RIIO-ED1 Cost Assessment Working Group:
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Julian Rudd

UK Power Networks

NON-OP CAPEX

DPCR5 Treatment of non-op Capex

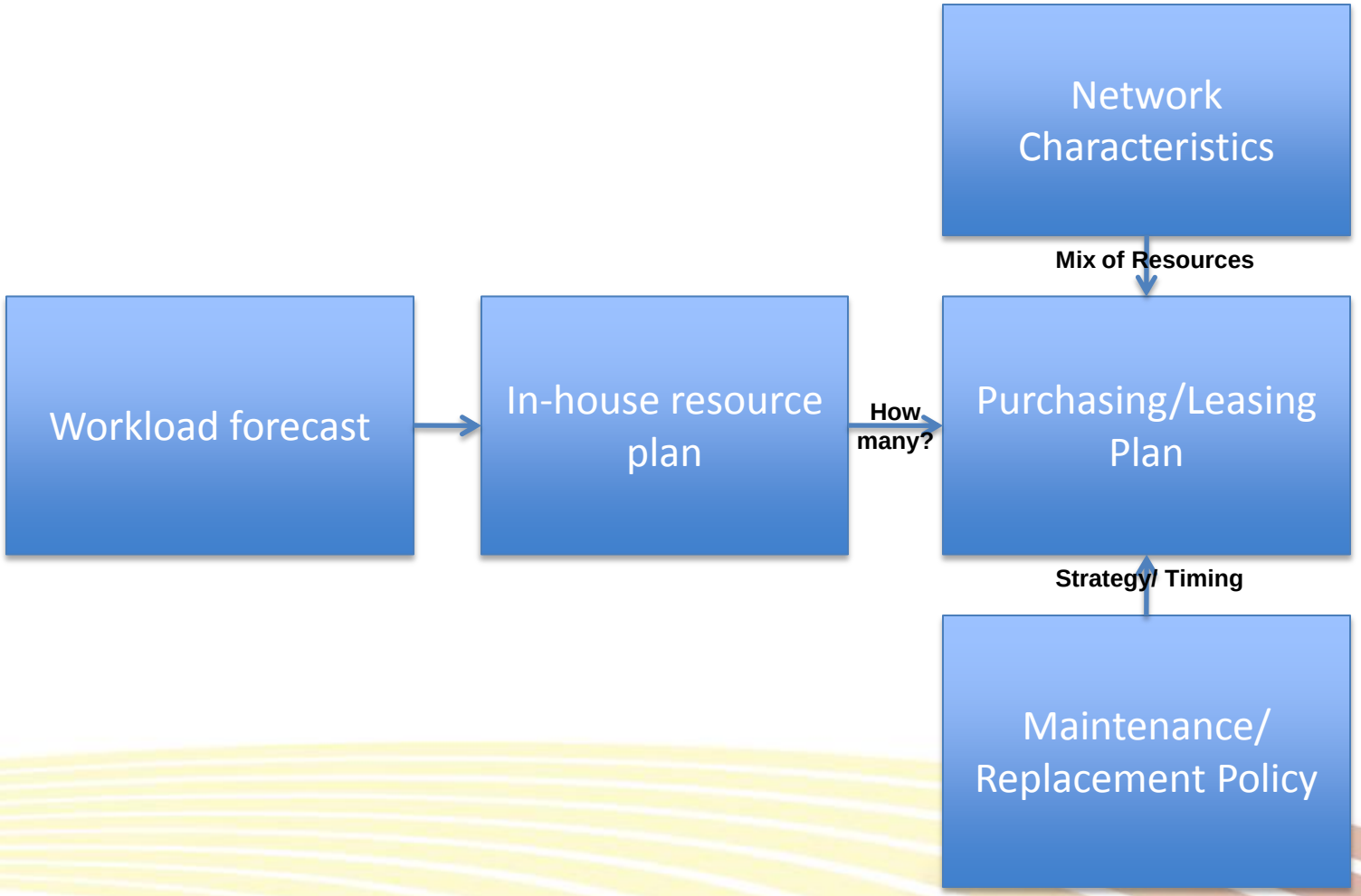
- DPCR5 treatment:
  - Non-op capex assessed using a 10 year average (DPCR4 + DPCR5 forecast) added into analysis of relevant cost categories
  - Vehicles & Transport (opex + capex) and Small Tools & Equipment capex were apportioned across the Network Investment and NOCs cost categories
  - IT and Property non-op capex assessed as part of the Expert Reviews

Questions for RIIO-ED1 assessment

- Do we continue to apportion relevant non-op capex costs into Directs?
  - Does this help/hinder assessment of non-op Capex and/or those Direct categories?
- Can we devise a sensible framework for assessing non-op capex in its own right?
- For which categories, if any, do we need to consider non-op capex alongside the corresponding opex category?

- How do we deal with non-op capex driven by new/changing requirements:
  - Smart Metering
  - Smart Grids

Non-op Capex: Work-related (V&T, STE)



Non-op Capex – Work-related

- Simple efficiency metric: $\frac{\text{Average expenditure}}{\text{No of direct FTEs}}$
- Comparison of metric: history vs forecast
- For V&T, require companies to provide lease costs to allow comparison against purchases

- A cost efficiency measure can only be an indicator of efficiency - Is there a requirement for a qualitative comparison?
  - replacement frequency/provision of vehicles or equipment: is this not already reflected within the cost forecast?
  - Mix of fleet/spec of vehicles: may require closer attention to detail in the business plan.

Non-op Capex – IT/Telecoms & Property

- For business-as-usual:
  - Scope for use of indicative efficiency metrics
  - Any investment proposals laid out in business plan
  - Benchmark as part of expert review of corresponding opex costs

Non-op Capex – ‘Smart’-related

- For investment related to new business functions (Smart Metering/Smart grids in particular):
  - Proposals including full cost/benefit analysis required within Business plan

Summary

- Benchmark non-op capex with its corresponding opex category
- Use of simple efficiency metric as an indicator
- Integrate with expert review where possible
- Link to workload proposals within business plan to make case for expenditure

BUSINESS SUPPORT

Benchmarking Business Support

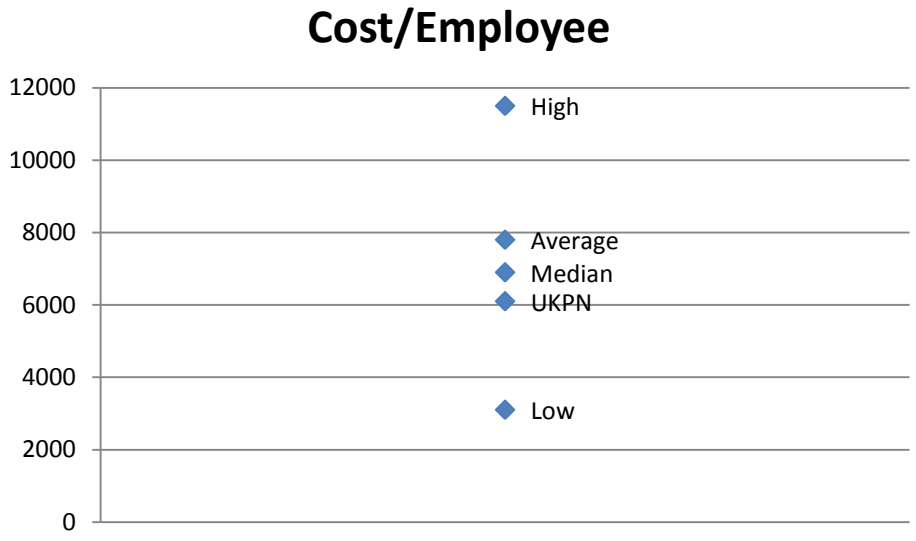
- We recognise that Ofgem will apply various techniques to benchmark our proposed Business Support costs
- Equally, there is an obligation on us demonstrate that our ED1 proposals are efficient
- How do we do that, in a way that is complementary to Ofgem's analysis

Business-as-Usual

- Commission external benchmarking against comparable organisations
- Third party to undertake benchmarking:
  - Provides access to external benchmark data – utility and other sectors
  - Better positioned to enable consistency of comparisons
  - Ensures objectivity and assurance of quality

Scope of review for Business-as-Usual activity

- Use of simple metrics to give a number of views, e.g. for each category –
  - cost/FTE,
  - cost/Customers,
  - cost/Total Revenue,
  - cost/Scale,
  - cost/Workload etc



- Complemented by specialist benchmarks where appropriate
- Qualitative review of:
  - Scope of function
  - Approach to managing cost e.g. evidence of market testing
  - Proposed efficiency improvements

New activities/investments

- Proposals including full cost/benefit analysis required within Business plan
- Probable cross-reference back to areas such as non-op Capex
- Use third party if appropriate to review scope, cost/benefits etc

WORKFORCE RENEWAL

Workforce Renewal

- Three strands:
  - Replacing the ageing workforce
  - Up-skilling the workforce
  - Re-skilling the workforce for ED1 and beyond

- Is it possible to define an Output?

Ageing Workforce

Proposal:

- Managing the risk associated with retirement
- For each of craftsmen, engineers and non-engineers, as defined under RIGs–
  - Identify average ‘man-years to retirement’ based on a notional standard retirement age
  - Create a weighted average ‘man years to retirement’ incorporating all 3 categories
  - Identify target ‘man years to retirement’ for end of ED1

The Ageing Workforce

Proportion of relevant workforce	Role	Average time to 'standard retirement age'	
50%	Craftsmen	20	Assumption re notional 'Standard Retirement Age'
30%	Engineers	15	
20%	Non-engineering	25	

Weighted average: 19.5 years to standard retirement age
Example Output Target: Maintain this average over ED1

Allowance based on assumed cost to recruit so as to deliver target
Questions:

- Is this too simplistic?
- Could averaging mask the problem of under represented age groups?

Up-skilling Workforce

- Requirement to manage the mix of skills amongst direct workforce
- Can we adopt a similar principle?
  - Baseline set by numbers of staff at each NVQ level
  - Output target set in relation to baseline e.g. maintaining/changing mix of skills levels during ED1

Re-skilling Workforce

Options:

- Separate training allowance based on skills training requirements being developed by EU Skills
  - An index based on roll-out of recognised training

- Do we simply include within any cost/benefit analysis for Smart?
  - Very rapidly, there will be a requirement to roll-out training to the wider workforce – potential to complicate analysis

An output for Workforce Renewal

Open Question:

- Whilst UKPN strongly supports the principle of output-led regulation, isn't this all too complicated ?
- An ex-ante allowance based on case made by companies in their business plan – a more pragmatic approach?