GDPCR - Updated Proposals - 24 September 2007

Loss of Metering Work and its Impact on Emergency Costs

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CONTENTS

1 Introduction

The GDNs have to provide an emergency service to customers to attend gas leaks with a general 1 hour response time. To be able to respond effectively within this response time, GDNs need to locate First Call Operatives (FCOs) at strategic situations across their service area.
Attending to gas leaks is not a continuous activity for the FCOs and there are significant waiting periods in an FCO's day between emergency jobs.

Metering work is used by a number of GDNs as fill-in work to minimise this waiting time. Changes to the metering work contracts will mean that many GDNs will lose metering work and as a consequence the waiting times for their FCOs will increase and the cost of running the emergency service will increase.

Ofgem has recognised this potential change and the Updated Proposals include the provision of a loss of metering revenue driver which is designed to financially "compensate" the emergency activity where metering work is lost.

This report by John Spiller Associates (JSA) on behalf of WWU, examines the proposal and comments on how its operation will impact WWU's emergency costs and proposes a simpler revenue driver arrangement.

2 Nature of the Work

WWU is not a Meter Asset Manager (MAM) and has no contracts with Gas suppliers. WWU has two contracts for the installation and maintenance of gas meters, one with Onstream and the other with National Grid Metering Services (NGMS). It is believed that at the present time WWU is the only GDN to hold a metering contract with Onstream.

The work in both contracts involves planned work (e.g. policy exchanges) and unplanned work (e.g. faults and other customer driven activities).

Both of the WWU contracts terminate in 2008, the NGMS contract on 1 June 2008 and the Onstream contract has just been extended to terminate in August 2008.
The NGMS contract is being re-tendered at the moment and it is expected that the Onstream tender document for 2008 onwards will be received in the next month or so.

The NGMS tender document stipulates that the contractor shall "use a dedicated workforce working only on NGMS metering to the exclusion of all other parties".
This effectively means that the emergency workforce should not use metering jobs as fill-in work. Even if WWU should win this contract the effect of "ring fencing" the metering work in this way will be equivalent to the emergency service activity losing the metering work - causing a consequential increase in emergency operating costs.

The UPs indicate that some GDNs have already lost metering work and this is true for WWU where a reduction of nearly 34,000 has occurred between 2006/07 to the current year 2007/08 forecast. This forecast is still under review by NGMS and Onstream at the present time.

The emergency service is not optional and emergency staff (FCOs) have to be strategically located across the service area in order to respond to leaks in the required 1 hour. In the case of WWU its long and narrow service area with a low customer density requires a larger number of FCOs than most GDNs. A separate report has been submitted to Ofgem showing examples of the derivation of emergency staff numbers for the WWU service area.

The cost of this "emergency only" stand-alone service has been submitted to Ofgem in response to

SQ WWU 130 as £16m for WWU and requires 328 FCOs.
Any fill-in work that can be obtained as fill-in work has the effect of reducing costs to the emergency service as the time of the FCOs spent on this work can be apportioned to the fill-in work. However, it is important to note that the number of FCOs is driven by the area to be covered and the need to meet the 1 hour response time.

3 Ofgem Methodology

3.1 WWU Figures

In the case of WWU the revenue driver figures from the UPs are:

GDN	Tipping Point (% of 2005-06 meter work jobs)	Tipping Point (Number of metering jobs losses above which the revenue driver would not apply)	Revenue Driver (£) (Unit cost per job - post tipping point
WWU	44%	147,471	21.72

WWU calculations show that these figures are too low to recover the unavoidable costs of a complete loss of metering and a deficit of about £3m occurs if the above figures are used.

3.2 Revenue Driver

The revenue driver consists of a "tipping point" in the number of metering jobs undertaken and a unit cost per job in £s. Ofgem's intention seems to be that up to the tipping point a loss of metering work will not trigger the revenue driver because the GDN may be able to lay off contractors to mitigate the additional costs that will fall on the emergency service, if the FCOs are unable to use their waiting time to carry out metering as fill in work.

However, there is some inconsistency between the description of the tipping point in the UPs paper and the example given of how it will be applied. In one instance it appears to be a "hurdle" over which the revenue driver will start to operate and in the example given in the UPs it appears to be a "cap" beyond which the metering driver will cease to operate.
This may be due to some confusion as to whether the driver will operate on metering jobs completed or metering jobs lost and this query has been raised separately with Ofgem.

3.3 Tipping Point

Ofgem explain that this is the point at which unit costs increase significantly but a somewhat complicated and cumbersome mechanism is used to calculate this point based on the point at which the unit costs appear to increase sharply.
In WWU's case this mechanism does not appear to take into account the termination of the metering contracts in the right way.

The calculation by Ofgem produces the additional number of FCOs required for emergency when metering is lost, based very much on the calculation of waiting time per hours worked. This is a high level figure and WWU suggests it is not sufficiently robust to be used in the revenue driver mechanism.

In addition in SQ 1032 WWU has completed the spreadsheet with FTEs being used in the actual years (as per the SQ guidance) but with actual numbers of people for a stand-alone emergency service in the forecast years. In fact the difference shows a reduction between these two situations.

This has been discussed with Ofgem and we understand that it is likely that the previous calculations of unit cost and tipping point will be revised.

However, it is suggested that a simpler approach can be used as outlined in Section 4 below.

4 WWU Approach to Calculation of Tipping Point

Supplementary Question 1032 sought financial and workload figures for metering that would be used in producing the revenue driver. We have used the information supplied as the answer to SQ 1032 as the basis for our calculation of the tipping point and unit cost.

4.1 Tipping Point Calculation

We agree with Ofgem that initially contractors can be laid off to mitigate the increased costs on the emergency service and this would be used in the tipping point calculation as follows:

Number of Contractors		
Emergency	12	
Metering	28	
Other	5	
Contractors released	33	
Metering Jobs per person per yr	1,744	Based on 8 jobs per day
Metering Jobs lost with contractors	57,552	
Tipping Point	**57,552**	
Total Metering Jobs	273,270	average 2 years 05/06, 06/07
Metering jobs to count for revenue driver or **Cap**	215,718	
Tipping Point %	**26.67 %**	

4.2 WWU Metering Costs as reported in SQ 1032

	2005-06 (£m 2005-06 prices)			**2006-07 (£m 2005-06 prices)**		
	Avoidable costs	**Unavoidable costs**	**Total**	**Avoidable costs**	**Unavoidable costs**	**Total**
Net Staff Costs		2.9	2.9		3.6	3.6
Materials and Liabilities	1.1		1.1	0.7		0.7
Subcontractors	1.9		1.9	1.6		1.6
Transport & plant	0.1	0.6	0.7	0.1	0.9	1
Allocation of overheads	2.9	2.8	5.7		1.7	1.7
Total	**6**	**6.3**	**12.3**	**2.4**	**6.2**	**8.6**

The cost per metering job that can be derived from this table are as follows:

Year		**05/06**	**06/07**	**Average 05/06 & 06/07**	**07/08**
Number of Meter Jobs		263,376	283,164	273,270	249,315
Total Cost per job	£	46.7	30.4	38.2	-

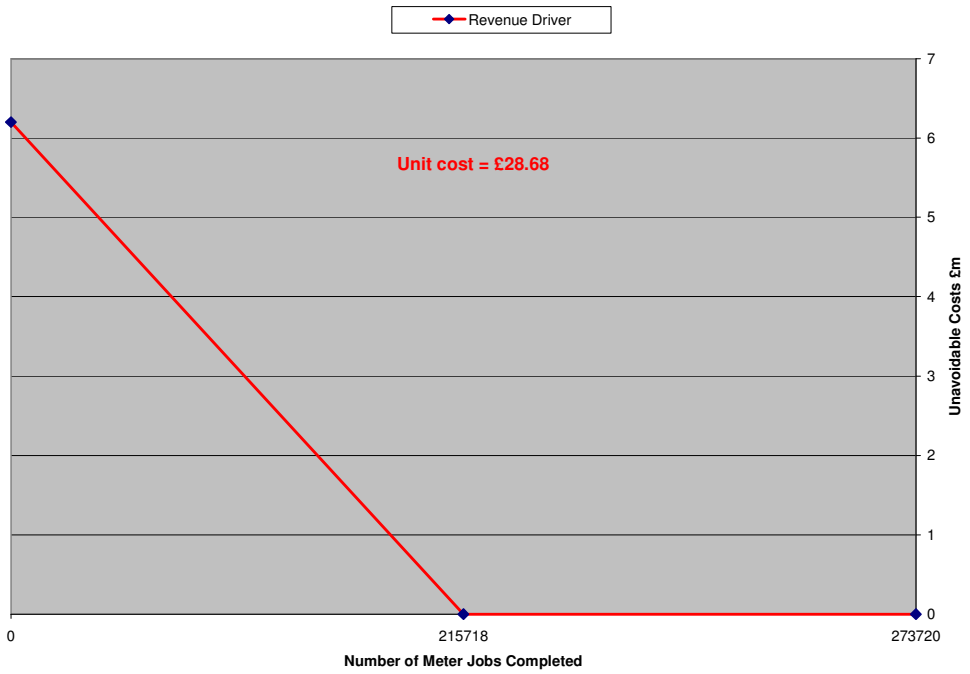
The unit cost element of the Revenue Driver is calculated as the cost per meter job lost post the tipping point which is £6.2m/215718 = £28·74.

4.3 Operation of the Tipping Point and Cap

The principle here is that GDNs would not recover any additional allowance for the loss of metering up to the tipping point. Equally the GDN would not be able to recover more than the additional

costs that would occur when all metering is lost and the emergency service operates on a "stand-alone" basis.
Thus the revenue driver mechanism would have a tipping point (hurdle) and a cap.

In the case of WWU the revenue driver would be :



4.4 Advantages of this Methodology

(i) The data for its operation has already been submitted to Ofgem in SQs 130 and 1032.

(ii) It does not rely on a high level calculation of waiting time.

(iii) It avoids a somewhat complicated and cumbersome calculation of additional FTEs.

(iii) It more closely resembles the practical operation of the Emergency and Metering Businesses.

(iv) It avoids any "windfall effects" because the use of a tipping point (hurdle) and an allowance "cap" relates the allowance more directly to the additional costs as they arise.