.11 | 1.47 | 1.58 | 0.10 | 1.48 |
| TOTAL | 1.21 | 14.33 | 8.51 | 24.05 | 6.73 | 17.32 |

- Compliance/Regulatory OPEX includes labour and third party expenditure related to corporate registration, mandatory health and safety requirements, statutory, technical code compliance and financial compliance. Examples of third party expenditure includes statutory account audit fees and reporting, CORGI registration, mandatory health surveillance and outsourced press costs covering mandatory notifications
- Contractual OPEX relate to third party expenditure currently under contract including fees to an external service provider for payroll processing, insurance premiums, information systems, rent and building facility contracts and logistics contracts relating to the delivery of goods.

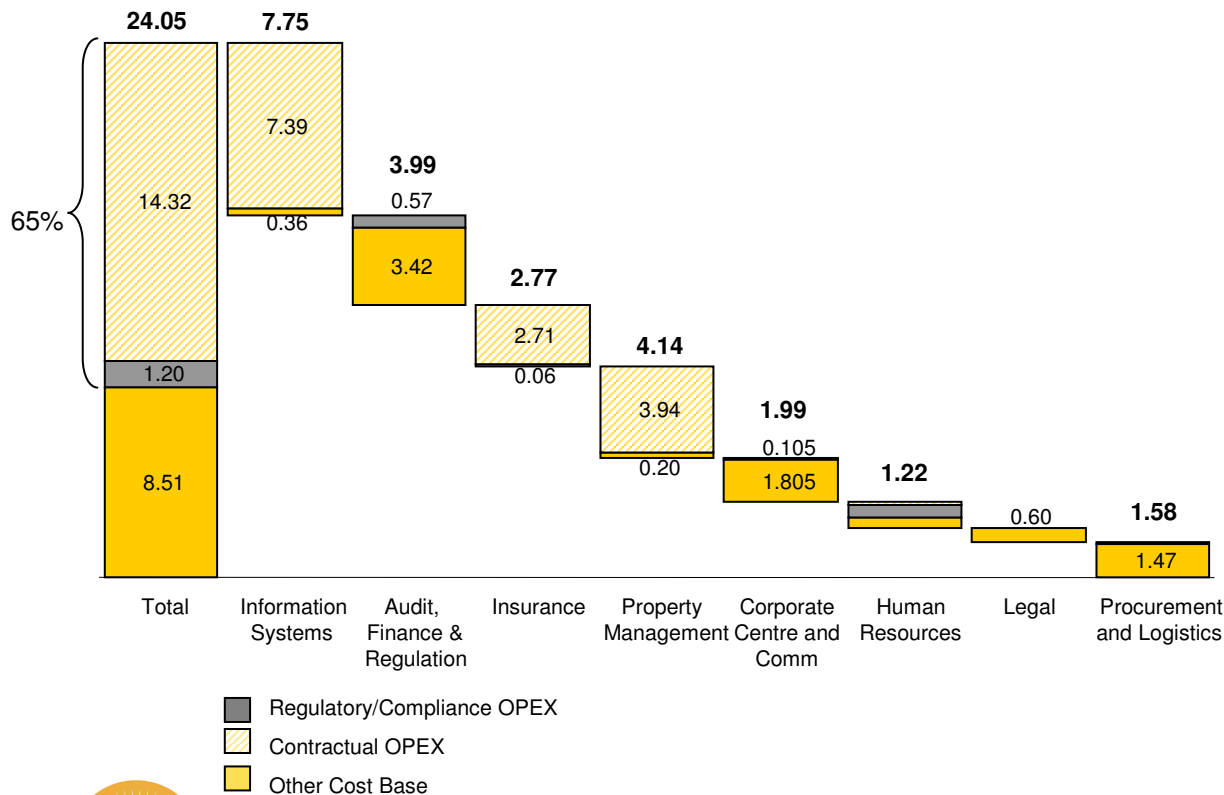
1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. In 05/06 prices
 2. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.



65% of the cost base is due to regulatory or compliance related activity or costs currently under contract with external service providers.

Indirect OPEX Support Services Expenditure

06/07 Total Regulatory, Contractual and Other Support Services Expenditure (£M)



Comments

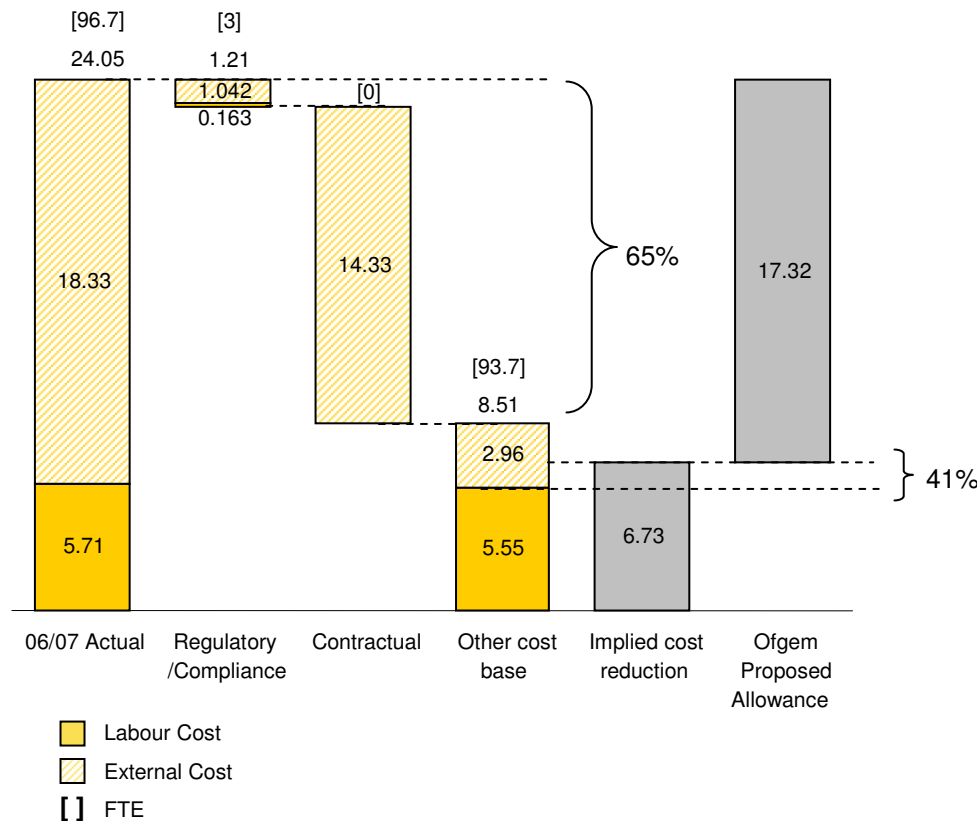
- Ofgem has suggested full cost reduction be realised in FY08
- Roughly 65%¹ of the current cost base is unavoidable due to regulatory and compliance activity and contractual requirements
- £1.21m¹ of the current cost base are related to the provision of compliance or regulatory activity. This includes external audit fees, mandatory OHS training and registrations and statutory reporting
- An additional £14.33m¹ are costs currently under contract with external service providers including an outsourced contract with IT vendors, property rent and payroll services
- This leaves an Other cost base of £8.51m from which to realise the Ofgem proposed reduction

1. Derived from source: Copy of WWU GPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance.

In order to meet Ofgem targets, WWU would have to remove 97% of support services labour (93.7 FTE) and further reduce external Indirect OPEX expenditure by 41%.

Indirect OPEX Support Services Expenditure

06/07 Total Internal and External Support Services Expenditure (£M)



Comments

- This other cost base includes £5.55m¹ in labour costs, which includes all net staff costs (including agency costs) and non salary staff costs (including T&S), and an additional £2.96m¹ in other external costs, including consultancy fees and materials
- In order to achieve Ofgems proposed cost reduction target, 97% of labour costs (93.7 FTE²) and an additional 41% of external costs would need to be eliminated from this other cost base
- If these reductions were to occur, WWU would no longer be a viable operation

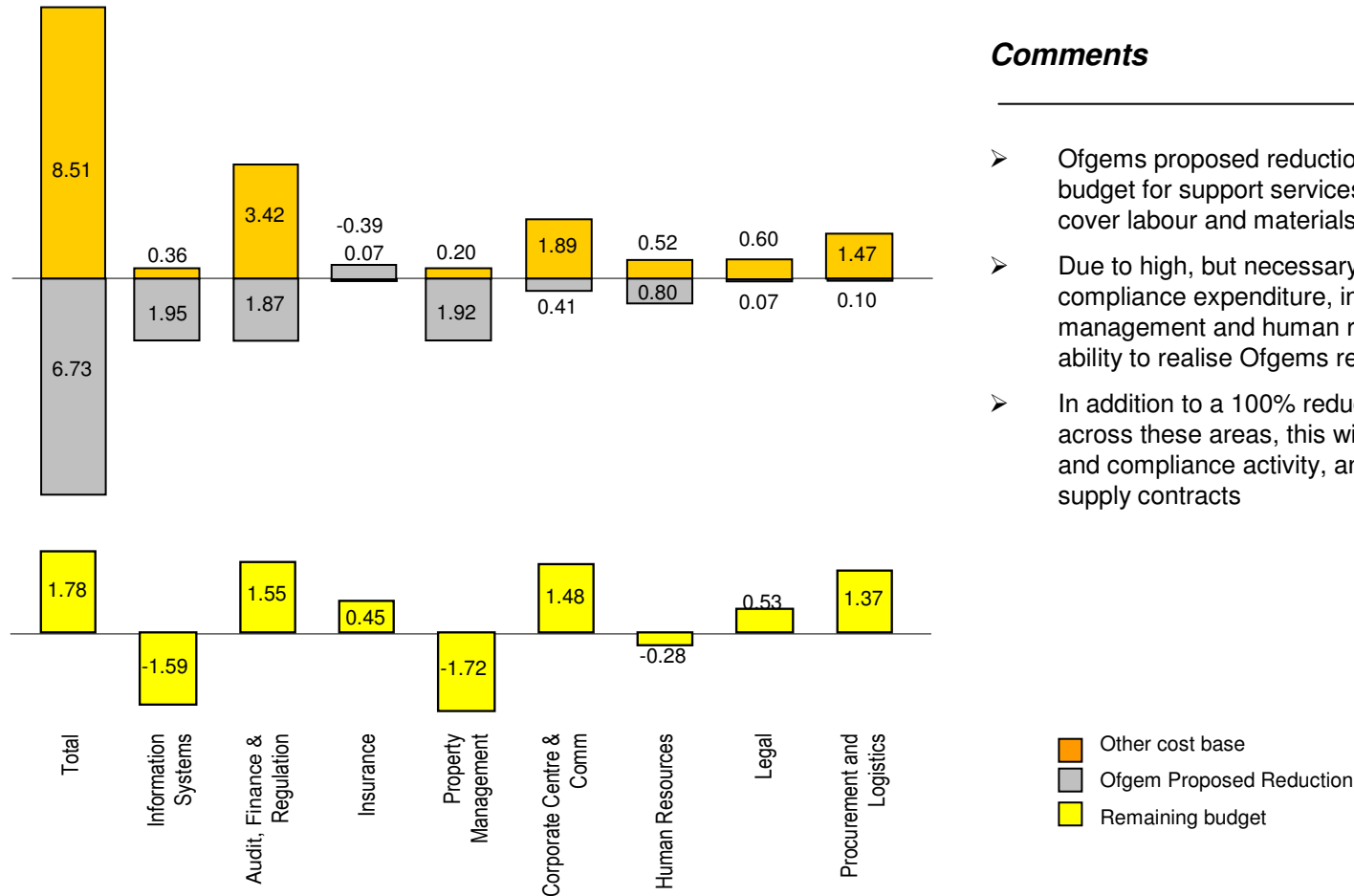
1. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance.
 2. Average cost per FTE derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance



In many functional areas Ofgems reductions exceed the non contracted and regulatory and compliance costs currently incurred, resulting in contract violations and a fall in regulatory and compliance activity

Impact of Ofgem Proposed Reduction on Existing Cost Base

06/07 Total Support Services Expenditure vs. Proposed Allowances (£M)



Comments

- Ofgems proposed reductions result in a combined budget for support services of £1.78m¹ with which to cover labour and materials across 8 support functions
- Due to high, but necessary contractual or regulatory and compliance expenditure, information services, property management and human resources do not have the ability to realise Ofgems reductions
- In addition to a 100% reduction in labour and materials across these areas, this will lead to a fall in regulatory and compliance activity, and breach in established supply contracts

1. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance.



Summary Expense Allocations and Impact of Ofgem Proposed Allowances

- Information Systems
- Audit, Finance & Regulation
- Insurance
- Property Management
- Corporate Centre and Communications
- Human Resources
- Legal
- Procurement and Logistics



The total Information Systems expenditure in FY06 was £7.75m including £7.40m in costs under contract.

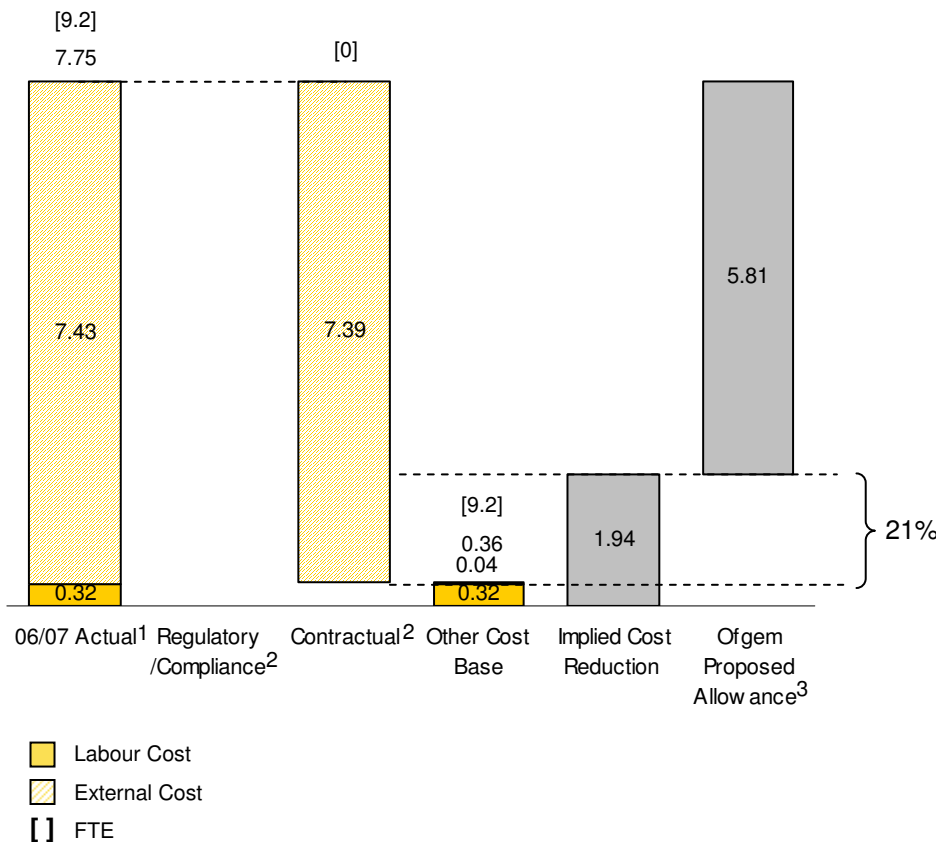
| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|------------------------|-----------------------|--|-----------------------------|-----------------------|-------------|--|
| labour | 0.32 | 0.00 | 0.00 | 0.32 | 9.2 | •Administrative personnel, including the CIO, IT finance personnel, IT sourcing personnel, vendor managers and any other individuals involved in IT administration. |
| Infrastructure Support | 2.43 | 0.00 | 2.43 | 0.00 | 0 | •Support cost relating to the maintenance of physical infrastructure including servers |
| Application Support | 1.56 | 0.00 | 1.56 | 0.00 | 0 | •Technical support contracts include telephone and online troubleshooting, installation assistance and basic usability assistance |
| Software Maintenance | 1.57 | 0.00 | 1.57 | 0.00 | 0 | •Software maintenance includes delivery of product updates and enhancements, |
| Hardware Maintenance | 0.06 | 0.00 | 0.06 | 0.00 | 0 | •These are preventive and remedial services that physically repair or optimize hardware, including basic installation, maintenance and incident repair. |
| Network/Telco | 1.77 | 0.00 | 1.77 | 0.00 | 0 | •Cost related to the maintenance of physical network and data movement across locations. •Includes enterprise networking equipment, mobile handsets and telecommunications services (voice and data). |
| Other | 0.04 | 0.00 | 0.00 | 0.04 | 0 | •These expenses may include items such as travel and entertainment costs, temporary help, training, repairs and maintenance and consultancy |
| TOTAL | 7.75 | 0.00 | 7.39 | 0.36 | 9.2 | |



In order to meet Ofgem targets 21% of costs under contract would be removed, in addition to all costs not under contract.

Information Systems Expenditure

06/07 Total IS Expenditure (£M)



Comments

- Removing the entire IS cost base would eliminate all IS FTEs², and other external costs
- In order to reach the Ofgem target, an additional £1.59m would need to be removed from contracted expenditure

Implications

- Reduced service levels and resolution time relating to mission critical incidences will impact business performance
- Slower data transfer and network speed will impact efficiency of workforce
- Severe business disruption due to reduced monitoring of physical infrastructure
- Response and resolution time to helpdesk calls and incidences will be reduced resulting in downtime across the business
- Applications and hardware will no longer be supported by external providers
- Breaching existing contracts with vendors will lead to prosecution

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance
 2. Derived from source: Opex Budget 0708 v0 6, WWU IT
 3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.

The total Audit, Finance & Regulation expenditure in FY06 was £3.99m including £0.57m in regulatory and compliance costs.

| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|------------------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|--|
| Business Planning | 1.42 | 0.23 | 0.00 | 1.19 | 2 | <ul style="list-style-type: none"> •Business planning •Regulatory/compliance costs relating to external audit and bank charges |
| Income | 0.11 | 0.00 | 0.00 | 0.11 | 2 | <ul style="list-style-type: none"> •Income and pricing analysis |
| Treasury | 0.11 | 0.00 | 0.00 | 0.11 | 2 | <ul style="list-style-type: none"> •Prepare and monitor cash flow forecasts •Establish and administer transactional banking services •Provide cash management services |
| Internal Audit | 0.20 | 0.15 | 0.0 | 0.05 | 1 | <ul style="list-style-type: none"> •Compliance costs relating to monitoring activities of non-compliance with company policy, laws and regulations •Other costs include 1 FTE to co-ordinate external providers of internal audit services |
| Management Accounting | 0.54 | 0.16 | 0.00 | 0.38 | 10 | <ul style="list-style-type: none"> •Preparation of management reports for Internal use and inclusion in the executive pack •Compliance costs include preparation of statutory accounts and regulatory reporting |



The total Audit, Finance & Regulation expenditure in FY06 was £3.99m including £0.57m in regulatory and compliance costs.

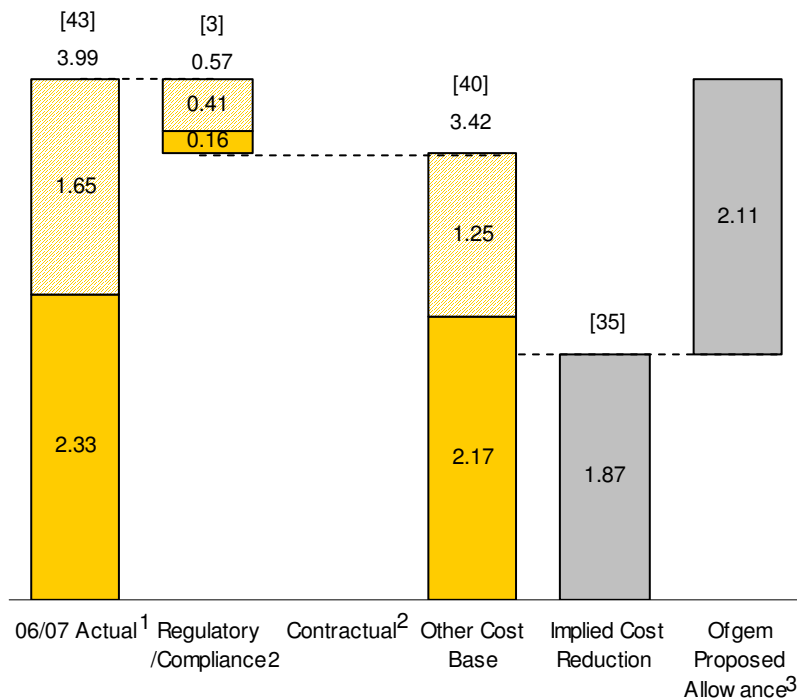
| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|----------------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|---|
| Accounts Payable | 0.22 | 0.00 | 0.00 | 0.22 | 4 | •Establish new supplier accounts and generate payments |
| Accounts Receivable | 0.49 | 0.00 | 0.00 | 0.49 | 9 | •Generate invoices for claims and customer billing including meter services and connections •Process and manage claims against WWU |
| Regulation | 0.68 | 0.03 | 0.00 | 0.65 | 9 | •Management of regulatory and commercial changes on business performance •Regulatory/ compliance costs include Network Code Expenses and £20k in consulting requirements |
| Management | 0.22 | 0.00 | 0.00 | 0.22 | 4 | •Management team and assistants |
| TOTAL | 3.99 | 0.57 | 0.00 | 3.42 | 43 | |



In order to meet Ofgem targets the equivalent of 35 FTE (81%) would be removed from the Audit, Finance & Regulation cost base.

Audit, Finance & Regulation Services Expenditure

06/07 Total Audit, Finance & Regulation Expenditure (£M)



Labour Cost
 External Cost
[] FTE

Comments

- In order to reach the Ofgem target, the equivalent of 35 FTE¹ would be removed from Audit, Finance & Regulation functions

Implications

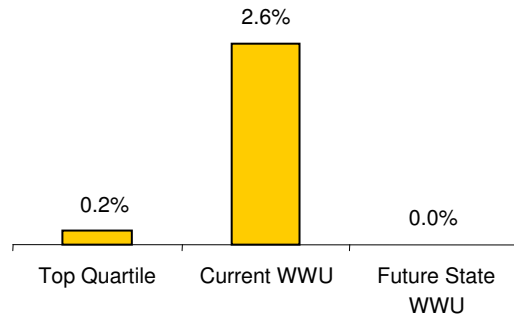
- The number of transactions per AP/AR FTE would exceed industry the top quartile benchmarks⁴
- Processing time relating to orders and invoices would be increased reducing service levels to customers and suppliers
- Management reports would be eliminated impacting the ability of the management team to make informed business decisions
- All business planning services and the management of regulatory and commercial changes on business performance would be eliminated

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance. Base on average labour cost of 54k per FTE
 2. Derived from source: Finance, Insurance & Pension 0708 Budget for Third Horizon, WWU Finance
 3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.
 4. KPMG Gauging Global Study

Ofgems proposed reductions across the Audit, Finance and Regulation cost base would cause WWU to exceed top quartile benchmarks.

Finance Best Practice Analysis

Finance FTE: Total FTE

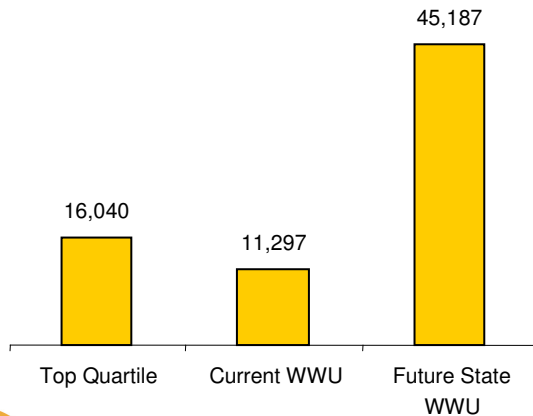


Comments

- Removing 35 FTE¹ from the audit, finance and regulation function would leave a maximum of 8 finance FTE to manage a total of 1198.7 staff²
- This correlates to a finance FTE to total FTE ratio of 0.01% which exceeds the top quartile benchmark by 0.19%³

Accounts Payable Best Practice Analysis

Invoices Processed per Accounts Payable FTE



Comments

- Assuming the retention of one Accounts payable FTE⁴, this would correlate to 45,187⁵ invoices processed per FTE
- This exceeds the top quartile benchmark by 29,147⁶ invoices per FTE

1. Based on Third Horizon analysis of Ofgem proposed cost reduction
2. source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance
3. Anderson 2001, Global Best practices finance and accounting report
4. Assume one FTE retained in each finance function
5. Number of invoices supplied by WWU Finance, email dated 28/06/07
6. KPMG Gauging Global Study



The total Insurance expenditure in FY06 was £2.77m including £2.71m in costs under contract.

| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|-------------------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|---|
| Insurance Services | 2.77 | 0.00 | 2.71 | 0.06 | 2 | <ul style="list-style-type: none"> •Contractual costs relate to insurance premium •Other costs relate to the internal management of insurance claim payouts, insurance contract negotiation and monitoring and the cost of uninsured claims |
| TOTAL | 2.77 | 0.00 | 2.71 | 0.06 | 2 | |

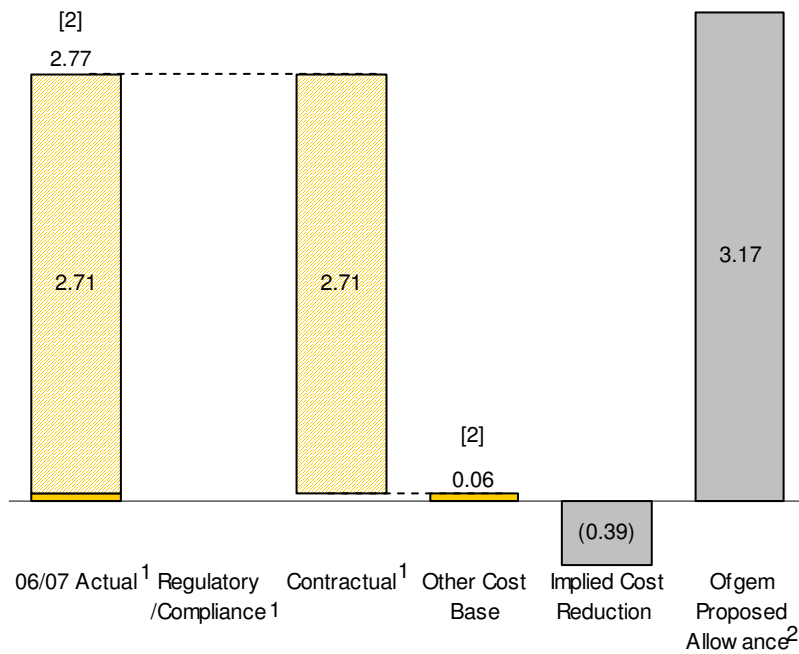


Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance.

The proposed Insurance allowance exceeds current expenditure resulting in a net gain of £0.39m.

Insurance Services Expenditure

06/07 Total Insurance Services Expenditure (£M)



- Labour Cost
- External Cost
- [] FTE

Comments

- The proposed Ofgem insurance allowance exceeds current expenditure on insurance premiums and associated services resulting in a net gain of £0.39m

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance.
 2. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.



The total Property Management expenditure in FY06 was £4.14m including £3.94m in costs under contract.

| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|--------------------------------|-----------------------------|---|-----------------------------------|-----------------------------|-------------|--|
| Facilities Management | 0.05 | 0.00 | 0.00 | 0.05 | 0.3 | •Onsite management of buildings and services including business administration and management of external services providers |
| Rent and maintenance | 1.95 | 0.00 | 1.95 | 0.00 | 0 | •Costs relating to leasing and maintaining workspace including offices and distribution plants |
| Utilities | 0.80 | 0.00 | 0.80 | 0.00 | 0 | •Costs relating to water, gas and electricity supply |
| Telephone | 0.57 | 0.00 | 0.57 | 0.00 | 0 | •Telecommunication charges including local and international calls |
| Printing and Stationary | 0.61 | 0.00 | 0.61 | 0.00 | 0 | •Office supplies including printing paper and other stationary |
| Other External Cost | 0.15 | 0.00 | 0.00 | 0.15 | 0 | •Incidentals |
| | 4.14 | 0.00 | 3.94 | 0.20 | 0.3 | |

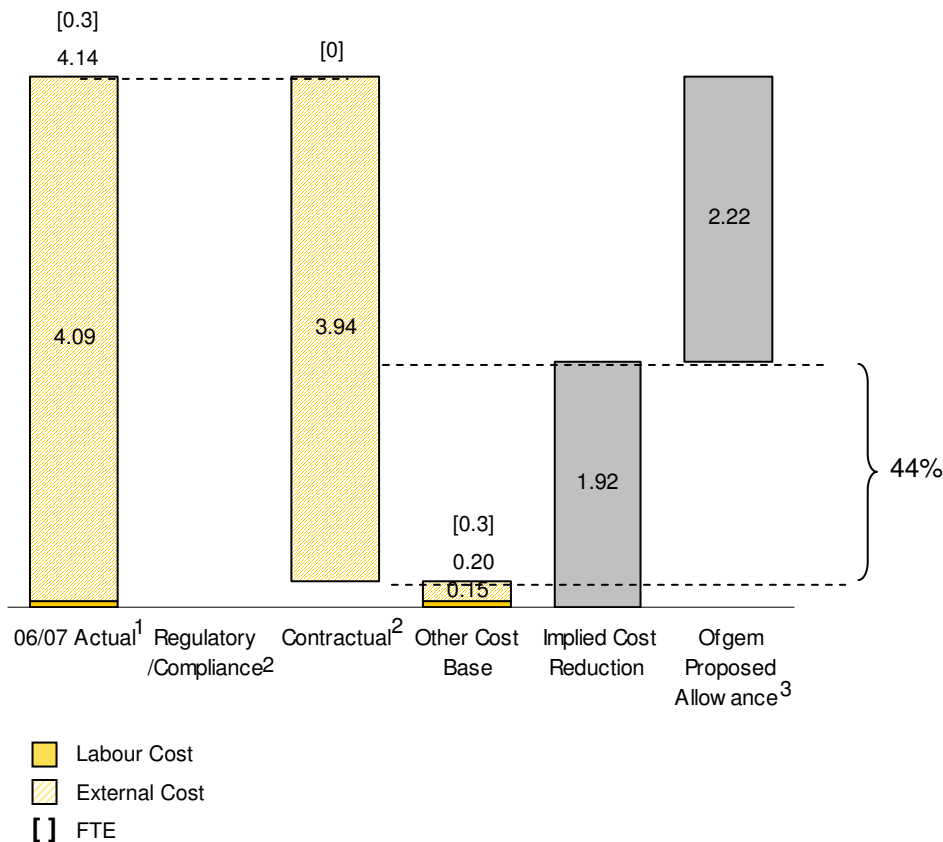


Source: Facilities_2007, WWU Property

In order to meet Ofgem targets the entire Property Management cost base would be removed in addition to 44% of costs under contract.

Property Management Services Expenditure

06/07 Total Property Management Expenditure (£M)



Comments

- Removing the entire Property Management cost base would eliminate all facilities management FTEs, and external costs¹
- In order to reach the Ofgem target, an additional £1.72m would need to be removed from contracted expenditure

Implications

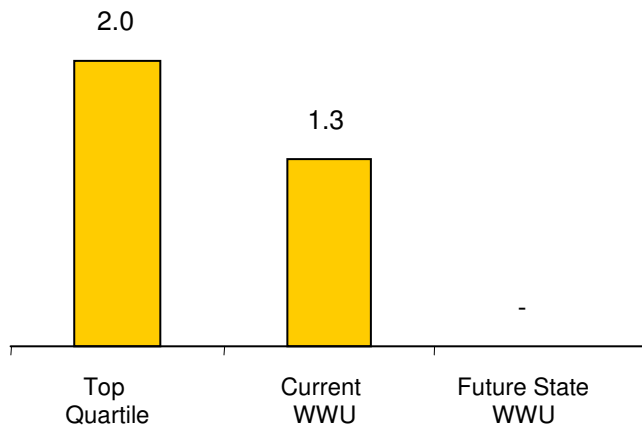
- Drastic property consolidation would be required and staff density would increase beyond best practice (12 sq mtr per person⁴)
- Cleaning services would no longer be employed on a daily basis
- Onsite vending machines, including water dispensers would be eliminated
- Grounds, building and equipment maintenance services would be reduced, or cease altogether
- Insufficient printing and stationary resources would be available for the business to function effectively
- Failure to pay rates, electricity, gas and water bills would lead to prosecution

1. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance
 2. Derived from source: Facilities_2007, WWU Property
 3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.
 4. Andersen 2001 Study (Multi Industry)

Ofgem's proposed reductions across the Property Management cost base would cause WWU to exceed top quartile benchmarks.

Property Management Best Practice Analysis

Total Property and Facility FTE to 100,000 sq ft (FTE)



Comments

- Top quartile benchmarks suggest 2 Property management FTE per 100,000 sq ft of property managed
- Removing all FTEs¹ from the Property Management function would exceed top quartile benchmarks by 2FTE per 100,000 sq ft of property²

1. Based on source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance and Third Horizon analysis
2. DTT Global Benchmarks



The total Corporate Centre and Communications expenditure in FY06 was £1.99m including £0.11m in regulatory and compliance costs.

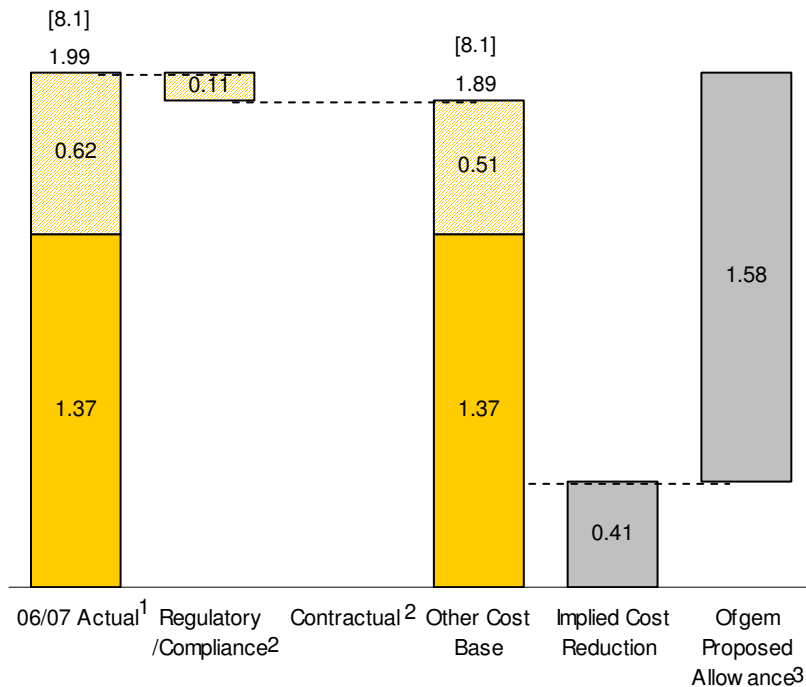
| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|-----------------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|---|
| Office of the CEO | 1.35 | 0.00 | 0.00 | 1.35 | 2 | •Labour costs and management expenses relating to the CEO and Personal Assistant |
| Corporate Affairs | 0.47 | 0.11 | 0.00 | 0.36 | 2.1 | •Public relations including press responses and membership to professional bodies and sponsorships •Regulatory expenses relating to the provision of an emergency telephone number and outsourced press costs covering mandatory notifications |
| Business Performance | 0.17 | 0.00 | 0.00 | 0.17 | 4 | •Management and implementation of business improvement initiatives including contract renegotiations and productivity enhancements (last year these initiatives achieved £6m in cost reduction) |
| TOTAL | 1.99 | 0.11 | 0.00 | 1.89* | 8.1 | |



In order to meet Ofgem target, 6.1 FTEs (100%) would be removed from the business performance and communications services cost base, in addition to £0.14m in external costs

Corporate Centre and Communication Services Expenditure

06/07 Total Corporate Centre and Communication Services Expenditure (£M)



- Labour Cost
- External Cost
- [] FTE

1. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance, *Based on average labour cost of 33k per FTE*
2. Derived from source: B473 for Emma Rose, WWU HR
3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.

Comments

- Assuming retention of the CEO, in order to reach the Ofgem target all FTEs¹ would be removed from business performance and corporate affairs in addition to £0.14m in external costs

Implications

- WWU corporate culture would severely suffer without tools such as the intranet, and staff retention would fall
- WWU would no longer have a community presence impacting profitability and the ability to attract and retain skilled employees
- Business performance initiatives would be eliminated directly resulting in an increase in CAPEX of up to £6m per annum (based on historical achievements)



The total Human Resources support expenditure in FY06 was £1.22m including £0.53m in regulatory and compliance costs and £0.18m in costs under contract.

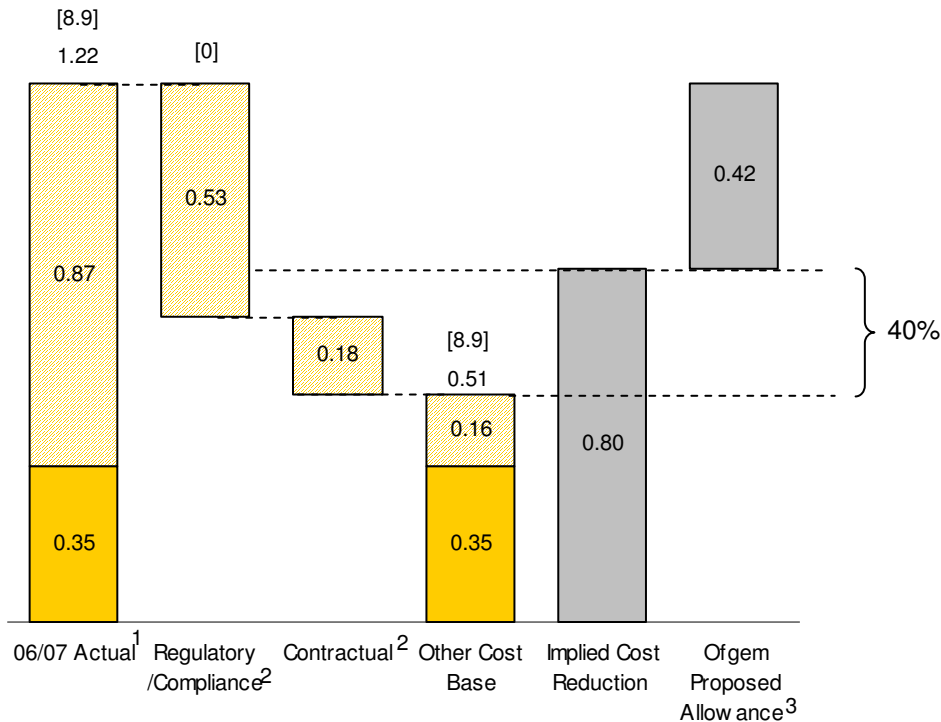
| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|--------------------------|-----------------------|--|-----------------------------|-----------------------|-------------|---|
| HR Administration | 0.20 | 0.00 | 0.00 | 0.20 | 5.9 | <ul style="list-style-type: none"> •Fixed component includes 1 HR Manager and 2 HR Advisors •Variable component includes 2 HR support staff •HR Services include: <ul style="list-style-type: none"> -HR Procedure and Policy development -Statutory Legislative requirements -Recruitment and selection administration management -Remuneration and Benefits Strategy, policy and procedures |
| Training | 0.57 | 0.41 | 0.00 | 0.16 | 0 | <ul style="list-style-type: none"> •Regulatory/compliance component includes mandatory CORGI registration and technical training for field workforce •Other training costs include includes management training and workforce up-skilling |
| OH&S | 0.12 | 0.12 | 0.00 | 0.00 | 0 | <ul style="list-style-type: none"> •Includes onsite medical support and mandatory health surveillance to comply with industry health and safety laws |
| Payroll | 0.33 | 0.00 | 0.18 | 0.15 | 3 | <ul style="list-style-type: none"> •Contractual component includes fees to external service provider for payroll processing •Other costs include 3 payroll FTE managing payroll service function |
| TOTAL | 1.22 | 0.53 | 0.18 | 0.51 | 8.9 | |



In order to meet Ofgem targets the entire HR cost base would be removed in addition to 40% of costs relating to regulatory and compliance activity and costs under contract.

HR Services Expenditure

06/07 Total HR Services Expenditure (£M)



Labour Cost
 External Cost
[] FTE

1. Derived from source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance
2. Derived from source: B473 for Emma Rose, WWU HR
3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.
4. Source: *D&T Human Resource Services Study*

Comments

- Removing the entire HR cost base would eliminate all HR FTEs, and external costs¹
- In order to reach the Ofgem target, an additional £0.29m would need to be removed from costs relating to regulatory and compliance activity or contractual costs

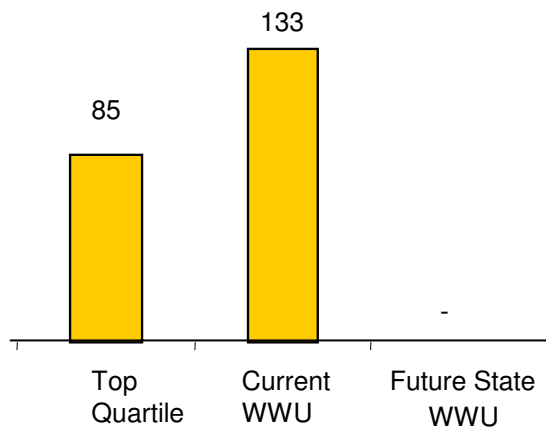
Implications

- WWU would not comply with industry best practice of 1 HR FTE:85 staff⁴
- Payroll services would be eliminated and staff remuneration would fail to be processed
- All management and staff training and development activity would be eliminated
- Operational line personal would assume all recruitment and HR administrative activity
- Mandatory regulatory/compliance activity including OHS health surveillance, licensing and registrations would fall by up to 40%
- Increase potential for prosecution and legislative breaches due to a lack of adequate supervision skills in the field force

Ofgem's proposed reductions across the Human Resource cost base would cause WWU to exceed top quartile benchmarks.

Human Resources Best Practice Analysis

Total FTE per HR FTE



Comments

- WWU currently exceeds top quartile performance with 133 employees per HR FTE
- Removing all FTEs from the Human Resource function would result in a ratio of HR FTE: Total FTE of 0:1198.7¹.
- Top Quartile benchmarks suggest a ratio of 14 HR FTE² to 1198.7 total FTE
- This reduction would cause WWU to exceed top quartile benchmarks by 8 HR FTE



1. source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance
2. D&T Human Resource Services - Delivery Ratios and Costs

The total Legal support expenditure in FY06 was £0.60m.

| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|--------------------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|--|
| Internal Legal Services | 0.49 | 0.00 | 0.00 | 0.49 | 2 | Legal services include: -providing Provision of legal Advice and Opinions -Drafting Legal Documentation (contracts etc) -The drafting and collation of Board and Board Committee papers and minutes •Externally sourced legal services for the provision of specialized legal requirements |
| Wayleave Services | 0.11 | 0.00 | 0.00 | 0.11 | 1 | •Wayleave services include management and resolution of wayleave claims and queries |
| TOTAL | 0.60 | 0.00 | 0.00 | 0.60 | 3 | |

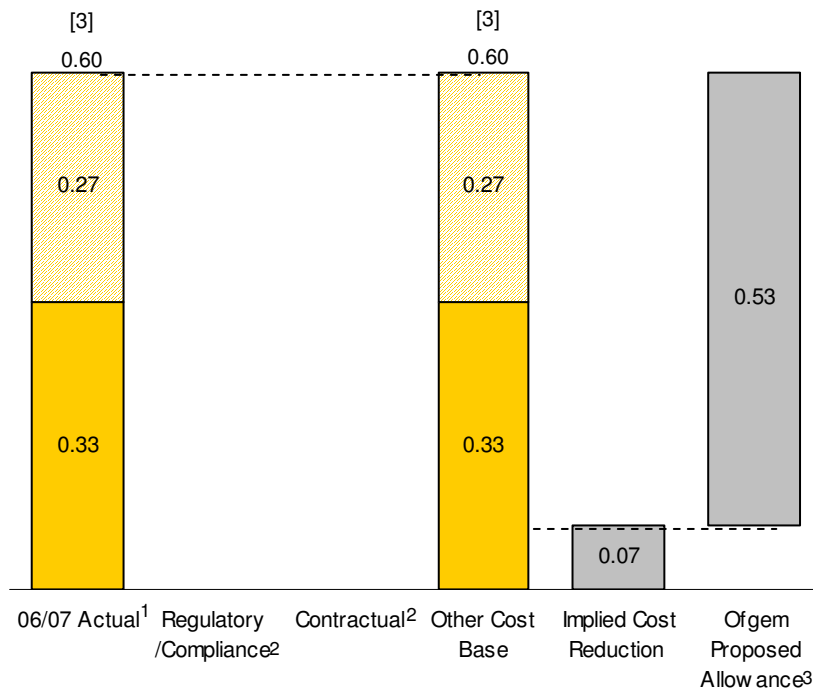


Source: Legal 0708 Budget for Third Horizon, WWU Legal

In order to meet Ofgem targets the equivalent of 1 FTE (33%) would be removed from the Legal services cost base.

Legal Services Expenditure

06/07 Total Legal Services Expenditure (£M)



Labour Cost
 External Cost
[] FTE

Comments

- In order to reach the Ofgem target, the equivalent of 1 FTE¹ would be removed from the Legal services function

Implications

- A decrease in response time to wayleave disputes would lead to fewer resolved incidences and a resulting increase in CAPEX
- An increase in administrative workload would impact the efficiency of the remaining legal team
- Legal support currently provided to business units for project work and business initiatives would be eliminated.
- Reduced litigation services and contract re-tendering would lead to an increase in direct OPEX

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance, *Based on average labour cost of 112k per FTE*
 2. Derived from source: Legal 0708 Budget for Third Horizon, WWU Legal
 3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.



The total Procurement and Logistics expenditure in FY06 was £1.58m including £0.11m in costs under contract.

| Activity Group | 06/07 Total OPEX (£m) | 06/07 Regulatory /Compliance OPEX (£m) | 06/07 Contractual OPEX (£m) | 06/07 Other OPEX (£m) | Current FTE | Key Activity Inclusions |
|--------------------|-----------------------------|---|-----------------------------------|-----------------------------|----------------|---|
| Procurement | 0.94 | 0.00 | 0.00 | 0.94 | 15 | <ul style="list-style-type: none"> •Management of all major purchases including establishing and management purchasing contracts and governance and compliance to procurement processes |
| Logistics | 0.64 | 0.00 | 0.11 | 0.53 | 7.2 | <ul style="list-style-type: none"> •Order management including planning, implementing, and controlling the efficient, cost effective flow and storage of raw materials and related information •Contractual costs relating to external logistics provider for delivery of goods |
| | 1.58 | 0.00 | 0.11 | 1.47 | 22.2 | |

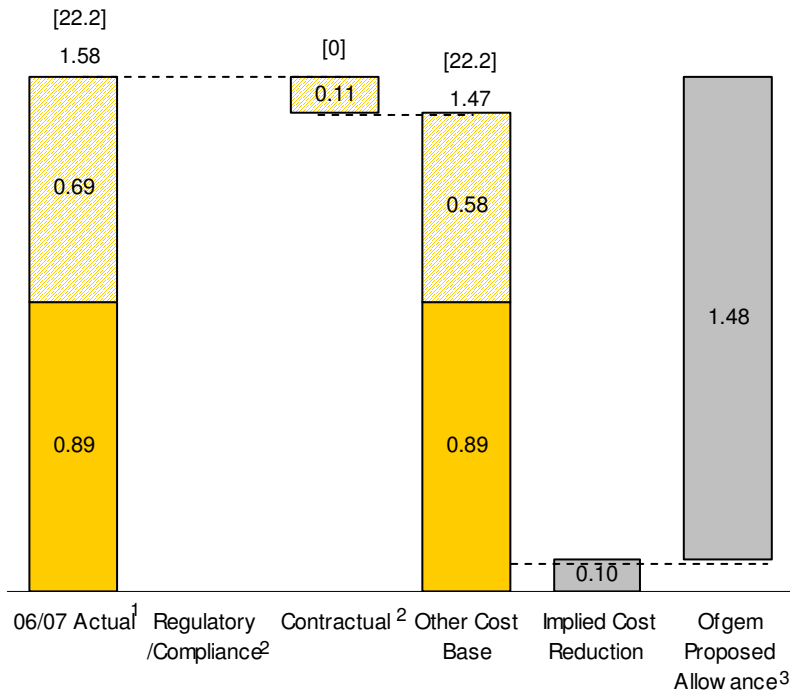


Source: B453 for Emma Rose, WWU Procurement

In order to meet Ofgem targets the equivalent of 3 FTE (14%) would be removed from the Procurement and Logistics cost base.

Procurement and Logistics Services Expenditure

06/07 Total Procurement and Logistics Expenditure (£M)



Labour Cost
 External Cost
[] FTE

Comments

- In order to reach the Ofgem target, the equivalent of 3 FTE¹ would be removed from Procurement and logistics functions

Implications

- A reduction in procurement resources would lead to less effective services and result in an increase in capital expenditure
- Fewer logistics resources would lead to insufficient management and control over the supply chain resulting in inventory shortage and reduced customer service

1. Source: Copy of WWU GDPCR 06/07 Opex BPQ 2006/07 Final, WWU Finance, Based on average labour cost of 40k per FTE
 2. Derived from source: B453 for Emma Rose, WWU Procurement
 3. GDPCR Initial Proposals Document, Main Supplementary Appendices, 29 May 2007, Tables A8.23. Includes 5.6% uplift adjustment.

