



Strategy consultation for the RIIO-ED1 electricity distribution price control

Submission by Prospect to Ofgem

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Introduction

Prospect represents over 120,000 engineers, scientists, technical specialists and managers across the public and private sectors, being the union of choice in the UK for managerial and professional employees. For a hundred years, Prospect, and its predecessor unions, has represented managers and engineers in the electricity supply industry: thus we have a unique insight into the challenges and opportunities stemming from the need to re-wire Great Britain as technology develops in response to the economic, environmental and engineering challenges facing Distribution Network Operators (DNOs).

We believe that the need to maintain and improve efficient electricity distribution networks is a challenge that will fully engage the technical excellence, professional judgment and determined commitment of the engineers and other professional staff we represent.

If the RIIO process delivers the financial incentives and revenue to encourage sufficient innovation and investment to meet the triple challenges of:

- Technical excellence in an evolving industry required to improve reliability and efficiency;
- Improved customer service to reflect the vital role of electricity to modern consumers and businesses; and
- Maintaining excellent health and safety standards in an inherently hazardous industry;

then the change in regulation will be seen to be a success.

If it does not, then the nation faces a loss of economic competitiveness and a higher environment impact as a key part of the nation's infrastructure fails to deliver an effective service.

From our long experience of the sector, electricity distribution depends upon the commitment and expertise of its staff; to maintain and improve this Prospect wishes to see a combination of revenue and incentives to deliver the three following goals for staff:

- High health and safety standards;
- Excellent professional training to boost innovation and technical excellence; and
- Sufficient revenue to enable the maintenance of a competitive remuneration package, including pensions, for professional staff with scarce technical skills.

This submission responds to the issues highlighted by Ofgem in the consultation document.

Chapter 3 Incorporating stakeholders views

We have no significant objections to the proposals used by Ofgem so long as DNO employees and their representatives are recognised as legitimate stakeholders who should be consulted formally about change within the industry. Given the wish of Ofgem to set rates of return at below 7.2%, there is a need to clarify the ability of Ofgem to modify licences without consent and the appeal process: we believe that investor concern about the risk of arbitrary regulatory decisions has increased the perception of risk and has inhibited investment, including investment in the recruitment and training of staff in the sector.

Chapter 4: Form and structure of the price control

We have no comment on this issue

Chapter 5: Output Delivery

We support a move from focusing on cost reduction which has in the past led to excessive reductions in employee headcount, an unjustified drive to reduce remuneration for employees in the sector and a bias towards capital investment over operational expenditure. The shift to outputs allows DNOs to adopt best engineering practice to ensure reliability, improve safety and reduce costs. We believe that in this sector there is an inherent link between long-term safety and reliability.

We are disappointed that Ofgem does not see the need to reward companies for long-term safety improvements: especially as the high safety standards in the sector and the catastrophic nature of process safety failures means that merely compliance with health and safety law allied to low-frequency HSE enforcement activity is a blunt instrument for ensuring safety in the industry. Safety failures have a significant impact on customer service and long-term costs with safety performance being a significant leading indicator of network health. Whilst we are fortunate to have senior management commitment to improving safety and a strong safety culture, it is regrettable that Ofgem sees no need to reward companies for strong safety performance.

On a technical point, recent changes in RIDDOR will reduce the level of reporting and we would wish to see a more detailed safety assessment set for this indicator by using a more detailed measure such as the OSHA measure used by some companies. We suggest that the safety measure be agreed by the industry subject to Ofgem approval.

Whilst we support the integration of safety into the leading indicator measures to be used to determine network health and see this as an improvement, we would wish to discuss this issue at greater length with Ofgem to understand how this process will work: we still believe that an explicit link to safety performance is a strong measure of operational efficiency and thus a safety performance financial incentive would be appropriate.

Whilst we recognise the importance of customer service, we believe that a more consistent measure is required and still believe that customer satisfaction is highly dependent upon reducing customer minutes lost and customer interruptions. Thus Ofgem needs to ensure that there is an appropriate balance between the two sets of incentives for customer service and reliability as we believe that it would be unhelpful to incentivise DNOs more to manage customer disconnect with supply interruptions than to avoid the interruption in the first place.

Chapter 6: Assessing efficient costs

Although we believe that the approach of assessing business plans as a whole is appropriate, we are concerned about the treatment of salaries, pensions and training costs.

Prospect negotiates salaries and other employment conditions with all the DNOs and these are robust negotiations informed by a range of factors including benchmarking and agreeing incentives for improving individual and team performance in line with company strategy. We are concerned that the crude use of salary benchmarking would remove the incentive for DNOs and their staff to innovate by creating a culture where the regulator disapproved of trading higher salary increases for efficiency gains and subjected this to higher scrutiny than pay levels near the benchmark. Over the past twenty years, Ofgem has avoided being involved in salary negotiations and we believe that the use of benchmarking should be constrained to avoid this occurring over the ED1 review period.

We are concerned that in the transmission review it appeared that Ofgem used unrealistically low estimates of salary growth for professional staff with scarce skills being asked to increase their levels of responsibility. Therefore we seek further discussion with Ofgem over projections of salary growth so we can share our expert knowledge of professional and managerial salaries within the utility sector. This is particularly important given the need for the industry to recruit new staff and upskill existing staff to deal with higher work levels and greater levels of technical innovation. In the past we believe that Ofgem has exceeded its remit by favouring capital expenditure and increased use of contractors whilst subjecting operating costs to tighter scrutiny and questioning headcount and salary levels, as part of that process.

Given the need to dramatically increase recruitment within the industry, we support the continuation of a training allowance ring-fenced solely for training since the benefits of training are medium to long term and may not be fully realised within the extended price control period.

Chapter 7: Innovation

Innovation is vital to achieve the economic, environmental and engineering challenges ahead and thus we support the combination of competition and fixed allowances to support innovation and experimentation within the sector.

Chapter 8: Managing uncertainty

We agree with the general approach but are concerned about the treatment of historic pension deficits: the provision of high quality pensions has had a beneficial impact for consumers as it has reduced turnover of expert staff and lowered general salary levels in a highly competitive labour market. We would wish to discuss the treatment of pensions further with Ofgem as this has a substantial impact in staff commitment and the attractiveness of the sector.

Chapter 9: Financial issues

We are concerned about the proposals to extend the asset life of the network for new asset from 20 to 45 years as the ability of assets to operate efficiently for this lifespan is dependent upon maintenance and other aspects of good asset management. Whilst this lifespan is possible, Ofgem needs to recognise that this requires investment in maintenance and engineering expertise that we believe was discouraged in previous price controls. Therefore we would wish to see that the longer asset life was matched by a more sophisticated analysis of asset management costs, including maintenance, and by an approach to professional salaries that recognised the need to build up engineering expertise and encourage continued professional development. To achieve this, we believe that clarity over the treatment of training and pensions is necessary.

With regard to rates of return, we are concerned that too low a rate of return would deter investment in the sector to the detriment of consumers and staff. We believe that there is still concern that imprecise regulation and over-stringent cost control will increase perceptions of risk and thus raise the required rate of return for new investment in the networks. This is a particular concern over the development of Smart Grids and thus we would wish to see the entire package of incentives and allowed rates of return encourage further innovation and investment in staff.

Summary

We believe that there are significant issues to be addressed in respect of:

- Safety
- Staff costs
- Training
- Pensions
- Extending asset lifespans

Therefore we would welcome an early meeting with Ofgem to discuss the concerns of the professional and managerial staff we represent in DNOs