



## **RIIO-ED1: Draft Determinations for the slow-track electricity distribution companies**

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Submission by Prospect to Ofgem

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## Introduction

1. Prospect is an independent, thriving and forward-looking trade union that represents over 113,000 professional employees: managers, engineers, scientists and professional specialists in both the public and private sectors. In the electricity supply industry, Prospect represents managers, engineers and other professional staff. We are a major stakeholder in the industry, providing advice based on the technical and managerial expertise of our members. We work constructively with a range of employers in distribution, both DNOs and contractors, to seek improvements in training, health and safety, and employment conditions so the industry remains an employer of choice whilst providing a reliable essential service to the public.
2. We have contributed to all distribution price control reviews and place a high value on Ofgem dealing with unions as stakeholders and critical friends of the electricity supply industry. Whilst we have welcomed the greater involvement of unions in the consultation process by individual companies, we feel that our contribution to the overall process has been reduced as Ofgem has relied on communication with individual DNOs as a substitute for direct consultation with stakeholders.
3. Prospect's comments on this document relate to the five following areas:
  - The balance between long-term investment and short-term costs;
  - The uncertainty over the benefits of smart metering and smart grids;
  - The assessment of safety costs;
  - The future of training;
  - The future trends in labour costs;
4. Electricity distribution is an essential public service as reliable electricity supplies are a key part of modern life. Given the wish to rebalance the economy, continued investment in the electricity distribution networks is essential if Great Britain is to continue to remain an attractive environment for business investment. With minimal spare generation capacity and increased reliance on intermittent renewable generation, we expect distribution networks to meet higher standards of performance if we are to make best use of available generation.
5. Whilst we support the use of incentives to reward DNOs who invest in technology, systems and people and deliver better outputs for customers, we believe that the current RIIO process is not clear and that the views of stakeholders other than DNOs are given little weight in the process. It is difficult to see how Ofgem's control of prices links to Government energy policy and the benefits of a distinction between fast-track and slow-track assessment are not clear.
6. Too tight control of distribution investment runs the risk of increasing both the risk of disruptions to supply and the cost of electricity as consumers and electricity suppliers make additional investment to respond to distribution constraints. We are concerned that Ofgem focuses too closely on the short-term cost of distribution without considering the wider electricity market and the long-term needs of customers.
7. We believe that the overoptimistic assessment of the immediate benefits of smart metering introduce further risk into the distribution sector, deterring necessary investment. The review mechanism if smart metering does not deliver the projected benefits is obscure. The level of innovation spending set by Ofgem at a time of dramatic change in generation is also unduly conservative.

8. We have consistently sought clarification of Ofgem's approach to safety over the past twenty years with little success. Whilst we welcome a shift from a refusal to discuss the issue, we do not believe that the impact of safety in an inherently hazardous industry is given full consideration. Whilst quite rightly the document points to measures that improve the safety of assets, this is undermined by the significant reduction in investment from the realistic levels proposed in business plans. We are also concerned that Ofgem's views on staff costs create pressure to reduce the level of skills in the industry at a time of significant technological change without any discussion with the representatives of staff in the industry.
9. Given the age profile in the industry, substantial recruitment is required to maintain staff numbers and skills before taking account of changes in the operation of systems as we shift from passive to active networks. In these circumstances, we are disappointed that Ofgem have abolished any specific allowance for staff training at the same time that BIS has recognised the power sector's valuable work in training.
10. The proposals on staff costs do not seem credible. Given the general wish of Government to reverse the real wage decreases in the wider economy as we move out of recession and the severe skill shortages for the key technical and engineering skills used by most staff in the sector, the assumptions set out in Chapter 12 of the expenditure document are misleading.

### **The balance between long-term investment and short-term costs**

11. The distribution sector has suffered from a long-term deferral of investment as a consequence of regulation seeking to reduce costs. Naively we believed that the RIIO process would resolve this. Despite Government support for major infrastructure improvements across the economy, these proposals seem more focussed on reducing costs marginally rather than improving the quality of this vital infrastructure.
12. As stakeholders rather than owners of DNOs, we cannot assess whether the proposed incentives address this adequately. The incentives is not transparent and thus it is unclear how far the proposed incentives will encourage investment in staff and systems that will be used beyond 2023. We believe that this uncertainty is major cause of continued regulatory risk in the sector which increase perceptions of investment risk.

### **The benefits of smart metering and smart grids**

13. In particular, Ofgem's decision to decrease the need for system reinforcement by taking a significantly more optimistic assessment of the impact of smart metering and smart grid technology than the DNOs introduces a higher level of risk. Whilst smart technology does allow significant savings, DNOs do not have control over the connection of intermittent renewable generation to the distribution network that can increase the need for capacity. We are concerned because the review process for RIIO-ED1 does not seem to allow for adjustments if the benefits of smart technology meet the lower expectations of the DNOs.
14. Low levels of innovation funding are a major problem for UK industry, causing long-term harm to consumers. We had hoped that the shift to RIIO would address this issue. With innovation funding restricted to between 0.5% and 0.7% of turnover, we are sceptical about the pace of technological change that can deliver the additional 10% cut in investment Ofgem believes appropriate. This is an example of the gap between DECC and Ofgem where decisions made by the regulator constrain the development of energy policy after 2015's general election.

### **Safety**

15. We are disappointed about the low priority given to safety in the document. Given the nature of UK safety legislation, compliance with safety regulations is not a simple matter of following certain prescribed rules but more one of operating safe management system.

16. The industry has an admirable safety record by aiming for more than mere compliance: however individuals still only have a 95% chance of completing career in the industry without accident or harm to their health. Whilst there is a long-term benefit from investment in the health of assets, this does not appear to have been considered in Ofgem's proposals.

## **Training**

17. The distribution sector has undergone dramatic change since privatisation with significant improvements in system reliability and efficiency. The commitment of our members, and other staff, to providing safe, reliable electricity supplies is without doubt and this was recognised by the Energy and Climate Change Select Committee in its investigation into the winter storms. This level of service requires adequate funding of training and salaries.
18. The need to significantly increase training investment was recognised in DPCR5 by a specific allowance; we are disappointed that this has been withdrawn and finance for the sector as a whole reduced. We are concerned that Ofgem seem to want to improve service, reduce costs and reduce investment in training. Whilst it is possible that the incentive processes provide a benefit for further training, this is not clear in the document. Our fear is that a £3 billion reduction in investment over eight years will reduce training to the long-term detriment of consumers. As with salary costs, we believe that Ofgem should have consulted unions on this issue as part of the regulatory review.

## **Salary Costs**

19. We believe that DNOs must pay competitive salaries that reward staff for effective performance and efficiency if they are to operate efficiently in consumer interests. As we have previously remarked, *'High quality training and excellent health and safety management are vital parts of an employment package required to meet the six primary outputs identified in Ofgem's Overview of the Strategy decision for the RIIO-ED1 electricity distribution price control document published in March 2013.'*<sup>1</sup> Ofgem have chosen not to respond to these comments.
20. Across the DNOs, up to 2010, constraints on the funding of training restricted recruitment, especially that of highly trained and flexible engineers, which has resulted in severe skills shortages and a distorted age structure in electricity distribution with a substantial proportion of staff due to retire over the next decade. Consequently, the cost of contractors has soared in response to demand and without significant recruitment and training, there is a high risk that long-term costs will increase by substantially more than the rate of inflation. Ofgem's response has been to reduce investment projections and to argue that specialist salaries will not increase in line with inflation.
21. This assumption is not supported as skill shortages have led to matched individual salaries retaining their real value over six years when general salaries have fallen in real terms.
22. The current skills shortage is expected to continue for the remainder of the current decade and into the mid-2020s. DNOs require staff with scarce and highly marketable scientific and engineering skills if they are to provide the high-quality service expected by Ofgem if licence holders are to secure competitive rates of return. There is a long-term shortage of school-leavers and undergraduates with the necessary academic qualifications to start training now, it would take these individuals five to nine years to become fully effective operational engineers.

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<sup>1</sup> Ofgem document 26/13 identified the six primary outputs as Safety, Environment, Customer Satisfaction, Connections, Social Obligations, Reliability and Availability  
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23. Moreover other buoyant parts of the economy such as aerospace, railways and the City also compete for these rare skills so remuneration for specialist staff is expected to raise more quickly than for the economy as a whole. Also as the industry has changed, there has been a significant reduction in non-specialist staff numbers, which we believe is more likely to continue as a result of pressure on corporate headquarter costs. Thus we believe that labour market pressures will be substantial and that the expenditure proposals should reflect the significantly higher remuneration costs in the sector compared to the rest of the economy.
24. In addition to recruitment, the increased technical sophistication of distribution systems to meet environmental targets and to satisfy consumer demand requires the up-skilling of existing staff. For example, obtaining the full benefit to consumers of the development of smart metering and the use of information captured by smart meters to create smart grids is dependent upon improving the skills of staff whilst retaining a flexible and professional attitude to work. We believe that upskilling will lead to an increase in individual salaries beyond the increase in salary bands as work shifts to higher skill levels. The cost proposals do not appear to account for this upskilling premium cost.