



Wales & West Utilities

Impact Assessment of the proposed OFGEM OPEX reductions

18th October 2007

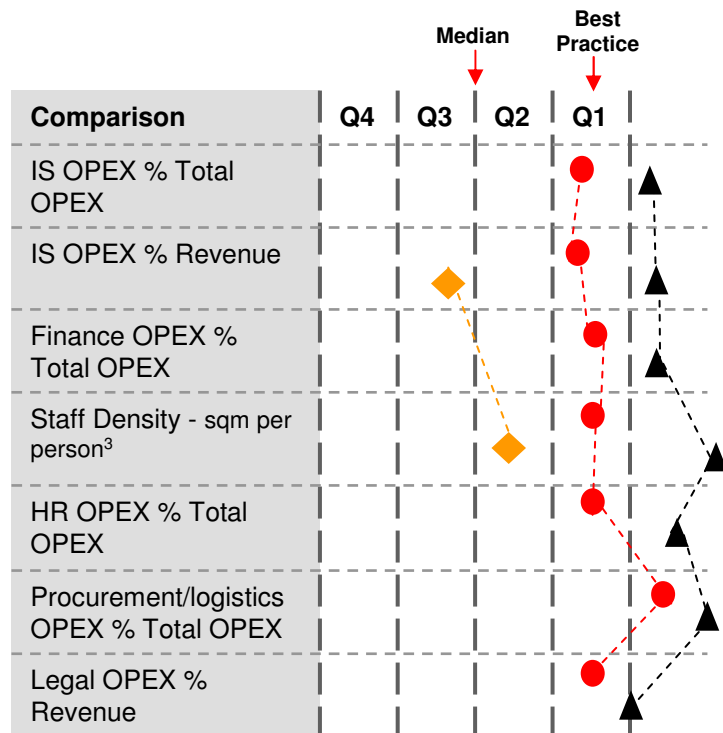
Key Findings of This Analysis

- WWU's current performance is shown to be significantly better than that shown by the LECG report when adopting a more appropriate methodology and approach. In all comparisons WWU is seen to be a strong performer and in many it is a frontier company.
- A critical oversight in Ofgems proposals is the lack of consideration of economies of scale and impact of GDN specific factors which have now been recognised by LECG¹
- Analysis shows that as revenues are regulated and costs continue to be driven down, achieving the Ofgem targets creates an increasingly difficult challenge which has not been reflected in Ofgem's approach
- Additional benchmark analysis considering methodology and benchmark selection adopted by other regulatory bodies² shows LECG target reductions may cause impact on quality of service
- Analysis of the methodology and approach adopted by other regulatory bodies² in setting cost reduction targets further supports the inadequacies identified by WWU in the LECG approach



1. Update assessment of GDN indirect opex based upon 2006/07 actual performance. 24 September 2007. p22
2. CAA initial price control proposals for Heathrow, Gatwick and Stanstead airports, Dec 2006
3. Thames Water Utilities Limited: Notice under and in accordance...to impose a penalty in respect of Thames Water Utilities Limited's breaches of its conditions of appointment in respect of regulatory reporting, 27 Sept 2007

Using a more appropriate approach and industry recognised tailored benchmarks, WWU's current performance is shown to be significantly better than that shown by the LECG report.



Comments

- 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 by LECG are actually achievable
- Previous assessment of WWU's support services (excluding communications and insurance) using a more appropriate methodology and recognised industry comparisons indicates that WWU is already a strong performer across the various service sectors
- LECG proposed targets have set OPEX allowances well beyond best practice in all areas.

	BP	Median	WWU ⁸	LECG ⁹	CAA ¹⁰
IS opex % total opex ¹	4%	9%	5%	3%	
IS opex % revenue ²		3.9%	2.9%	2.1%	4%
Finance opex % total opex ³	2%	3%	2%	1%	
staff density - sqm per person ⁴	12	14	12	6*	13
HR cost % total opex ⁵	1%	4%	1%	0.4%	
P&L opex % total opex ⁶	2%	4%	1%	0.5%	
legal costs % revenue ⁷	0.20%	0.40%	0.22%	0.17%	

- WWU Current OPEX against Industry recognised benchmarks
- ▲ LECG Proposed Targets against industry recognised benchmarks
- ◆ CAA Target Performance

1. DTT Global Benchmarking Study
 2. Meta Group 2005
 3. 2001 UMS Group Utility Benchmarks
 4. Andersen 2001 Study (Multi Industry)
 5. DTT Global Benchmarking Study
 6. UMS Utility Benchmarks
 7. PwC Study
 8. Update assessment of GDN indirect opex based upon 2006/07 actual performance. 24 September 2007.
 9. Based on comparison of high target savings
 10. Civil Aviation Authority Benchmarks, 2006
 * Assume a 46% reduction in floor space in line with a 46% reduction in property OPEX



A critical oversight in Ofgem's proposals is the lack of consideration of economies of scale and the impact of GDN specific factors which has now been recognised by LECG¹

LECG

Draft
Confidential
28 August 2007

2.27 As discussed in our Phase 1 Report, we recognised that the efficient level of support services costs may be affected by factors such as economies of scale, regional factors, GDNs specific factors and trade offs between different cost categories, and we would normally seek to consider these factors in performing our analysis. However, we have been instructed by Ofgem to consider the GDNs as equals. Consequently, whilst we have used metrics to normalise the data, we have made no further allowance to adjust for these factors between the GDNs. We understand that in its Initial Proposals, Ofgem has modified our proposed efficient support services costs to account for the some of the factors above, where appropriate. Ofgem has requested us to present our findings in the same format as in Phase 1, to allow it to make similar adjustment where appropriate.

2.28 As discussed in our Phase 1 Report, for each of the support services costs we indicate the efficient cost level and the efficiency savings for 2006/07. We

Comments

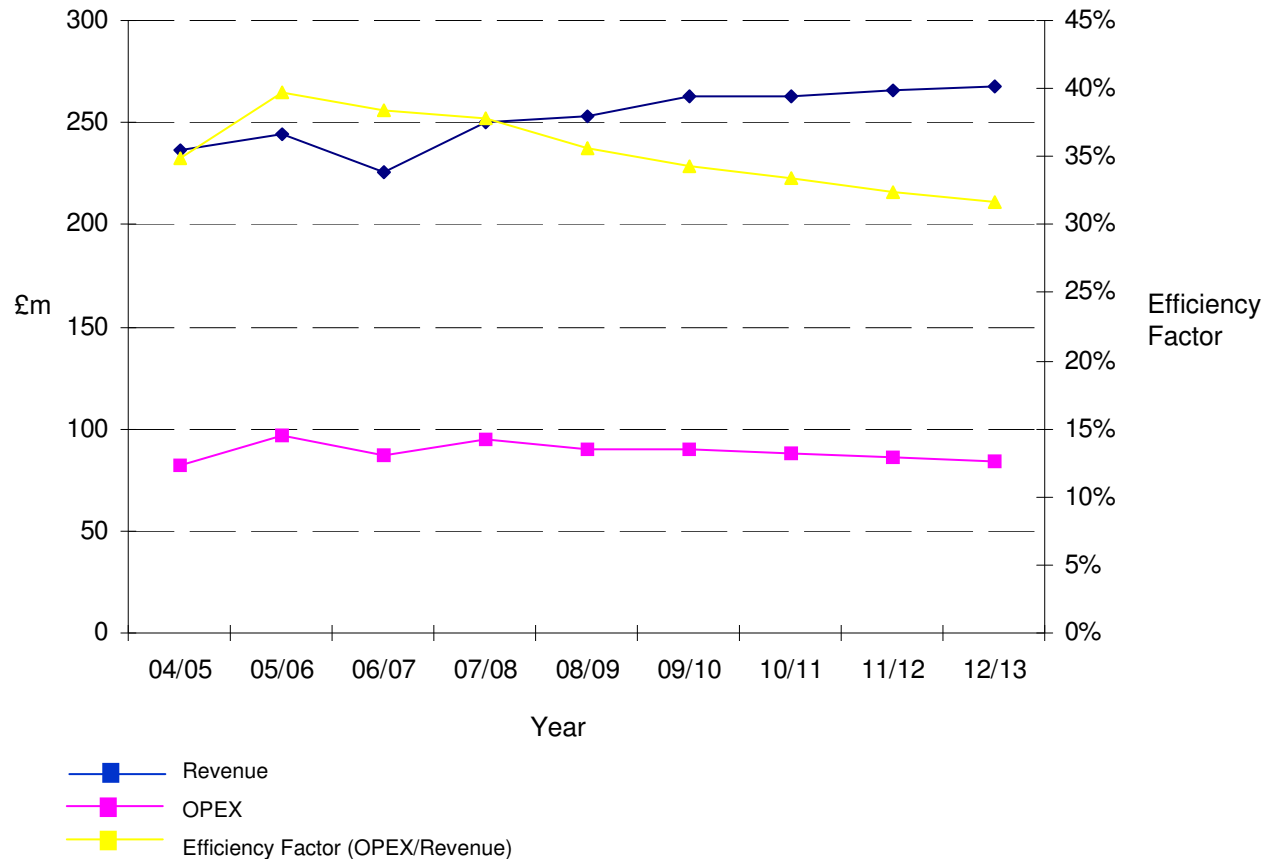
- Vast differences, including varying levels of outsourced services, exist between the 4 GDN's selected by Ofgem as a comparison group rendering it invalid for the purpose of this analysis.
- Additionally, as shown in previous reports submitted by WWU, a critical oversight in LECG's findings is the lack of consideration of economies of scale which have a significant impact on the relative operating costs of WWU support services.
- Ofgem have not adhered to methodology advice provided by LECG which accounts for these factors.
- LECG recognise in their final submission (24 September 2007) the need to account for economies of scale and regional factors, however they were instructed by Ofgem to consider the GDNs as equal¹ and as such have not made any allowances to adjust for these factors in determining cost reduction targets.

1. Update assessment of GDN indirect opex based upon 2006/07 actual performance. 24 September 2007. p22, 2.27



As revenues are regulated and costs continue to be driven down, achieving the Ofgem targets creates an increasingly difficult challenge over time

OPEX Efficiency Analysis



Comments

- Ofgem requires a decrease in OPEX budget from £96.9m in 2005/06 to £84.5m in 2012/13 (approximately 13%), while target revenues will stay relatively stable
- This relates to an increase in OPEX efficiency from 40% to 32% which creates an increasingly difficult challenge over time
- In order to meet this target, a step change may be required¹ in order to achieve greater economies of scale
- This cost reduction strategy is currently not viable given budget and time constraints to meet targets

Source: WWU Finance Support Services,
 • 04/05 to 06/07 revenue from regulatory accounts adjusted for inflation to get to 05/06 prices.
 • Controllable OPEX for 04/05 to 06/07: OPEX BPQ.
 • Figures for from 07/08 to 12/13: Ofgem financial model
 1. Third Horizon Analysis

Additional benchmark analysis considering methodology and benchmark selection adopted by other government bodies³ shows LECG target reductions may cause impact on quality of service

Function	Current FTE	Cost Base £m (Adjusted) ¹	Proposed Allowance £m (LECG)	Implied Reduction £m (LECG)	Estimated FTE Reduction ²	Quality of Service Implications
Information Systems	9.2	7.29	5.66	1.63	9.2	<ul style="list-style-type: none"> Elimination of onsite labour will lead to reduced internal service standards through increased response rates to systems issues used to fulfill client requirements In order to decrease IT OPEX, WWU will need to reduce the scope of IT services particularly on PM support which will increase the likelihood of deteriorating PM efficiency and possible system implementation failure
Audit, Finance & Regulation	43	3.80	2.21	1.59	20	<ul style="list-style-type: none"> Potential for transaction process errors and duplication Reduced speed of settlement and issue resolution Reduced ability to meet regulatory reporting requirements
Insurance	2	2.80	2.74	0.06	1	<ul style="list-style-type: none"> Removal of internal support leading to increased claim processing time
Property and Facilities	0.3	4.30	1.99	2.31	0	<ul style="list-style-type: none"> Further property consolidation will inevitably lead to being more remote from the WWU customers who are already geographically dispersed This will lead to increased response time to onsite requests as field staff have further to travel between client sites
Corporate Centre & Communications	4.1	1.79	1.28	0.51	2	<ul style="list-style-type: none"> Communication constraints may impact WWU ability to respond to all customers and more generic response media will be required. Speed of response may also be impacted as less resource will be available to complete
Human Resources	8.9	1.10	0.72	0.38	4.9	<ul style="list-style-type: none"> Reductions in the training budget may result in less/or slower skills enhancement and less customer handling skills being available
Legal	3	0.60	0.47	0.13	1	<ul style="list-style-type: none"> Reduced Wayleave resources would lead to a decrease in response time, and fewer resolved incidences
Procurement & Logistics	22.2	1.73	0.84	0.89	5	<ul style="list-style-type: none"> Reduction in external costs would reduce current bi-weekly delivery to once a week and less contact with the Customer
Other	4	0.21	0.21	0.00	4	

96.7

23.65

16.15

7.50

47.1



Analysis of the methodology and approach adopted by other regulatory bodies in setting cost reduction targets further supports the inadequacies identified in the LECG approach

CAA Approach ¹	LECG Approach ²	Impact of LECG Approach
Median approach to benchmark targets	Top Quartile approach to benchmark targets	Target reductions consistently set above industry average, and in most cases, above world class performance
Accounts for variations in comparison groups (i.e. customer profile and economies of scale)	No consideration of regional or GDN specific factors or the proven relationship between support cost and overall size	Allowances fail to reflect the unique environment WWU operates in
Benchmark analysis performed at the process level with consideration of performance drivers	Benchmark analysis performed at the functional level which does not account for performance drivers	Target reductions do not take into account size of operation and resulting support requirements
Consideration of the impact of cost drivers when analysing results (normalising a wide cross section of comparisons)	Comparison groups have not been normalised to account for individual cost drivers	Target reductions do not account for unique cost drivers, such as geographic reach
Consistent and formally defined approach to benchmark selection	Benchmarks 'cherry picked'	Efficiency targets implied by LECG lack justification and credibility
Alignment of processes to the needs of the business and consideration of quality of service	No consideration of the impact of cost reductions on quality of service	Target reductions will impact the quality of service offered by WWU to its clients
Consideration of the cost of projects in OPEX reductions (the ability to benefit from CAPEX projects)	No relationship acknowledged between CAPEX, OPEX and REPEX when setting targets	Target OPEX reductions will have an impact on CAPEX and REPEX creating even greater difficulty in achieving targets across the consolidated cost base



1. CAA initial price control proposals for Heathrow, Gatwick and Stanstead airports, Dec 2006
2. Update assessment of GDN indirect opex based upon 2006/07 actual performance. 24 September 2007

Summary of previous submissions to Ofgem have also demonstrated:

- 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
- Analysis of data from the UK Water Industry, the UK Electricity Industry and the Australian Gas Distribution sector, have shown that economies of scale play a major part in the overall efficiency of support costs in the Utility sector which have been ignored by Ofgem
- WWU operates in a challenging geographic environment which requires additional support expenditure² to maintain. This has not been taken into account when comparing WWU to other GDN's or to external benchmarks
- No recognition of the significant cost, disruption and timescale involved in achieving Ofgem cost reductions have been implied.
- Target reductions in allowance exceed remaining internal costs once contract costs and mandatory costs related to regulatory and compliance activity have been considered.



APPENDIX 1

- Methodology
- Service Quality Impact Assessment:

<i>Page</i>	<i>Function</i>
10-30	Information Services
14-16	Audit, Finance and Regulation
17	Insurance
18-19	Property and Facilities
20	Corporate Centre and Communications
21-22	Human Resources
23	Legal
24	Procurement and Logistics



METHODOLOGY

- The allocation of costs to each activity group in this report are consistent with the previous submissions¹. LECG adjustments² have been applied to determine the adjusted cost base in this report.
- In most cases, implied reduction across each activity group within a function have been calculated as a percentage of total costs in each function
- Contract costs are assumed to be at current market rates. A reduction in costs under contract will result in a decrease in functional scope, or efficiency factor of current activity inclusions.
- Previous submissions have been based on comparison to industry efficiency averages and best practices. OFGEM have chosen to ignore the comparative recommendation from these benchmarks.
- No further effort to substantiate the inadequacies of the OFGEM approach are made in this report. Objections made in all previous submissions to Ofgem remain valid³



IS target savings are likely to impact project management efficiency and ability to sustain service quality standards

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Infrastructure Support	0	1.97	0.36	•Support cost relating to the maintenance of physical infrastructure including servers	•Reduced service levels and resolution time relating to mission critical incidences resulting in downtime
Application Support	0	1.56	0.29	•Technical support contracts include telephone and online troubleshooting, installation assistance and basic usability assistance	•Reduced response and resolution time to helpdesk calls and incidences
Software Maintenance	0	1.57	0.29	•Software maintenance includes delivery of product updates and enhancements,	•Reduction./elimination in application upgrades and enhancements
Hardware Maintenance	0	0.06	0.01	•These are preventive and remedial services that physically repair or optimize hardware, including basic installation, maintenance and incident repair.	•Business disruption due to reduced monitoring of physical infrastructure
Network/Telco	0	1.77	0.32	•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).	•Slower data transfer and network speed impacting efficiency of workforce

1. Remaining cost reduction apportioned proportionally across current costs under contract



IS target savings are likely to impact project management efficiency and ability to sustain service quality standards

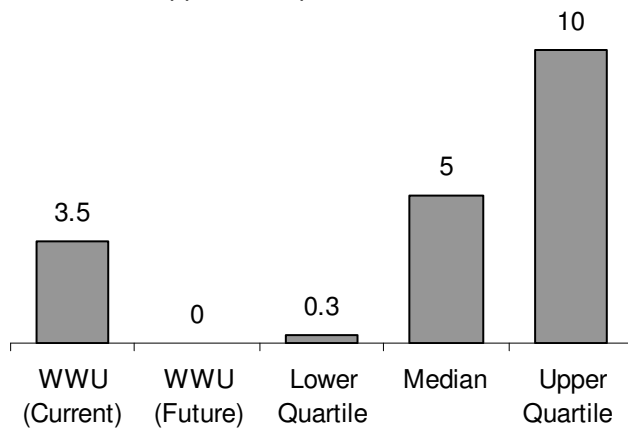
Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG)	Current Activity Inclusions	Cost reduction Impact
labour	9.2	0.32	0.32	<ul style="list-style-type: none"> Administrative personnel, including the CIO, IT finance personnel, IT sourcing personnel, vendor managers and any other individuals involved in IT administration. 	<ul style="list-style-type: none"> Removal of all 9.2 internal IS resources eliminating all onsite IS support for issue resolution which may result in increased response time to user requests and issues Increase in CAPEX budget is likely to be unsupported resulting in possible project management errors e.g. Southern / Thames Water Project failures Loss of WWU knowledge and tailored IT solutions
Other	0	0.04	0.04	<ul style="list-style-type: none"> These expenses may include items such as travel and entertainment costs, temporary help, training, repairs and maintenance and consultancy 	<ul style="list-style-type: none"> Elimination of all temporary staff to cover project work
TOTAL	9.2	7.29	1.63		



LECG implied reductions will cause IS support levels to fall below industry average which is supported by other Regulatory Authorities (i.e. CAA¹)

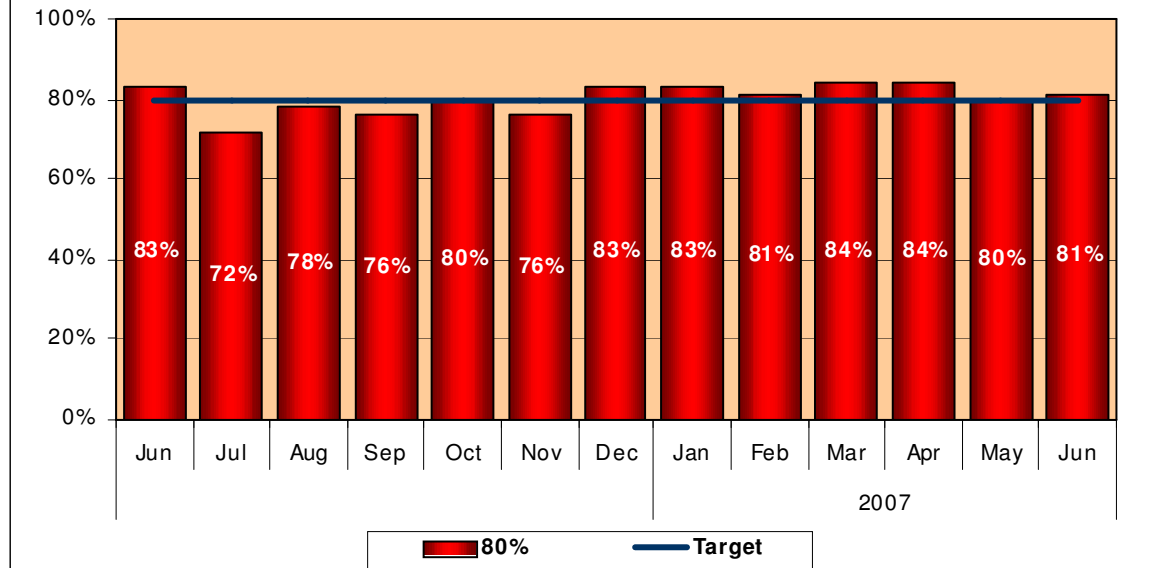
IT Support Analysis

IT Support Staff per 1000 Users¹



- WWU currently performs above industry average for IS support staff ratio. In order to meet Ofgem target, all non-contractual costs must be removed from the IS cost base. This will cause IS support levels to fall below lower quartile benchmarks

Number of IS Support Calls Answered Within 20 Seconds²

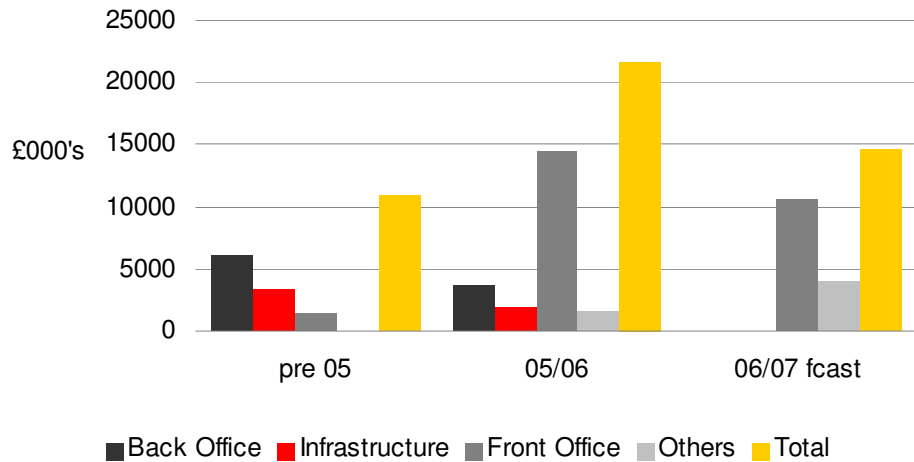


- Further reduction in external support fees will cause a decrease in service levels causing further reduction in call response time below the current SLA of 80%

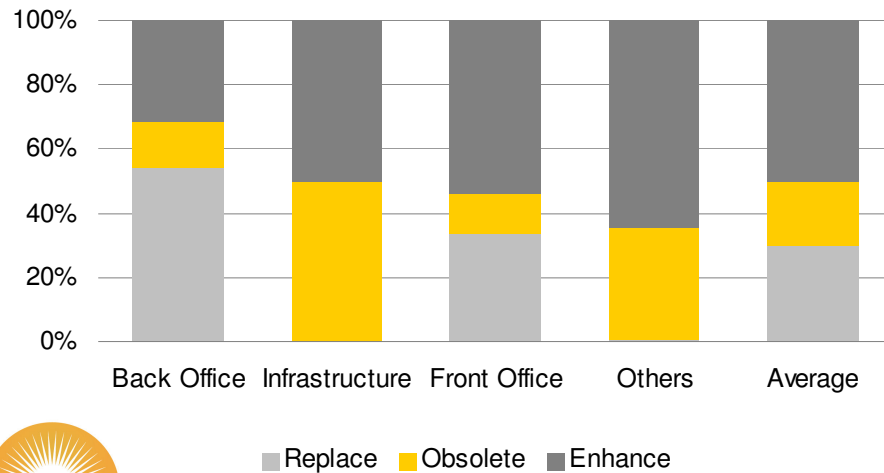


Analysis of WWU IT projects suggests reduced IT OPEX could impact potential benefits of future projects which is supported by analysis from other regulatory bodies¹

Summary of IT CAPEX Expenditure



Focus of IT CAPEX Expenditure



Implications for OPEX

- Increased spend on enhancements will result in OPEX increase. If CAPEX is curtailed or fails to deliver successfully then OPEX is at risk
- Backoffice has seen a diminishing CAPEX focus and this would suggest that OPEX is starting to increase and will be more dependent on future enhancements to prevent OPEX increases
- Infrastructure CAPEX stopped in 06/07 indicating a period of harvesting benefits. A dependency would be the future investment in enhancements to restrict OPEX increases
- Massive new Front Office expenditure needs to be forecast in the depreciation charges and will eventually result in a dependency on future enhancements.
- WWU Project Assessment paper¹ sights only 2 cases (1.1.5 and 2.0.7) of project overspend which is good against practice. But if IT PM support is restricted then future CAPEX success would not appear as secure¹
- IT Project Assessment paper demonstrates good Project Governance and strong Delivery Relationship Management which is to be encouraged. If IT Support costs are restricted or Delivery Scope curtailed then this best practice would look to be under threat.
- IT Project Assessment paper highlights that benefits are quickly embedded into Operational Accountability and again with the prospect of less IT OPEX for Governance this ability to realise benefits may come under pressure
- Section 1.1.7 of the IT Assessment Paper also references the very competitive nature of the existing outsource arrangements that would be threatened if WWU have to renegotiation or find new suppliers.



Audit, Finance and Regulation target savings will potentially impact WWU's ability to meet regulatory requirements and quality standards

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Business Planning	2	1.23	0.51	<ul style="list-style-type: none"> •Business planning including the purchase of exit capacity, build reinforcement and scenario planning •Management of regulatory and commercial changes on business performance Professional services and consulting charges	•All professional services and subscriptions would be eliminated, limiting the availability of information to make sound business decisions
Treasury	2	0.11	0.05	<ul style="list-style-type: none"> •Prepare and monitor cash flow forecasts •Establish and administer transactional banking services •Provide cash management services 	•Hedging and cashflow management implications may arise due to resource reductions and lack of system developments
Internal Audit	1	0.20	0.08	<ul style="list-style-type: none"> •Monitor activities of non-compliance with company policy, laws and regulations •Co-ordinate external providers of internal audit services 	•Increased potential for prosecution and legislative breaches due to insufficient budget allocated to external and internal audit and bank and credit charges
Income	2	0.11	0.05	•Income and pricing analysis	
Other	4	0.22	0.09	•CFO, PA to CFO and 2 finance analysts	

1. Total cost reduction apportioned as a percentage of cost base in each activity group

Audit, Finance and Regulation target savings will potentially impact WWU's ability to meet regulatory requirements quality standards

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Management Accounting	10	0.54	0.23	<ul style="list-style-type: none"> •Preparation of management reports for Internal use and inclusion in the executive pack •Preparation of statutory accounts and regulatory reporting 	<ul style="list-style-type: none"> •The management reporting team would be reduced to 3FTEs with only enough resources to focus on matters relating to 3rd party requirements (Ofgem, compliance and statutory reporting) •Requirements are increasing to meet professional and regulatory requests. •A reduction in IT budget to reporting systems will possibly result in erroneous statutory reporting leading to Ofgem penalties in excess of reduction targets²
Accounts Payable	4	0.22	0.09	<ul style="list-style-type: none"> •Establish new supplier accounts and generate payments 	<ul style="list-style-type: none"> •Reduction in the accounts receivable team to 3FTE •Potential for vendor process errors and duplication and reduced speed of settlement and issue resolution
Accounts Receivable	9	0.49	0.21	<ul style="list-style-type: none"> •Generate invoices for claims and customer billing including meter services and connections 	<ul style="list-style-type: none"> •Reduction in the accounts receivable team to 6FTE to manage all transactions, •Increase in debtor days (currently 76 days) and level of bad debt
Regulation	9	0.68	0.28	<ul style="list-style-type: none"> •Requirements are increasing to meet professional and regulatory requests. 	<ul style="list-style-type: none"> •Reduced resources leading to compliance and governance issues at a time of increased regulatory requirements
TOTAL	43	3.8	1.59		

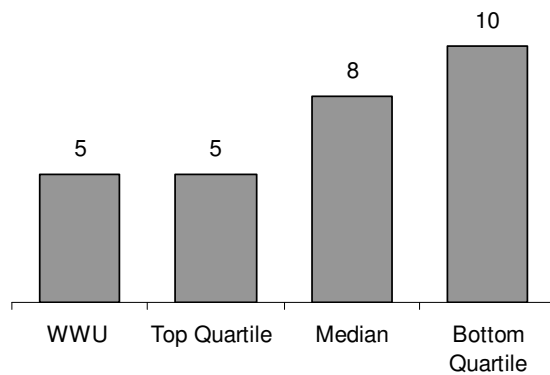
1. Total cost reduction apportioned as a percentage of cost base in each activity group
2. Thames Water Utilities Limited: Notice under and in accordance...to impose a penalty in respect of Thames Water Utilities Limited's breaches of its conditions of appointment in respect of regulatory reporting, 27 Sept 2007



Reduction in transaction processing expenditure would cause WWU to increase invoice processing time and sale days outstanding

Finance Best Practice Analysis

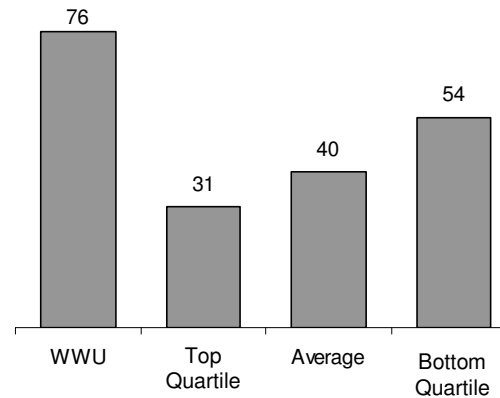
Days to Close the Books



Source: KPMG, 2004

Finance Best Practice Analysis

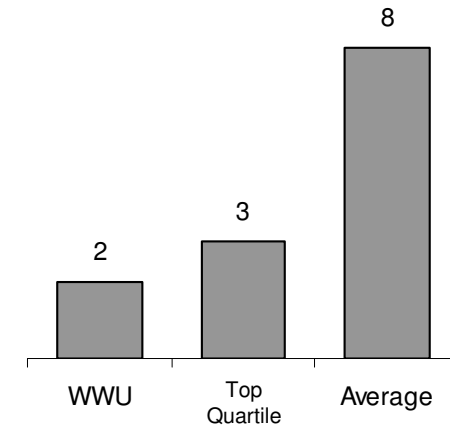
Days Sales Outstanding



Source: KPMG, 2004

Finance Best Practice Analysis

Days between receipt and approval of invoice for payment



Source: KPMG, 2004

Comments

- WWU is currently performing in the top quartile in comparison to average days to close the books. Reduction in finance resources in this area would cause WWU to fall below best practice performance.
- WWU currently performs poorly in average days sales outstanding which is contributing to high levels of bad debt. Further reduction in accounts receivable labour will cause days sales outstanding to increase even further
- WWU currently perform above average for days between receipt and approval for invoice payments. Performance in this area and days to close the books would decrease with a reduction in transaction processing labour also contributing to an increase in days taken to close the books



Insurance target savings will impact current resource levels which will lead to increased claim processing time and service levels to clients

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Insurance	2	2.80	0.06	<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 	•Removal of internal support leading to increased claim processing time
	2	2.80	0.06		



Further property consolidation will result in WWU field staff being further removed from the client base and hence decrease response rates

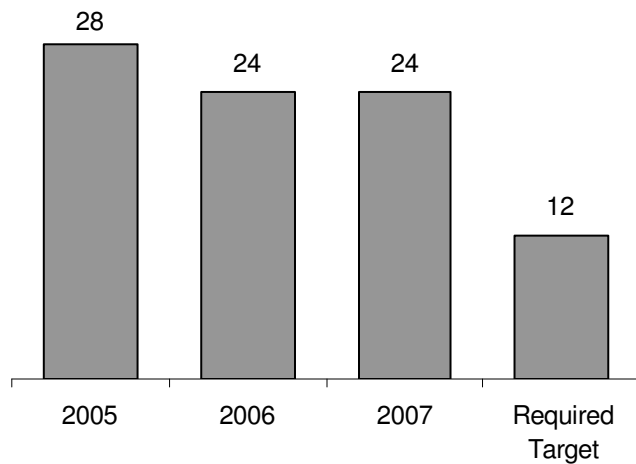
Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Facilities Management	0.3	0.05	0.03	•Onsite management of buildings and services including business administration and management of external services providers	•Cleaning services could no longer be employed on a daily basis •Onsite vending machines, including water dispensers could be eliminated •Grounds, building and equipment maintenance services would be reduced, or cease altogether
Rent and maintenance	0	1.95	1.05	•Costs relating to leasing and maintaining workspace including offices and distribution plants	•Drastic property consolidation could be required and staff density would increase beyond best practice (12 sq mtr per person ²) •Decrease in field force response time due to increased distance to client sites from consolidated WWU base
Utilities	0	0.80	0.43	•Costs relating to water, gas and electricity supply	•Imposed restrictions on usage
Telephone	0	0.57	0.31	•Telecommunication charges including local and international calls	•Introduction in call barring on desktop phones
Printing and Stationary	0	0.61	0.33	•Office supplies including printing paper and	•Insufficient printing and stationary resources would be available for the business to function effectively
Other External Cost	0	0.32	0.17	•LECG adjustment - Reclassification of non-salary recharges from capex/repex	
	0.3	4.30	2.31		

1. Total cost reduction apportioned as a percentage of cost base in each activity group
2. Support Services Review – Indirect Operating Expenditure, 13th July 2007

In order to meet Ofgem reductions, WWU will need to further rationalise their current property base which will impact client service levels and staff density

Property Rationalisation Analysis

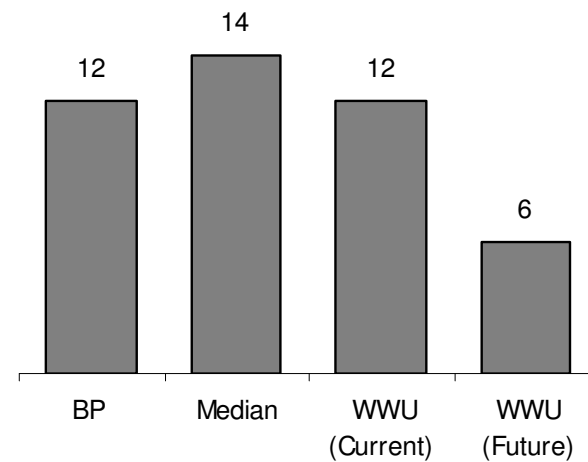
Rationalisation of WWU Property Portfolio



Source: WWU Property Services Division

Property Rationalisation Analysis

Staff Density (Square Metres Per Person)



D&T Global Benchmarking Study

Comments

- WWU have rationalised 4 properties in the past 2 years. In order to meet Ofgem's targets, WWU will need to remove a further 12 properties from current base (46% reduction)
- WWU currently has a low customer density which requires relatively high resources to meet agreed service levels to isolated and fragmented consumers and assets
- This will have a negative impact on client service levels as field staff will take increased time to reach client sites.
- Staff density will fall below best practice by 50%



Target reductions in Corporate Centre and Communications expenditure will reduce the number of customer tailored communications produced

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Office of the CEO	2	1.15	0.33	<ul style="list-style-type: none"> •Labour costs and management expenses relating to the CEO and Personal Assistant 	<ul style="list-style-type: none"> •Reduced management related expenses
Corporate Affairs	2.1	0.47	0.13	<ul style="list-style-type: none"> •Public relations including press responses and member ship to professional bodies and sponsorships •Regulatory expenses relating to the provision of an emergency telephone number and outsourced press costs covering mandatory notifications 	<ul style="list-style-type: none"> •WWU would no longer have a community presence impacting profitability and the ability to attract and retain skilled employees •Fewer customer interactions and more generic communications damaging the Corporate Relationship with Customers
Business Performance	4	0.17	0.05	<ul style="list-style-type: none"> •Management and implementation of business improvement initiatives including contract renegotiations and productivity enhancements (last year these initiatives achieved £6m in cost reduction) 	<ul style="list-style-type: none"> •Business performance initiatives could be eliminated directly resulting in an increase in CAPEX of up to £6m per annum (based on historical achievements provided by WWU)
TOTAL	4.1	1.79	0.51		



Human Resources target reductions will result in less customer facing staff training impacting quality of service

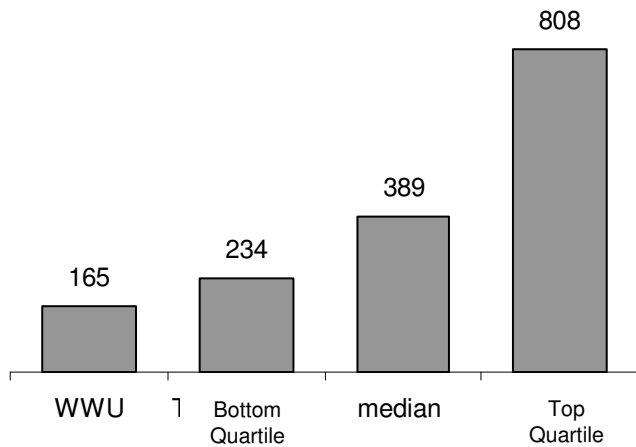
Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
HR Administration	5.9	0.20	0.20	<ul style="list-style-type: none"> •1 HR Manager and 4.9 HR Advisors for the provision of HR Services including: <ul style="list-style-type: none"> -HR Procedure and Policy development -Statutory Legislative requirements -Recruitment and selection administration management -Remuneration and Benefits Strategy, policy and procedures 	<ul style="list-style-type: none"> •Reduction of all HR personnel would cause WWU to exceed top quartile benchmarks by 8 HR FTE •Mandatory regulatory/compliance activity could fall •Operational line personal may need to assume all recruitment and HR administrative activity •WWU community profile could be detrimentally impacted
Training	0	0.57	0.11	<ul style="list-style-type: none"> •Mandatory CORGI registration and technical training for field workforce •Management training and workforce up-skilling 	<ul style="list-style-type: none"> •Reduction of training cost per FTE would fall £69 further below best practice •Increase potential for prosecution and legislative breaches due to a lack of training, registrations/operating licenses and adequate supervision skills in the field force •Management and staff development activity could be eliminated
Payroll	3	0.33	0.07	<ul style="list-style-type: none"> •Fees to external service provider for payroll processing •1 payroll manager and 2 payroll clerks 	<ul style="list-style-type: none"> •Eliminate all payroll resources to manage external payroll contract and internal issues
TOTAL	8.9	1.10	0.38		

1. All labour costs removed and additional £0.11m removed from training contract costs

A reduction in training costs will cause training costs per FTE to fall further below best practice which will impact staff moral and quality of service

HR Best Practice Analysis

Training Budget per FTE



Source: Saratoga Utilities Benchmarks, Dec 2005

Comments

- Compared to benchmarks, WWU currently performs below bottom quartile on learning and development costs per FTE
- Ofgem proposed HR reduction in training budget will cause WWU to fall further below bottom quartile performance
- Reduced investment in training limits the ability to up skill internal employees and save on recruitment costs for external hires
- Reduced training expenditure also has the potential to negatively impact productivity levels of the workforce



Target reductions in legal expenditure will decrease Wayleave claim response time impacting service standards

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Internal Legal Services	2	0.23	0.05	<ul style="list-style-type: none"> •1 Legal manager and 1 legal trainee for the provision of Legal services including: <ul style="list-style-type: none"> -Provision of legal Advice and Opinions -Drafting Legal Documentation (contracts etc) -The drafting and collation of Board and Board Committee papers and minutes 	<ul style="list-style-type: none"> •Potential reduction of 1 legal trainee •Legal support currently provided to business units for project work and business initiatives would be eliminated.
Wayleave Services	1	0.11	0.02	<ul style="list-style-type: none"> •Wayleave services including management and resolution of wayleave claims and queries 	<ul style="list-style-type: none"> •Reduced Wayleave resources would lead to a decrease in response time, and fewer resolved incidences causing an increase in CAPEX
External Legal Services	0	0.28	0.06	<ul style="list-style-type: none"> •Externally sourced legal services for the provision of specialized legal requirements 	<ul style="list-style-type: none"> •Potential increase in legal fines being incurred as we are unable to defend WWU
TOTAL	3	0.60	0.13		



Target reductions in Procurement and Logistics expenditure will cause a reduction in delivery frequency and may effect customer response rates

Activity Group	Current FTE	Cost Base £m (Adjusted)	Implied Reduction £m (LECG) ¹	Current Activity Inclusions	Cost reduction Impact
Procurement	15	0.94	0.48	<ul style="list-style-type: none"> •Management of all major purchases including establishing and management purchasing contracts and governance and compliance to procurement processes 	<ul style="list-style-type: none"> •Reduced resources to perform buying analysis leading to less effective procurement practices •Increase the stress on the capital budget as a result of less effective procurement services
Logistics	17.2	0.79	0.41	<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 	<ul style="list-style-type: none"> •Reduction in external costs would reduce current bi-weekly delivery to once a week •Decreased service standards •Poor planning and a potential reduction in customer response rates
	22.2	1.73	0.89		

1. Total cost reduction apportioned as a percentage of cost base in each activity group

SUMMARY

- Cost savings required by Ofgem can only be achieved by WWU if:
 - WWU improve labour productivity in excess of best practice and become clear world leaders which may require a step change
 - The risk of increased number of operational incidences is accepted
 - WWU reduce the level of program management support to CAPEX programs with an increased risk of either timing, cost or lost benefit being achieved
 - WWU become further remote from an already dispersed customer base as it consolidates to achieve savings

- OPEX savings are implicitly likely to result in an impact to quality of service:
 - IT service standards may drop
 - Billing services may deteriorate
 - Insurance claim processing time may increase
 - Field staff will be further removed from the client base and cause decrease response rates
 - Fewer customer tailored communications will be produced
 - HR training will be reduced
 - Wayleave claim response and resolution rates would decrease
 - Delivery frequency will be reduced which may effect customer response rates

