

# Northern Ireland Electricity – Transmission and distribution price controls 2012-2017

Submission by Prospect to the Utility Regulator for  
Electricity, Gas and Water (Northern Ireland)

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## **Introduction**

1. Prospect is a trade union for professionals throughout the UK. Our members are engineers, scientists, managers and specialists in areas such as defence, energy, environment, heritage, shipbuilding, telecoms and transport. In the energy sector we represent scientists, engineers and other professional and specialist staff in the nuclear and radioactive waste management industries, the wider electricity supply industry and, increasingly, also in the gas industry. We are the largest union in the UK representing professional engineers. Our members are engaged in operational and technical management, research and development, and the establishment and monitoring of safety standards.

2. Prospect views with great concern the Initial Proposals issued by the Utility Regulator for Northern Ireland (UReg) issued in response to Northern Ireland Electricity's (NIE) Price Control Submission, RP5. Whilst respecting the Devolution Settlement, it is worth noting at the outset that Northern Ireland will be affected by Westminster's proposals for electricity market reform (EMR). It is therefore important that the regulatory framework is flexible enough to encourage investment in new plant, new techniques and new skills. The operation of smart grids will be crucial to reducing the carbon intensity of the UK economy. Investment in staff and skills will be crucial to delivering progress.

3. We would emphasise that the regulatory framework should support energy policy objectives and not inhibit them. The regulator should therefore focus more on medium to long-term security of supply and environmental issues, and less on the traditional approach focusing on cost minimisation and asset sweating.

4. In our opinion any expectation that labour costs in particular can be maintained at or below inflation over the next 5-year period is simply unrealistic. This view arises not simply from what may be the conventional expectation that a trade union would seek to raise labour costs to further the interests of their members, but rather because it is contrary to the evidence of the growing recruitment and retention challenge for skilled engineers. We have been contacted by many of our members who already feel that the current salaries offered by NIE are out of step with the rest of the energy sector and are now becoming increasingly disillusioned following the assessment outlined in the Initial Proposals. Securing the skills pipeline is equally as important as securing the right financial framework.

5. We therefore believe the following points should be considered prior to UReg's final determination.

### **Demand for engineering skills**

6. Within the local Northern Ireland market, there has been an increase in the number of companies who require experienced power engineers. The recent market opening has offered the opportunity for energy supply companies to enter the market. Such companies are very keen to secure ex-DNO staff, whose experience is seen as invaluable to secure as much market share as possible. The introduction of smart grid technology within the UK has encouraged electrical engineering companies to enter the marketplace in order to take advantage of the opportunities created for supplying new equipment. One such company, Kelvatec, is actively approaching NIE staff in order to secure their invaluable experience. The imminent

arrival of DONG Energy to the Belfast Harbour estate will create further competition for engineering resources. Indeed a number of our members in NIE have already been approached regarding future employment opportunities. We are also aware that SONI have a requirement for an additional 14 experienced engineering staff. A number of NIE staff have been approached and have subsequently left NIE for SONI.

### **Job security**

7. In the past companies like NIE and other DNOs have been able to retain staff because of the perceived benefits of job security. NIE has always been seen as an area of secure employment and we anticipate that this will remain so. However, despite the economic downturn, the energy sector is experiencing unprecedented levels of demand for skilled resources. Job security is therefore becoming anchored around the employee's skills and experience rather than the company that they work for. There is already evidence within NIE's workforce that this is a factor: some skilled and experienced staff have left the company for relatively short term contracts.

8. Therefore within the energy sector RPI is no longer an appropriate benchmark for the retention of existing staff. In practice, real price effects are already having an impact in the energy sector with many companies offering more attractive packages in order to secure the skills they need. The desire to employ DNO trained staff is becoming increasingly prevalent as it is well recognised that such staff are amongst the best trained within the industry.

### **Regional variations in pay**

9. It has been well documented that, among other regions, the average wage in Northern Ireland is lower than for Great Britain as a whole. However, it would be fallacious to assume that a regional pay approach could or should be applied in this context. Official data confirms that pay varies according to employment sector, age and experience as well as skill level. Research recently undertaken for Prospect by the independent pay analysts at Incomes Data Services confirms that pay for many highly skilled workers is determined by the UK labour market or, in some cases, internationally. Energy companies operate in a world market, with many workers travelling to secure high reward contracts. Conversely, Prospect has evidence in areas where pay is being held down of an inability to recruit skilled engineers.

10. These pressures are already evident in NIE as increasing numbers of highly skilled engineers travel to GB and further afield to secure very attractive contracts. The assumption in UReg's Initial Proposals that salaries within NIE are above the Northern Ireland average is misleading and meaningless. Robust pay comparisons depend on accurate job matching, and any statements that are not transparently based on such evidence should be discounted. We do not believe that objective evidence has been provided and that, unless corrected, the Initial Proposals will impact negatively on NIE's capacity to retain skilled employees in the future.

### **Demand for skills**

11. The UK energy sector is facing a huge challenge with the availability of skilled resources. Some £200bn is required in new energy infrastructure over the coming decade, requiring a doubling of the annual rate of energy investment. The largest network upgrade in over half a century will be facilitated by the considerable uplift

in the Ofgem allowance for infrastructure rebuild during DPCR5. But delivery depends also on companies' ability to source a sufficient and appropriately skilled workforce. Energy and Utility Sector Skills Council has identified evidence of skills shortages and gaps and increasing demand for skilled engineers across the UK, and the National Skills Academy for Power has highlighted the urgency of this challenge, noting that 4 out of 5 employees in the sector is set to retire in the next 15 years. This position is compounded by difficulties in attracting graduate engineers, amidst cross-sectoral competition for their skills, including an estimated £100 billion investment in the off-shore renewable industry by 2020. This competition for resources has required energy companies to review salaries and incentives both for recruitment and retention. It is in this context that we are concerned for NIE and its ability to retain the appropriate skilled resources over the coming years.

### **Pension Costs**

12. We understand that the regulator has a legitimate interest in ensuring that pension costs are managed efficiently. We broadly support the pension principles adopted for this price review. However we have difficulties with the phrasing of the principle that deficits that the company "could not legally avoid" can be recovered; this could be taken to suggest that the company is obliged to minimise all pension costs rather than manage them efficiently. We also have difficulty in understanding what the regulator means by "in order to ensure that electricity consumers do not pay twice". By their nature pension costs are difficult to estimate in advance and that is why deficits or surpluses emerge. That a deficit might emerge in relation to a decision taken in previous price controls does not amount to the consumer paying twice. We urge the regulator to tighten the wording of its pension principles in the final determination.

13. We agree with the determination in relation to ongoing costs.

14. Prospect understands the principle of splitting the deficit across different entities participating in the NIE pension scheme but we have some concerns about the approach used. While allocating the liability for deferred and pensioner members according to the employer at deferment or retirement has the advantage of being a simple approach, it may not be the most accurate method of attributing liabilities across the different entities. We believe that length of service should also be taken into account so that late moves in members' careers do not distort the proportion of liabilities attributed to the regulated business. At a minimum the regulator must at least consider whether this approach would make a material difference to the calculation.

15. We do not agree with the proposal to allow the deficit to be recovered over 15 years. There is no evidence from the regulator that adopting an 11 year recovery period is inefficient. Furthermore there is no evidence that the regulator's preferred approach will reduce costs. Ultimately the regulator is simply redistributing costs between different generations of consumers in adopting this approach. An 11 year recovery plan was agreed between the trustees, the company and the Pension Regulator; there is no reason to undo this work or evidence that doing so would benefit consumers in the long run. If the regulator is minded to influence the choice of recovery period through the price controls then this should apply to future deficit recovery plans rather than retrospectively to plans already agreed.

16. Prospect's greatest concerns about the treatment of pension costs in the draft determination are in relation to the concept of "avoidable deficits". We understand, from analysis of the note prepared by the Government Actuary's Department on 10 April 2012, that this largely relates to (a) past benefit improvements and (b) early retirement costs. These are dealt with separately below.

17. Fundamentally Prospect is of the view that the current deficit arises from current market conditions and developments in demographic assumptions. Past contributions to the pension scheme, above the price control allowances, had ensured that the scheme was not in deficit in the past. That there is a deficit currently, is due to current conditions and it is right for the associated costs to be recovered. If the scheme was currently in surplus then the regulator would not be seeking to revisit decisions made up to 15 years ago. It is only the fact that there is a deficit that gives the regulator this opportunity but the deficit is due to current market conditions and therefore the regulator's approach is inappropriate.

18. As noted in relation to the pension principles above, we are concerned about the regulator's view that electricity consumers are being asked to "pay twice". The cost of pension benefits is uncertain and surpluses or deficits may arise as market conditions change (or for other reasons). What the regulator describes as "avoidable deficit costs" simply do not equate to electricity consumers being asked to "pay twice" as the draft determination implies.

19. A significant proportion of the regulator's "avoidable deficit costs" can be attributed to past decisions to improve benefits in the scheme. We do not think it is appropriate to re-examine decisions taken up to 15 years ago in the current price control period. The draft determination does not consider the circumstances in which those decisions were made. At the time the scheme was in surplus and similar decisions were made by both regulated and unregulated businesses across the UK. In effect the regulator is seeking to retrospectively allocate a surplus that existed some time ago to consumers. Unfortunately that surplus no longer exists. The regulator is also ignoring scheme members' reasonable expectations that their interests would be treated fairly in the use of surplus. We are not aware of other UK regulators seeking to adopt this approach.

20. Another significant element of the regulator's "avoidable deficit costs" is attributable to early retirement costs. The regulator states that these are "legally avoidable or inefficient". We cannot agree. Efficient management of the workforce will sometimes result in the need to make redundancies. It is not appropriate for the regulator to second guess decisions about workforce management many years after they were made. The regulator has not even attempted to show that the redundancy programme was inefficient. These costs were certainly not legally avoidable either as the redundancy benefits applicable are part of the terms and conditions of the relevant workers. That the benefit in some cases resulted in payment from the pension scheme is incidental.