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union for professionals

Draft Determination to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland (SONI)

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. Our members are engaged in operational and technical management, research and development, and the establishment and monitoring of safety standards. We are the largest union in the UK representing professional engineers and the recognised trade union representing employees at SONI.

2. Prospect views with great concern some of the Proposals issued by the Utility Regulator for Northern Ireland in its Draft Determination to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland (SONI).

3. This document constitutes Prospect's formal response to the consultation. The response has been prepared with the assistance of Prospect's Head of Research and Specialist Services and Prospect's Pensions Officer, taking into account the views of Prospect members in SONI.

4. We hope this response is viewed as a constructive attempt to deal with the issues driving the consultation. Prospect officials, including Prospect's Pension Officer, are available to discuss any aspects of the response in more detail if this would be helpful.

Salary / Payroll Controls

5. The proposal from the Utility Regulator to reduce the mean average 2013/14 base salary by 5%, as the benchmark allowance for the 2015/2020 price control period is unnecessarily restrictive. This figure has been calculated from the ASHE (All Employees by Occupation (SOC 4) Annual Pay) Gross Tables. Although ASHE earnings estimates are a useful guide for salary movements they do not provide a suitable benchmark for salary levels for Network Professional Engineers without reference to other salary surveys.

6. There are some particular problems with using ASHE figures as a single reference point. Although the Regulator has focused on certain job roles these will be drawn from a number of different sectors. There is a considerable variation of pay by sector for each of these job roles and so the Regulator cannot be certain that £46k is a suitable comparator for the Utilities sector. This problem is exacerbated by the inclusion of Engineering Professionals and Engineering Professionals n.e.c (not elsewhere classified) in the average, which includes all sectors and therefore is likely to reduce the average as shown in the Table below.

7. The Regulator has not made it clear whether the data includes part time employees. Although only a small proportion of jobs are part time for these SOC codes this will still reduce the average. In the Table below we show the figures for full-time employee jobs, which is likely to be a more representative comparison.

Annual pay - Gross (£) - For full-time employee jobs: United Kingdom, 2014

	Code	Number of jobs (thousands)	Mean average salary
Engineering professionals	212	315	41,959
Electrical engineers	2123	20	47,761
Engineering professionals n.e.c.	2129	120	42,230
IT specialist managers	2133	135	50,200
IT project and programme managers	2134	16	49,126
IT business analysts, architects and systems designers	2135	90	47,034
Total Average			46,385
Average excluding engineering professionals and engineering professionals n.e.c			48,530

8. The Regulator states that the ASHE data is based on gross earnings including bonus pay, however this is slightly misleading. The data is not adjusted to account for changes in the composition of the labour market. The mean average might be affected by an increase in people entering the labour market which would tend to lower pay. There is also some uncertainty about how effective ASHE is at picking up bonus payments.

9. The mean pay level will also be affected by the size of organisation included in the sample. Larger organisations tend to have higher levels of pay than Small and Medium Sized Enterprises.

10. A significant factor that will not be included in the figures presented by ASHE is the additional payments for shift work, standby and call-out payments. This is an important element of pay for those working in the electricity sector when compared with other sectors included in the ASHE sample of job roles.

11. To attract and retain engineers SONI needs a pay structure that is able to reflect pay in the wider labour market. Salaries in the energy sector are higher than elsewhere in the economy as shown in the tables below from Income Data Services and Croner Rewards. The difference in salaries rises to nearly 10% for professional engineers. This is reinforced by the findings from the Engineering Council 2013 Survey of Professionally Registered Engineers and Technicians, which found that basic median pay of engineers in the utilities sector was £55,000 and the mean average was £59,322. The survey also found that the median overtime, bonus and commission payments to professional engineers was an additional £4,000 to £6,000. **This shows that the benchmark salary levels used by SONI are in line with market pay.**

Income Data Services - Pay and conditions in engineering 2015
Average salaries for engineering staff

£ per annum	All Organisations	Utilities Sector	Percentage Difference
Skilled craft worker	26,858	27,685	3.08%
Technician	29,416	29,853	1.49%
Senior Technician	32,054	32,699	2.01%
Qualified Engineer	37,521	40,723	8.53%
Senior Engineer	46,190	49,605	7.39%
Engineering Manager	57,502	61,041	6.15%
Engineering function head	73,301	81,900	11.73%

Croner Technical Rewards 2014 Median Earnings

£ per annum	All Organisations	Energy Sector	Percentage Difference
Rank 6 - Technician	23,362	25,513	9.21%
Rank 5 – Senior Technician	27,564	31,309	13.59%
Rank 4 - Engineer	33,831	34,430	1.77%
Rank 3 – Senior Engineer	39,537	43,212	9.30%
Rank 2 – Department Head	49,789	55,414	11.30%

12. Excepting the cost allowance for the Network Planning Project, what it is proposed that SONI is allowed to spend within the framework over the next five years represents only a 6% increase on what was actually spent in the last five. After allowing for inflation, this means a period of extensive cost reduction which will have a damaging impact on jobs and investment, including in green energy given DETI's 40% renewables target by 2020 (by the end of this five-year framework). This will place considerable pressure on SONI's ability to plan for its future and for the future of transmission across Northern Ireland. It might also be expected to have knock-on effects on Northern Ireland's role in green energy R&D associated with the 'world leading and demanding targets' it has set itself for the production of renewable energy.

13. In the last five years, SONI spent a sum on payroll (including pension) costs that was within the sum allowed for; some £31.2m compared to an allowance of £33.2m (93.8%). Over the next five years, SONI believed its payroll costs needed to rise to £44.4m in order to meet an anticipated rise in workload over and above business as usual, but has been allowed only £37.6m within the proposed determination. The draft being consulted on here thus leaves it heavily short of finance to pay wages and pensions: it will have less than 85% of what it thinks it needs; a shortfall of £6.8m. This will have an impact on the quality of jobs within SONI, via the additional workload pressures that this will place upon staff, as well as on the quality of service provided to customers and indeed on economic growth in Northern Ireland; since that money will now not be spent elsewhere to support jobs and growth.

14. Within the framework, such a position is not a credible way of "incentivising the management and control of costs"; it is a way of seeking reductions in operating costs, largely in pay and pensions. Prospect does not believe that this is appropriate. It will have an impact on quality of service and, potentially, on the safety, reliability and resilience of the service SONI provides. This is only likely to discredit SONI, as it will have no headroom to tackle the issues that arise. The draft determination itself actually prepares the ground for this; it is unreasonable to state that "compliance, performance and quality of service should not be compromised in achieving efficiency gains" (para. 47) whilst simultaneously seeking to undermine the cost base on which SONI must depend to manage its potential to achieve exactly that.

15. The draft determination states that the previous framework allowed the recruitment of an additional 19 FTE staff. This was welcome and no doubt helped to deliver the improvements in reliability to which the Regulator also draws attention. Nevertheless, continuation of this success is jeopardised by a draft price control that seeks to reduce costs, rather than put quality and the resilience of the service first. The regulatory framework needs to recognise that it has a responsibility both to ensure and to deliver credibility in terms of the outcomes of its model. A constant focus on driving costs downwards will have a major impact on the ability of the business to respond appropriately and with good customer service in mind.

16. Furthermore, Prospect does not believe it appropriate for the Regulator to put itself in SONI's shoes as regards its personnel planning policies or its positioning *vis-à-vis* the market, when it comes to the salaries and reward package it needs to offer to attract suitably-qualified personnel to meet its responsibilities to the market and to consumers. This is not an appeal to allow excess or over-staffing; or indeed a lack of scrutiny of business plans; but the Regulator has to recognise that SONI also has no

interest either in over-paying or over-staffing its workforce. The requests that it has made for additional staff in the next control period are reasonable and fair within its assessment of how it can meet the demands placed on it within the next period. Prospect believes that such a request ought to be encompassed within the price determination and for the Regulator to work better with SONI on these demands. Alternatively the Regulator needs to publicly recognise that part of the increased work-stack envisaged over the next five years will remain undone.

Pensions

17. Specifically on the pensions issue, Prospect notes that substantial steps have already been taken by SONI to control pensions costs. The only scheme open to new staff is of the defined contribution type, and clearly now contains the majority of SONI staff given that the defined benefit scheme which is still in place as regards long-serving staff was closed to new entrants as far back as 1998. Indeed, the DB scheme contains only one-quarter of SONI's staff complement, with all those who are current members having protected person status, meaning that opportunities to reduce service costs are heavily restricted.

18. Prospect notes that total pension costs are, under SONI's own submission, around 22% of basic wage and salary costs. This does not strike us as an excessive contribution to employee's health and wealth in retirement.

19. The existing contribution rate to the DC scheme (of 6-8%) might be above the benchmark average for an employer of this size (6%) but we believe that it is, nevertheless, within the ballpark and that such a marginally higher figure is not a sign of an inefficient employer; merely one that is trying to juggle its offer to employees to match its recruitment and retention requirements. Additionally, as a public authority, the Regulator must recognise that an employer contribution of 6% (plus admin costs) – even where it meets the benchmark – is substantially below what is required to deliver an adequate income for scheme pensioners in retirement, and that joining in a race to the bottom on pensions contributions, with the bad undercutting the good, ultimately helps no-one.

20. Furthermore, in the draft determination the Regulator references two wholly different external datasets when benchmarking the SONI DB and DC pension schemes. For the SONI DB pension scheme, the Regulator references an OFGEM report entitled "Review of Network Operators' Pension Costs". In doing this, the Regulator is comparing the SONI DB pension scheme against others in the GB electricity sector, which is a reasonable approach. The majority of the data used in this report appears to come from the Electricity Supply Pension Scheme which is utilised by many different electricity companies.

21. However, in terms of the SONI DC scheme, the Regulator does not appear to reference any other electricity sector DC pension schemes and instead refers to a general ONS dataset that covers *all* sectors and thus potentially results in average employer contribution data being lower than an electricity sector average.

22. Point 102 of the draft determination states that "an analysis of data available on the Office of National Statistics (ONS) website indicates that the weighted-average contribution rate for a private sector pension scheme with DC membership of c100

members is around 6%". However this statement on its own may be misleading. The ONS data also shows that the average employee contribution is 2.9%, suggesting that most companies have an employee/employer contribution ratio of around 1:2. Looking at the DC pensions schemes run by some of the employers cited in the same OFGEM report with which the Regulator compares the SONI DB scheme:

- National Grid DC Scheme: Employer *double matches* employees contributions up to 6% (i.e., employee = 6%, NG = 12% Total contributions = 18%) http://library.standardlife.com/ngmemberguide.pdf
- Electricity North West DC Scheme: Employer *double matches* employee contributions up to 7% http://www.enwl.co.uk/about-us/electricity-north-west-pensions/defined-contribution
- Scottish Power DC Scheme (aka Manweb): Employer *double matches* employees contributions up to 5% http://www.scottishpower.com/pages/preparing_for_the_future.asp

23. In light of information relating to these schemes being freely available, Prospect would have expected the Regulator to compare the SONI DC scheme to similar electricity sector DC schemes, in the same way it did for the SONI DB scheme.

24. Prospect urges the Regulator to review its approach here and agree a proposal based on *at least* the existing higher level of employer contribution, as a way of recognising social justice and in terms of the need to support adequate occupational pension provision in general.

25. In terms of the benchmarking exercise in respect of the future service costs of the DB scheme, Prospect notes what the draft determination says as regards these being higher than average – but there is little that SONI can do about this. The valuation on which its future service contribution rate is based is dependent on assumptions that the trustees of the scheme – who are independent of the company – determine on the basis of the specialist advice that they receive from their actuaries. If the trustees and the actuaries between them decide that this is an appropriate rate, then the company has no choice but to pay it.

26. In any case , Prospect notes that benchmarking is of limited use here: each scheme is individual, and will have specific requirements and assumptions which reflect its status (open or closed to new service) and its membership (chiefly as regards their average age). What is an appropriate assumption for one scheme, based on its individual characteristics, may not be appropriate for another with different ones. The Regulator may point to the 'prudent' nature of the assumptions as regards the costs of future liabilities, but this is by no means unusual in mature schemes that are closed to new members (since the trustees are primarily concerned with securing the assets from which they need to pay pensions rather than with increasing the asset base, with an inevitable impact on the sorts of returns that a scheme may earn).

27. The draft determination also recognises that these are unusual times with regard to the financial conditions which attach to the assessment of the value of a pension scheme's liabilities. A business here for the long-term – such as one engaged in electricity transmission – ought to be capable of adopting an approach to this issue

which allows it to overcome the short-term nature of these conditions. It is somewhat beyond the nature of a draft determination like this, but we would point out, in this context, that a ten-year recovery plan looks conservative and that it could be extended without unduly threatening the ability of the scheme to pay pensions. This would reduce the weight of the deficit on the draft determination and we would urge all relevant parties to come to an agreement on what a sustainable recovery plan looks like in the context of the needs both of the scheme as well as of the Regulator.

28. We would also point, in spite of the reference to 'prudent', to the position of the SONI scheme at the last independent valuation which, being 95% funded, is actually in a better position than the average DB scheme. As at the end of March 2013, the UK's Pensions Protection Fund reported that the assets of UK pension funds were only sufficient to meet 82.6% of their liabilities:

    http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/PPF_7800_April_13.pdf

    Things have not improved since – but neither have they grown substantially worse:

    http://www.pensionprotectionfund.org.uk/Pages/PPF7800.aspx

    Prospect believes that this advanced position is down to the secure and sensible way in which the SONI scheme trustees have gone about their job in protecting the scheme's asset base and in making rational, and clever, investment management decisions. Consistent with the Regulator's benchmarking approach (with which Prospect has reservations, as outlined, but which otherwise has determined its approach) we believe that benchmarking indicates here that the scheme is in an above-average financial position, and is therefore being run on a highly efficient basis.

29. Consequently, the proposed determination's allowance of a level of 28% in respect of future service costs, in the face of the 40% provided for within the independent actuarial valuation, is entirely inadequate (as well as a poor reward for the hard work of the trustees in getting the scheme to the position it is in). Prospect therefore urges the Regulator to re-think its proposal. These costs have to be met: they cannot be avoided or reduced, or otherwise mitigated given the protected persons status of those who are continuing active members. Should the determination not allow these in full, then the costs of doing so will have to be met from elsewhere in the business with a knock-on effect, as we have outlined above, on the provision of good jobs within SONI and/or the quality of service it can offer its customers.

30. In respect of the past service deficit, Prospect notes the position here that the costs of the deficit going beyond March 2015 will be met by the shareholders and that the annual costs over the next five-year period (£148,000) are less than 2% of best estimate payroll costs for 2014/15. We believe this to be supportable within the context of overall operating expenditure and urge the parties to each a rapid conclusion as regards the 31 March 2015 valuation which provides transparency and security as regards the size of the deficit at this point and how this will be funded as the business continues.