

Base Emergency Costs

Funding consistent outputs

Setting a suitable allowance for GDN emergency services necessitates a balance between strong incentives for ongoing efficiency improvements and sufficient funding to deliver the licence condition. The process must draw upon **all** the experience gained in operating the emergency service, meeting standards and without alternative metering filler work. The benchmark funding assessment will only be equitable if the **all** the evidence is understood, recognised and applied consistently in the analysis. The following sections review the historic costs and business plan forecasts, drawing upon the evidence of Ofgem's review of winter 2010/11 emergency standards and the proposals made by individual GDNs.

In summary the conclusions are as follows:

- The **experience of GDNs** in meeting emergency standards is a **crucial** and valuable piece of evidence. Ultimately more valuable than the experience of operating without metering and failing standards.
- The need for an upward adjustment to costs when standards are failed is recognised. However the **adjustment must be credible**, verified independently where possible and reflect the scale of the standard gap.
- **Base emergency costs and stranded labour costs are inseparable**. More efficient delivery will result in higher stranded costs, lower efficiency reduces the stranding proportion – the total costs are unchanged.
- **Benchmarking** Base costs and Stranded costs **separately is 'cherry picking'**.
- Upon making a reasonable adjustment for failed standards **there is very little difference between GDN proposals** – this must be recognised in emergency allowances.

Based on these conclusions the following recommendations are made:

- Adjust 2010/11 Emergency costs in those networks not achieving licence standards as follows:
 - NGN £2.7m
 - NW £2.7m
 - Lon £0.4m
 - EoE £1.1m
 - WM £0.5m
- Use this 'total' cost to inform the upward adjustment required for all historic and forecast years.
- Run the cost assessment on the total base + stranded cost.

Introduction

The Initial Proposals document, 27th July 2012, raised issues over whether a GDN can predict the base funding requirements for an ongoing emergency service in the absence of alternative metering contract when it has not experienced such a scenario. This has led to the adopting of a NGN base funding value as the benchmark for stranded labour across the industry.

The following sections demonstrate why the approach in the IP document only considers half of the resourcing issues raised and suggests a pragmatic solution to enable a balanced and comprehensive outcome.

Base emergency resources – choosing a suitable benchmark

The proposed approach in the July Initial Proposal document is to use Northern Gas Networks as a benchmark for the level of unproductive labour created by the loss of alternative workload (e.g. metering contracts). An upward adjustment of £0.75m is proposed to represent the increase in the base emergency costs required to discharge the emergency standard. A further £0.9m normalisation is purported to reflect the stranded labour which can not be absorbed into other GDN activities. Using this, base level of emergency service provision has been evaluated and a GD1 allowance set.

Similarly, the remaining seven GDNs have proposed different levels of net unproductive labour costs under the scenario of no alternative metering activity. However the alternative stranded labour costs have not been used to set the final allowance on the grounds that none of these GDNs have experience of operating a 24/7 emergency service without concurrent metering contracts.

There is a material difference between the levels of stranded labour costs per PRE proposed by all GDNs. NGN have proposed the lowest £ / PRE at c. £8 per job, NGGD the highest at c. £44 per job.

The decision made in the IP document is to use the lowest forecast as it is the only data point which represents the experience of a GDN providing an emergency service while retaining minimum alternative metering activity. Benchmarking is performed separately for Base costs and Stranding.

However this is an inconsistent assumption. It fails to recognise that the benchmarking GDN has not demonstrated it can deliver the emergency standard output in all operating conditions; it does not have the experience of resourcing to achieve this outcome. Therefore it is unable to state what additional resources are required to meet standards in all circumstances; it has not successfully achieved such an outcome. It can not possess the operating knowledge otherwise it would have been able to avoid the failure. Crucial to setting emergency service funding is the expenditure level required to meet even the most testing operating conditions.

Lessons learned of the difficult operating conditions experienced in winters 2009/10 and 2010/11 are that the resourcing requirements are not only driven by sharp increases in volume but also the job accessibility experienced by the emergency engineers in conditions of prolonged snow cover and cold. It has been suggested that the GDNs that failed standard in 2010/11 did so because they could not mobilise their labour to cover the entire network. (*Decision of Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into the failure by XXX GDN to comply with standard special condition D1- paragraph 2(g) of its gas transporter's licence, pp. 3, 3.4).*

Operating conditions were recognised as not being a reasonable justification for failure. The standard required of GDNs, contained within each licence, is 97% with no allowance for force majeure, it is an absolute standard. (*Decision of Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into the failure by XXX GDN to comply with standard special condition D1- paragraph 2(g) of its gas transporter's licence, pp. 2, 2.3*). As indicated in Ofgem's review of standard failures during 2010/11 one finding was that GDNs had not made preparation to resource up to the level required to meet such extreme conditions.

It is this experience in planning and provision of resources that three of the UK GDNs can and have provided in their business plan submissions, WWU, Sc and So. These are the only GDNs to meet the absolute emergency standard for all years since GDN sale. All three suffered from the same conditions, evidence is that Scotland may have suffered most of all GDNs and for two consecutive years.

Selecting the lowest stranding cost as the single reference benchmark regardless of performance implies the following:

- experience operating a network without associated meterwork – **of value**
- experience of operating an emergency service under the harshest of winters – **of no value**

This is the inconsistent nature of the IP assumptions. To state that the benchmark should represent experience of one operating condition, loss of metering, but ignore a second more important quality, resourcing to deliver standards, invalidates the benchmark.

Conclusion 1) Extrapolation of historic performance must reflect the full experience of all GDNs, those with minimal metering workload and those with experience in resourcing their network to deliver consistent standard.

Adjusting for a fully funded emergency service

Recognising that a Network which has not achieved minimum standards does not provide an appropriate benchmark for the model GDN an adjustment can be made to reported costs to reflect the additional investment necessary to deliver minimum standards. This raises the question, what upward adjustment is reasonable and reflective of the incremental costs required?

The adjustment proposed is a one off increase of £0.75m in the year of failure. A conclusion of Ofgem's Authority review of SSC D10 was that GDNs which failed standard had failed to make sufficient preparation to enable them to respond to potential difficult operating conditions. The key is that the resource planning is recognised as essential in advance of the potential event, i.e. before actual conditions are known for certain. GDNs are required to commit resources in advance, whether ultimately they will be required or not. This has a direct implication through higher base emergency costs and increased stranded labour. This applies each and every year for all circumstances.

This was noted within the review of 2010/11 performance when Ofgem recognised that even though the conditions were harsh across the UK, some GDNs had made the investment and could accommodate conditions which were in some instances more extreme.

This differentiates the individual proposals by GDNs. There remain 3 GDNs; WWU, Sc and So, which provided sufficient resourcing to meet the absolute emergency standard while coping with the worst operating conditions. Adjustments to remaining Networks' expenditure should be evaluated with reference to the additional costs these GDNs had to incur to enable standards to be met. While the full annualised resource impact is masked by the continued presence of existing metering contracts absorbing stranded labour in the summer these entities have demonstrated in their submissions what residual stranded labour will endure into GD1. This they are able to do as they understand the need for available resources once metering contracts are lost and the implications on increased stranded labour.

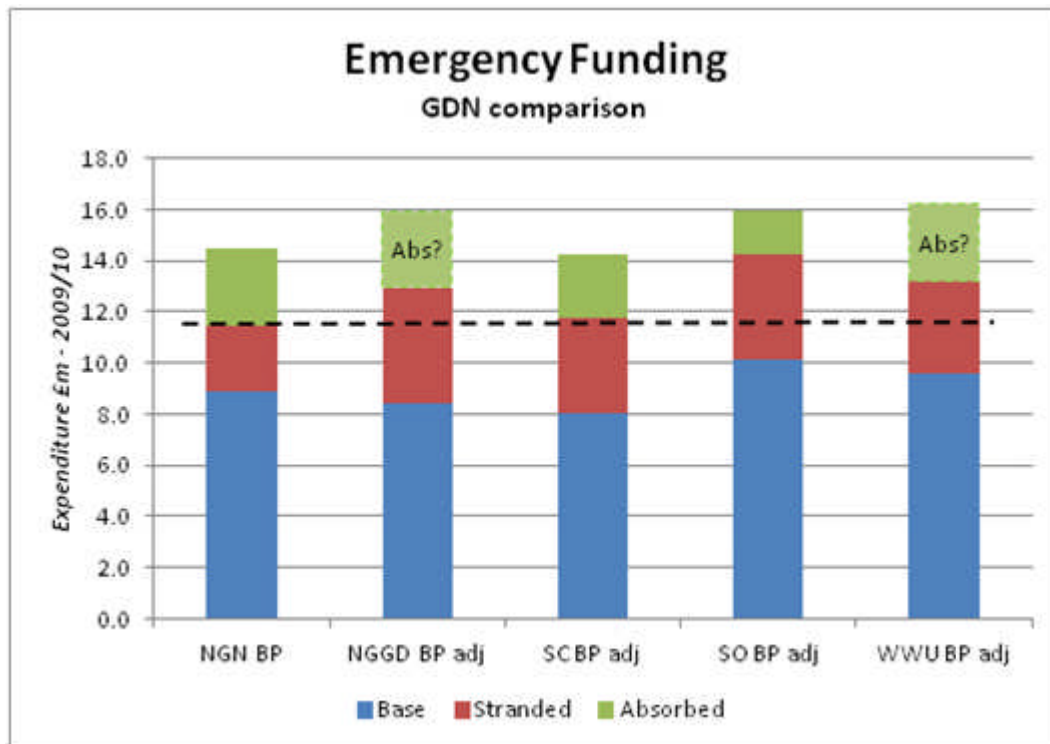
It is possible to contrast the proposals of those GDNs which have met emergency standards with those that have not.

	NGN		NGGD - average			Sc			So			WWU		
	2010/11 act	Base Apr BP	2010/11 act	Base Apr BP	wrk adj	2010/11 act	Base Apr BP	wrk adj	2010/11 act	Base Apr BP	wrk adj	2010/11 act	Base Apr BP	wrk adj
PREs	120,553	120,619	124,249	119,587		104,085	108,087		191,191	194,913		107,584	113,919	
FTEs - 2012		225.5		264.8	248		225.0	250		452.0	280.2		198.0	220.0
avg £k/FTE		£57.0		£57.0	£57.0		£57.0	£57.0		£57.0	£57.0		£57.0	£57.0
£m - labour base	£0.0	£12.9	£0.0	£15.1	£14.2	£0.0	£12.8	£14.2	£0.0	£25.8	£16.0	£0.0	£11.3	£12.5
£m														
Base	7.8	8.9	11.7	9.0	8.4	7.4	7.3	8.1	16.4	16.4	10.2	9.7	8.7	9.6
Stranded lab	0.9	0.9	2.4	3.6	3.4	3.4	3.4	3.7	6.6	6.6	4.1	3.2	3.2	3.6
Emergency service	8.7	9.8	14.1	12.6	11.8	10.7	10.6	11.8	23.0	23.0	14.3	12.9	11.9	13.2
Implied absorbtion	3.1	3.1	not shown separately			2.2	2.2	2.4	2.8	2.8	1.7	not shown separately		
	11.8	12.9	14.1	12.6	11.8	12.9	12.8	14.2	25.8	25.8	16.0	12.9	11.9	13.2
Gap in Standard	5%		2%			0%			0%			0%		
Eqv workload	5,859		2,544			0			0			0		
FTE required:														
5 jobs / day	39		17			0			0			0		
3 jobs / day	65		28			0			0			0		
FTE Costs (26% abs'd)														
3 jobs / day - £m	£2.7		£1.2			£0.0			£0.0			£0.0		
£m - adjustment	2.7	1.7	1.2	1.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Emerg resource total	14.5	14.5	15.3	13.8	13.0	12.9	12.8	14.2	25.8	25.8	16.0	12.9	11.9	13.2
Base	7.8	8.9	11.7	9.0	8.4	7.4	7.3	8.1	16.4	16.4	10.2	9.7	8.7	9.6
Stranded lab	3.6	2.6	3.6	4.8	4.5	3.4	3.4	3.7	6.6	6.6	4.1	3.2	3.2	3.6
Emergency service	11.4	11.5	15.3	13.8	13.0	10.7	10.6	11.8	23.0	23.0	14.3	12.9	11.9	13.2
Implied absorbtion	3.1	3.1	0.0	0.0	0.0	2.2	2.2	2.4	2.8	2.8	1.7	0.0	0.0	0.0
	14.5	14.5	15.3	13.8	13.0	12.9	12.8	14.2	25.8	25.8	16.0	12.9	11.9	13.2

* prior to adjustments for sparsity and labour GDN differentials

The above analysis shows the derivation of a reasonable upward adjustment to 2010/11 expenditure to reflect the additional resources which would have been required to avoid the winter 2010/11 gap in performance incurred in 1 month harsh operating conditions. It assumes that of the additional resources required a similar proportion can be absorbed into non emergency activities (26%).

This sets a 'total cost' for the emergency service. This total cost is used to derive an upward adjustment for all periods historic and future, e.g. £2.7m in base year of which £0.9m already recognised giving an annual adjustment of £1.7m.



Note: workload adjusted BP, base year determined by steady state stranded labour, 2009/10 prices.

Workload adjusting the other GDNs (Sc, So and WWU) provide a comparison of ‘total emergency’ costs. **Note:** this is prior to all adjustments for Sparsity and labour costs. Applying these will close any remaining gap.

Upward Adjustment – 2010/11

The one of additional £0.75m allowed for the costs not incurred by GDNs failing standards. This adjustment represents 13 FTEs on an annual basis. This has been derived using the estimates of two GDN groups, NGN and NGGD.

NGN proposed £0.4m p.a.

This equates to approximately 7 FTE p.a. (@£57k per FTE). The standard was failed by c. 5,900 jobs in 2010/11 during the month of December. A check for credibility suggests the £0.4m is an unrealistic estimate. Preventing 5,800 failures in one month at 200 jobs per day requires a considerable resource commitment. The prevailing issue during this time was travel constraints. Therefore allowing a reduced average job / FTE / day of 3 would imply an additional 65 FTEs would be required during the winter period to cover this peak and allow for the potential for further peaks during the November to March period.

Assuming absorption of stranded labour during the summer can continue in line with NGN’s base proposal of £3.1m / £12.9m then approximately 26% of this additional cost will be offset. The total cost of 65 FTEs annually is c. £3.7m. This implies an additional cost of £2.7m p.a. This is significantly adrift from the £0.4m proposed.

NGGD proposed £1.0m p.a.

This equates to approximately 18 FTE p.a. (@£57k per FTE). The standard was failed by an average 2% (4.3% NW and 0.7% Lon) c. 2,500 jobs in 2010/11 on an average NGGD GDN. A check for credibility suggests the £1.0m is a more realistic estimate. Preventing 2,500 failures in one month at 85 jobs per day again requires a material resource commitment. Allowing the reduced average job / FTE / day of 3 would imply an additional 28 FTEs would be required during the winter period to cover this peak and allow for the potential for further peaks during the November to March period.

Assuming absorption of stranded labour during the summer can continue in line with NGN's base proposal of 26% then the total impact on emergency costs is £1.2m p.a. This is very similar to the £1.0m proposed.

Enduring impact

On experiencing falling standards, not only does a GDN require sufficient resources to preserve the standard it will also require increased resourcing after the difficult period to ensure that all jobs are met within the standard. This enduring resource commitment, as experienced in Scotland in the last quarters of 2009/10 and 2010/11, has the effect of preventing the labour from returning other work, if available.

Conclusion 2) For the reasons stated above it is essential that the total emergency operating cost of a GDN must be credible in light of the experience of all GDNs, in particular those achieving standards.

Conclusion 3) Comparison of both GDN group proposals with their respective gap in standards suggests the independent analysis and the NGGD proposal are more closely aligned. The NGN proposal, £0.4m, materially under forecasts the total additional resource required.