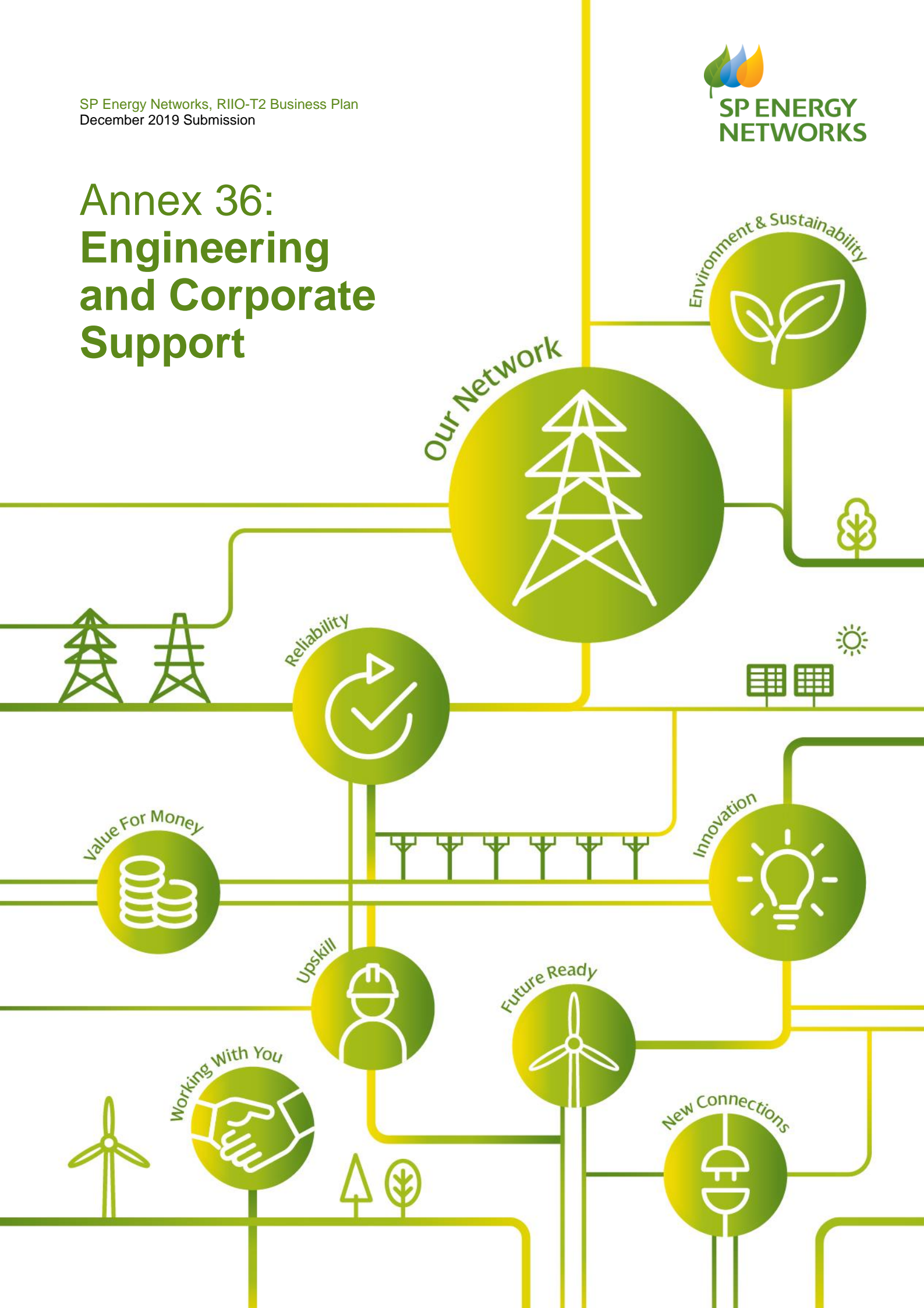


# Annex 36: Engineering and Corporate Support



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## 1.0 ENGINEERING AND CORPORATE SUPPORT

To deliver our considerable outputs and secondary deliverables efficiently, our frontline staff and contractors rely on an extensive network of support staff and services.

These are referred to as Closely Associated Indirect Costs (CAI's) and Business support costs (BS). We thoroughly reviewed our costs in these areas to make sure our support staff services are efficient and cost effective. Then we compare our costs to available industry data.

### 1.1 What are Indirect Costs?

Ofgem currently describes indirect costs as activities that generally don't involve physical contact with system assets yet play an integral role in the delivery of direct activities.

- Indirect Cost Allowances equate to 22% of Total Allowances in the RIIO-T1.
- Indirect Costs will equate to 20% of Total Expenditure in RIIO-T2.
- Indirect costs are currently forecast to be £273.1m in RIIO-T2 (CAI £169.2m, BS £103.9m).

These costs are broken down by year in the table below:

**Table 1:** *Indirect Costs breakdown per year*

Indirect Costs	21/22	22/23	23/24	24/25	25/26	T2 Total	T2 Average
CAI	34.8	34.2	33.9	33.4	32.9	169.2	33.8
BS	21.1	21.0	20.8	20.6	20.5	103.9	20.8
Total	55.9	55.2	54.7	54.1	53.3	273.1	54.6

### 1.2 Our Model

SP Transmission is part of the wider SP Energy Networks (SPEN) group which consists of 4 separate entities:

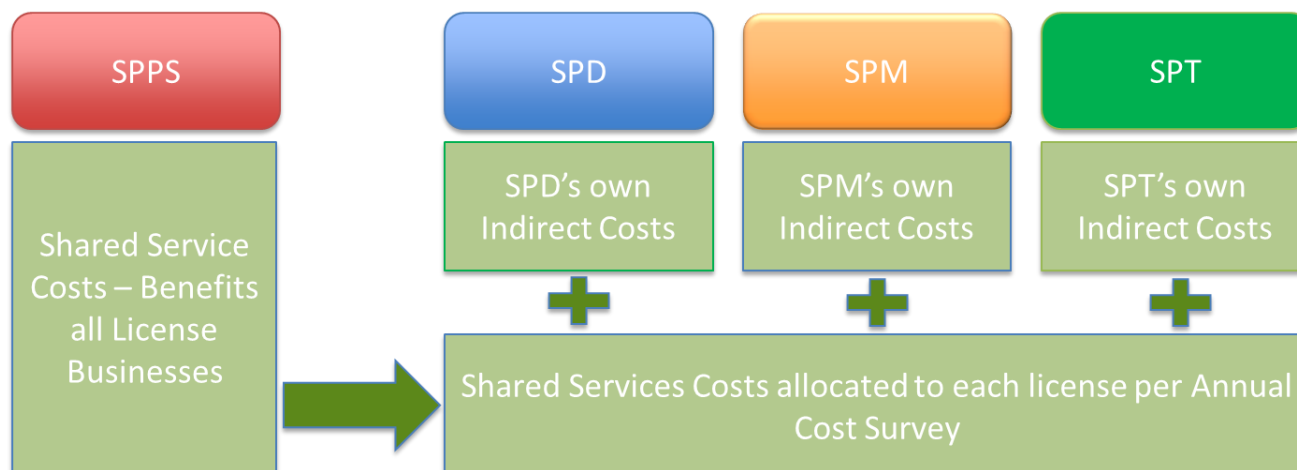
- SP Power Systems Ltd (SPPS) which contains all the staff that currently undertake work for two or more of the license businesses.
- SP Transmission PLC (SPT) which contains all the staff that undertake work exclusively for the Transmission license business.
- SP Distribution PLC (SPD) & SP Manweb PLC (SPM) which contains all the staff that undertake work exclusively for the Distribution license businesses.

Shared Service Costs such as those incurred by SPPS are allocated to each license based on an annual labour survey undertaken by each department (Customer Services, Network planning etc) allocating costs based on a set of drivers. For example, FTE time spent on activity relating to each license etc.

This ensures that efficiencies are gained by sharing of support services across each license.

Furthermore, SPEN is part of the wider Iberdrola group which has a global presence and provides a range of services such as procurement that incorporate best practice from across the group.

Our Indirect Costs above are therefore a summation of these elements. The group structure is shown in figure 1.



**Figure 1:** Indirect Cost allocation across SPEN

### 1.3 Our Process

In SP Transmission, indirect costs are reported across three separate cost categories:

- Costs within controllable operating expenditure – i.e. Opex or Net indirects (£139m as shown on page 118 of the BP document);
- Costs relating to investment activity – i.e. capex or capitalised indirects (£134m in other expenditure sections); and
- Total Indirect Costs i.e. Totex Level that are described as Gross indirects (£273m above).

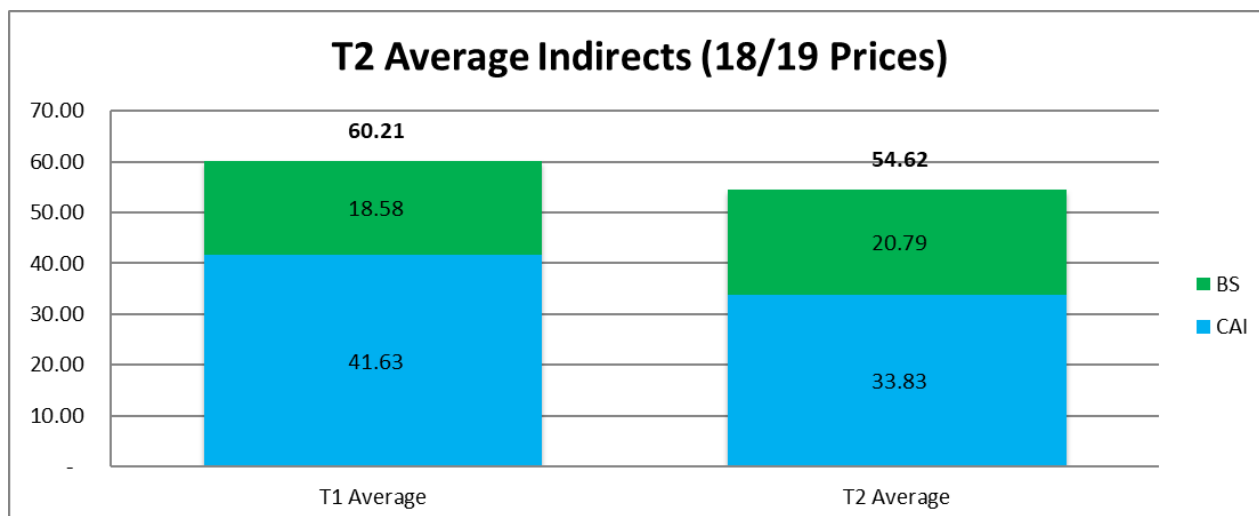
For RIIO-T1, the focus has been more on project reporting on a oncosted basis (i.e. including capitalised Indirects) than purely on Prime and Indirect basis (Which is the approach in RIIO-ED1). A project reporting basis was deemed more appropriate for Transmission as it typically involves the delivery of high value individual projects.

This approach can lead to variation in comparing net indirects across TO's or across time depending on investment levels and capitalisation policy used at a particular point in time.

For RIIO-T2, the focus has shifted from Capex and Opex split of indirects to reporting indirect costs at a Totex level to negate this.

It therefore makes sense to compare the level of costs at a total indirect cost basis (i.e. Gross Indirects).

## 1.4 Comparison across Price Controls



**Figure 2:** Indirect Cost comparison RIIO-T1 against RIIO-T2

As the RIIO periods in question (T1 & T2) have a different number of years we have chosen to focus on the annual average across each period which can be seen in the figure above.

On an annual average basis, we are forecasting the total indirect costs will be £5.6m lower in RIIO-T2 than they were across the RIIO-T1 period with CAI costs decreasing by £7.8m whereas BS costs increase by £2.2m. Further details on RIIO-T1 performance can be found in Annex 27 - Track Record

Due to their nature and the delivery model outlined in our main business plan document “Delivering our Plan” chapter, CAIs are linked to the level of activity being undertaken and so can flex depending on the incremental changes to the volume of work that is required to be delivered over a price control period. This is usually the main driver for costs across time.

One of the main drivers for the change identified above is the integration of our Iberdrola Engineering & Construction business (IEC) into SP Transmission in 2017. This has reduced our CAI costs when compared with our RIIO-T1 forecast.

Our Operational training forecast partly mitigates the other reductions in CAIs. This substantively increases in RIIO-T2 (£0.8m p.a. in T1 to £2.3m pa in T2). This increase will ensure we are developing our workforce to manage retirement projections and crucially facilitate the delivering of our outputs for RIIO-T2 and beyond. More details can be found in Annex 2: Sustainable workforce Strategy.

Business support costs are in the main unaffected by movements in our capital investment programme. These costs are generally by their nature remote from direct activities, Capex and Opex, and are more typically a reflection of the size and scale of an organisation. However, we will incur additional insurance costs in RIIO-T2 in relation to our HVDC link that were not present during the construction phase in RIIO-T1 this contributes to the higher business support costs in RIIO-T2 compared with RIIO-T1.

It is also worth noting that due to changes in reporting requirements (RIGs), the RIIO-T2 value above contains costs that are not present within the RIIO-T1 equivalent. For example, we now include Pension deficit payments (£0.5m pa) within indirect costs whereas they would not have been included as indirects within RIIO-T1. Another area of divergence is due to the inclusion of costs in relation to new RIIO-T2 initiatives such as costs to deliver our Environmental Action Plan (EAP) of £0.5m pa. These costs are mostly reported within our Network policy category. Further details can be found in Annex 7 - Environmental Action Plan.

Further to this we have endeavoured to identify and deliver efficiencies wherever possible, to make sure that our support costs represent value to consumers. As a consequence, our indirect costs are forecasted to decline over the period at both a CAI and BS level.

## 2.0 ENGINEERING SUPPORT – CLOSELY ASSOCIATED INDIRECT

Closely associated Indirects (CAIs) as the name suggests are those activities that are directly involved in co-ordinating and supporting the operational aspects of SPT.

These can be split broadly into 2 types – Engineering related activities & General operational support:

- Engineering Activities include project management and delivery, engineering design and planning of the network, management of the network on a day to day basis via the control room.
- General operational support includes Stores & Logistics, Vehicle management, Operational IT as well as Health & Safety and training functions.

Below is a table which splits the cost by year for each type of CAI.

### 2.1 Closely Associated Indirects Breakdown

**Table 2:** *Closely Associated Indirect Costs breakdown per year*

Closely Associated Indirects	21/22	22/23	23/24	24/25	25/26	T2 Total	T2 Average
Engineering Activity	30.7	30.1	29.8	29.4	28.9	148.9	29.8
General Support	4.1	4.0	4.1	4.1	4.0	20.3	4.1
Total	34.8	34.1	33.9	33.5	32.9	169.2	33.8

We are currently forecasting to spend £169m over the five years of RIIO-T2 across our CAI activities which compares to £335m over the eight years of RIIO-T1. Of these costs 80% are labour related and will support the business with c.403 FTE per annum, ranging from Engineers to graduates and apprentices.

The largest proportion of CAI costs are in relation to the engineering activities of Design, Project management and general Engineering management (77%) as would be expected for a Network Operator.

### 2.2 Cost Drivers and Basis of Allocation

All these activities are vital to ensuring the Business' direct (investment and maintenance, labour, contractor and materials) activities are targeted in the right areas in a cost-effective way, such that operational and key business risks are understood and that the direct activities of the business can progress effectively on a daily basis.

We have explained how our disaggregated delivery model has provided benefits to the end consumer through efficiency when compared with the historical UK industry approach in our main business plan document “delivering our network” chapter.

A knock-on effect of this approach results in SP Transmission requiring an internal resource for activities such as design and project management that otherwise would be outsourced. This internal resource allows us to deliver our projects and outputs more efficiently in “direct cost” terms but does increase our closely associated indirect costs in the process. In Totex terms a more efficient overall outcome is driven for the consumer.

As explained above, CAI's are linked to the level of activity being undertaken and this is usually the main driver for costs across time.

## 2.3 Closely Associated Indirect Cost Categories

Stores & Logistics	<ul style="list-style-type: none"> <li>The Activity of managing and operating stores such as delivery costs of material/stock, monitoring stock levels and quality testing etc.</li> </ul>
Vehicles & Transport	<ul style="list-style-type: none"> <li>The activity of managing, operating and maintaining the commercial fleet and mobile plant utilised by the Network for the purpose of providing services to the network.</li> </ul>
Operational Training	<ul style="list-style-type: none"> <li>Includes training Workforce Renewal new recruit, Operational Upskilling and Operational Refresher Training such as apprentices/graduates</li> </ul>
Health Safety & Environment	<ul style="list-style-type: none"> <li>The activity of promoting and maintaining health and safety of employees, contractors, customers and the public.</li> </ul>
Operational IT & Telecoms	<ul style="list-style-type: none"> <li>IT equipment which is used exclusively in the real time management of network assets, but which does not form part of those network assets</li> </ul>

**Figure 3:** Engineering Activities breakdown

Project Management	<ul style="list-style-type: none"> <li>Relates to the activity of managing projects from authorisation through preparation, construction and energisation to completion.</li> <li>Includes overall responsibility for delivery of single major project or multiple minor projects</li> </ul>
EM&CS	<ul style="list-style-type: none"> <li>Relates to office based activities of engineering staff managing or assisting employees undertaking direct activities.</li> <li>Also work planning, budgeting, strategic network plan development and implementation as well as operational performance management.</li> </ul>
Network Design & Engineering	<ul style="list-style-type: none"> <li>Development of high-level plans that facilitate the economic development of the network.</li> <li>Specific planning and design necessary for individual projects</li> </ul>
Network Planning	<ul style="list-style-type: none"> <li>Includes Control Centre Activities such as Outage planning &amp; management, Real time monitoring and major incident and emergency planning</li> </ul>
Network Policy (R&D)	<ul style="list-style-type: none"> <li>All processes and tasks involved in the development and review of environmental, technical and engineering policies, and including research and development.</li> </ul>

**Figure 4:** General Operational Support activities breakdown



### 3.0 CORPORATE SUPPORT – BUSINESS SUPPORT COSTS (BS)

Business Support Costs are activities that are further removed from the running of the network but are integral to any business. These cover corporate functions like IT & Telecoms, Finance, Property Management and Human Resources as well as a Regulation department that is the main interface with the regulator Ofgem.

Without these functions the Network operator would not be able to deliver its license obligations.

#### 3.1 Business Support Breakdown

**Table 3:** Business Support Costs breakdown per year

Business Support Costs	21/22	22/23	23/24	24/25	25/26	T2 Total	T2 Average
IT & telecoms	5.0	5.1	5.0	4.9	4.9	24.8	5.0
Property management	3.5	3.5	3.4	3.4	3.4	17.1	3.4
HR & non-operational training	1.6	1.6	1.6	1.6	1.5	7.9	1.6
Finance, audit & regulation	6.1	6.1	6.1	6.1	6.0	30.4	6.1
Insurance & Procurement	2.7	2.7	2.7	2.6	2.6	13.4	2.7
CEO & group management	2.1	2.1	2.1	2.1	2.0	10.3	2.1
Total	21.1	21.0	20.8	20.6	20.5	103.9	20.8

We are currently forecasting to spend £104m across our BS activities during RIIO-T2.

These costs are equivalent to c. 74 FTE as well as an array of professional services that the business requires to function such as Treasury, Legal, Audit, Regulation etc. The largest individual proportion of BS costs are in relation to Financial and Regulatory compliance activities such as statutory, regulatory reporting (29%)

#### 3.2 Cost Drivers and Basis of Allocation

Business support costs are in the main unaffected by movements in our capital investment program. These costs are generally by their nature remote from direct activities, Capex or Opex, and are more typically a reflection of the size and scale of an organisation.

The Business Support services described in detail below are, for the most part, provided through our UK Corporate Shared Services model. Under this arrangement group services are charged to the respective business units in the UK group by direct allocation, where this is possible, or by apportionment using an agreed basket of indicators ranging from “Number of FTE/Users/Vehicles” to financial metric values such as Massachusetts formula<sup>1</sup>

The charging methodology is reviewed annually by Ofgem as part of the cross-subsidy agreed-upon-procedure report undertaken by our external auditors.

<sup>1</sup> Massachusetts formula is a recognised approach consisting of a blend of Fixed assets, Personnel expenses & Margin

### 3.3 Business Support Cost Categories

A breakdown of Business Support activities can be seen in figure 5 below

Human Resources	<ul style="list-style-type: none"><li>• The personnel management of all staff, including Industrial &amp; Employee relations , development of HR strategy , employee policy and procedures governance.</li></ul>
Finance & Regulation	<ul style="list-style-type: none"><li>• Performing the statutory, regulatory and internal management cost and performance reporting.</li><li>• This includes Tax, Audit , Treasury , Procurement , Insurance &amp; Regulatory activities</li></ul>
CEO	<ul style="list-style-type: none"><li>• Combines the activities of: Non-executive &amp; group directors labour and board meeting costs, Corporate communications/Community Awareness, Legal Services etc.</li></ul>
IT & Telecoms	<ul style="list-style-type: none"><li>• The purchase, development, installation and maintenance of non operational computer and telecommunications systems and applications.</li></ul>
Property Management	<ul style="list-style-type: none"><li>• The costs of providing, managing and maintaining all non operational premises(with the exception of operational training centres)</li></ul>

**Figure 5:** *Business Support activities breakdown*

Further detail on our IT & Property costs can be found within Annex 24 - Business IT Security Strategy & Annex 29 - Estates.

## 4.0 BENCHMARKING AND EFFICIENCY

We have endeavoured to undertake cost benchmarking for our indirect costs (CAI & BS), however have found availability of data an issue.

### 4.1 Transmission

On a Transmission basis we have acquired detail of each Transmission Network Operator (TNO's) indirect cost data from the 2018/19 annual reports. This report contains a breakdown of the actual and forecast expenditure for each year across the RIIO-T1 period (13/14 – 20/21). These costs are only available at an Opex level due to the nature of reporting in RIIO-T1 that is described above (Gross Vs Net).

We have used a Composite Scale Variable (CSV) to allow us to scale the other TO's expenditure to compare our RIIO-T2 costs against the current costs of other TNO's. The CSV is constructed by taking the average FTE & RAV value for each entity over the RIIO-T1 period and applying an equal weighting to each (50%). We have also used regression analysis to test the outcome of these results.

**Table 4: CSV Benchmarking Analysis results**

Indirect Benchmarking	Original Values	Scaled Values	Rank
SPT (RIIO-T2)	27.9	27.9	1
SPT (RIIO-T1)	23.3	28.0	2
SHETL	23.6	31.4	3
NGET*	176.9	36.8	4

CAI Benchmarking	Original Values	Scaled Values	Rank
SPT (RIIO-T2)	9.7	9.7	2
SPT (RIIO-T1)	7.3	8.8	1
SHETL	13.3	17.7	3
NGET*	85.3	17.7	4

BS Benchmarking	Original Values	Scaled Values	Rank
SPT (RIIO-T2)	18.2	18.2	2
SPT (RIIO-T1)	16.0	19.2	4
SHETL	10.3	13.7	1
NGET*	91.6	19.0	3

\*NGET currently does not split out Opex within the published annual report, therefore we have used the 18/19 actual split to derive a CAI & BS value for the remaining years of RIIO-T1.

After applying the CSV in the tables above, Our RIIO-T2 Indirect costs are ranked as the most efficient closely followed by SPT(RIIO-T1) with SHETL and NGET 3<sup>rd</sup> and 4<sup>th</sup> respectively. When applying this analysis to the CAI and BS costs separately the results are similar with our RIIO-T2 CAI's ranked second overall and our RIIO-T2 BS costs ranked second again. However, it should be stated that the capitalisation policy of each TO will impact this analysis due to the fact that only the Opex(Net) proportion of costs are being compared. Therefore, there could be a different outcome if the Capex element is included. Also SPT and SHETL have similar forecast indirect costs across RIIO-T1 (£186.8m and £188.5m respectively) however there is a large variance in the CAI and BS costs for both. This may be due to the capitalisation policies across both companies however without further data we cannot explain the difference. Further to this as we do not currently have a view of the TNO's forecasted RIIO-T2 costs, therefore we cannot determine how these values will vary when compared against the levels recorded during RIIO-T1. For this reason, we cannot currently benchmark our RIIO-T2 costs against the other TNO's at this time.

As there is no Data Share exercise in electricity transmission, unlike in electricity distribution, where all companies share their annual Regulatory Reporting Packs(RRP), we do not have access to the required data to improve our analysis. This is something we would like to commence as part of the RIIO-T2 process for all areas of expenditure to help drive best practice across the transmission sector.

## **4.2 Distribution**

We have also repeated the analysis described above by using the data from the 14 Distribution Network Operators (DNO's) via the output from the Data Share exercise mentioned above. This contains the actual and forecast data for each DNO across the RIIO-ED1 period (15/16 – 22/23). As these are reported at a gross level the capitalisation issue raised in the transmission analysis will not occur. Our RIIO-T2 Indirect costs are again ranked as most for efficient, with CAI's scoring 1<sup>st</sup> and BS costs 2<sup>nd</sup> against the 14 DNO's. We have not provided the table with the results as per the TNO analysis due to the rules around confidentiality of the Data Share exercise.

We believe that the distribution analysis is relevant, especially for BS costs, as these should not differ drastically by network as they should be reflective of the size of a company and are not necessarily influenced by the activity being undertaken.

## **4.3 Conclusion**

Therefore, we have concluded that the our RIIO-T2 indirect costs forecast (both CAI & BS) is set at an efficient level against both the TNO's & DNO's equivalent across the RIIO-T1 and RIIO-ED1 periods, based on the available information. As a result of this exercise we believe that our Indirect costs represent value for money to the consumer and are set at an appropriate level to allow SP Transmission to deliver the required outputs in RIIO-T2.

## 5.0 FURTHER COST BREAKDOWN

Currently our average annual total indirect costs for the RIIO-T2 period are £54.6m. These costs can be further split into 3 main categories:

1. Labour related expenditure such as Salary, Pensions, NIC etc;
2. External Services such as Staff related costs, Consultancy/technical services, Various association fees (ENA, IET etc); and
3. Other expenditure which mostly consists of charges from the Iberdrola group (e.g. IT related charges) and Wayleaves costs.

**Table 5:** Indirect Costs breakdown by Type

By Type	T2 Ave (£'m)	T2 Ave (%)
Labour	35.4	65%
External Services	12.1	22%
Other	7.2	13%
Total	54.6	100%

Further detail on each type is outlined below:

### 5.1 Labour Related Costs

Labour costs currently represent 65% and £35.4m of the total indirect costs above. This is equivalent to 484 FTE which represent a broad range of backgrounds & activities including engineers / accountings / admin staff etc. These FTE associated costs are allocated across Ofgem's categories as per our internal labour survey process that is undertaken on an annual basis. This cost includes the full cost of the employee for example includes pensions, national insurance contributions and standby/overtime etc.

### 5.2 External Services

"External services" currently represent 22% and £12.1m of total indirect costs. These are any activity or service that cannot be provided either internally or at a group level by the FTE above. This category can be broadly broken down further into the following groups:

- Staff related expenditure – this is mostly composed of equipment/material rentals for internal staff in relation to vehicles/IT equipment etc with further expenditure relating to staff travel such as fuel/mileage/training etc;
- Technical & Consultancy Services – these costs are representative of the professional services that are required for the company as a whole to run the network ranging from the technical related services that would aid in our engineering activities under CAI's to the BS type consultancy services such as IT/Financial/Property & Site Services et;
- Subscriptions and Insurance – mostly Insurance related costs for buildings/IT/Operational Assets etc. Also, a small amount for subscriptions such as Ordnance surveys and weather services;
- Various Associations Fees – Costs in relation to the various associations that we are affiliate with or participate in for example the Energy Networks Associations (ENA), European Network of Transmission System Operators for Electricity (ENTSOE), European Benchmarking exercise (CEER). This section also covers Legal fees; and
- Other – Represents miscellaneous items such as Research & Development, PR/Sponsorship/Donations, Fines & Penalties, Comp to 3rd parties etc.

### 5.3 Other

“Other” currently represents 14% and £7.2m of total indirect costs. This category can be broadly broken down further into the following groups:

- Iberdrola Charges – recharges from the parent company Iberdrola in relation to support services undertaken on behalf of SP such as group reporting/treasury/IT etc;
- Group Charges – represents the recharge to SPT for group assets that SPT share a benefit from for example Group IT systems, Group Buildings etc; and
- Wayleaves - Annual payments made in advance to the owner and/or occupier to cover the financial impact of having equipment on their land and for access to that equipment.