



Mr. Bill McKenzie
Senior Manager, Regulatory Finance (Networks)
Office of Gas and Electricity Markets
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LONDON
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20th August 2009

Dear Mr. McKenzie,

PRICE CONTROL PENSION PRINCIPLES

I am writing on behalf of the Trustee Board of the EDF Energy Group of the ESPS (Electricity Supply Pension Scheme). The trustees reviewed Ofgem's second consultation document on price control pension principles at a special meeting held on 13th August and have agreed these comments set out below.

Given the way in which the current price control treats pension costs, we rely heavily on the role of EDF Energy's three DNOs in maintaining the strength of the employer covenant. Our assessment of that covenant as a very strong one enables us to take a rounded view of our duty to act prudently, so that, for example, we were able to agree a less onerous outcome with EDF Energy in respect of the most recent triennial valuation than would otherwise have been the case.

Ofgem's first consultation document, on which we commented last September, was much concerned about supposedly high contribution rates in the industry's legacy schemes. However, we noted at the time that Ofgem did not identify any examples of inefficient or inappropriate stewardship.

That position has not been altered by the report commissioned by Ofgem from the Government Actuary's Department (GAD) which is published alongside Ofgem's current document. On the contrary, the findings of the GAD report reinforce the view that the ESPS schemes are and have been managed efficiently and that their investment strategies, funding levels, and underlying technical assumptions are all broadly consistent with those of other large private sector schemes.

Against that background, we would be very concerned indeed should Ofgem decide to make any significant material changes to the now well-established price control pension principles for energy network operators.

It is a matter of public record that, when it introduced the principles some five years ago, Ofgem stated that they were intended to be enduring and would be applied by Ofgem to all network operators at future price control reviews. They were not to be seen as fair-weather

principles that could be materially varied or diluted according to the vagaries of the UK macro-economic environment as it affects defined benefit pension schemes.

In view of that strong commitment expressed by Ofgem, our own Trustee Board has conducted the management of its scheme on the basis of a rational expectation about Ofgem's future actions, consistent with the principles of good regulatory practice. In particular, our efforts over the past five years have been directed at reducing the level of risk associated with pension scheme investments.

We have worked diligently to do so – after taking much professional advice and discussing possible changes in investment strategy at length – in a considered and phased manner that takes due account of current market circumstances. While aiming to de-risk the scheme, however, we have also been concerned in all our activities to maintain the level of potential upside, and so we have not reduced our aspirations and efforts to outperform the market, albeit at a realistic level.

Ofgem's current suggestion that it might consider changing the basis on which the network price controls treat pension costs would accordingly add a substantial amount of risk back into the process for trustees, as well as increasing volatility over and above the unprecedented levels that we have experienced in the past two years. This increase in risk would inevitably force trustees to take a significantly more conservative view of their responsibilities.

In reviewing Ofgem's current document, we have been very perplexed by the idea that Ofgem might consider setting standard conformed scheme assumptions against which to measure and compare the formal outcomes of individual scheme triennial valuations – particularly in view of all the legitimate differences in the composition, characteristics, and history of these schemes, as noted in the GAD report.

We spend a great deal of time taking advice and debating the assumptions that we think will best match our fund's particular circumstances and the strength of our employer's covenant. We do not believe – and nor does the GAD report appear to believe – that it would be possible to set assumptions that can realistically and sensibly be applied to all of the DNO schemes.

As scheme trustees, we are independent holders of relatively new and considerably strengthened statutory duties. We take these duties extremely seriously and try to discharge them to the best of our abilities. In our opinion, neither Ofgem's current document nor the findings and conclusions of the GAD report establish a case for moving away from the existing price control principles.

Regulatory uncertainty is the last thing that trustees want when negotiating with the sponsoring companies over, for example, deficit repair periods. The simple truth of the matter is that Ofgem can best facilitate the continuing efficient and responsible stewardship of the DNO pension schemes by publicly confirming the long-term stability of its price control pension principles and the enduring application of a consistent view of its own past decisions.

We are happy for this letter to be published on Ofgem's website.

Yours sincerely,

Tim Boylin
Chairman of Trustees
EDF Energy Group of ESPS

