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Date: 12 April 2013

Dear Colleagues.

Decision letter on the pension deficit allocation methodology applicable to our funding in price controls of network operators' pension deficits

Today, we publish our methodology that sets out the framework for how network operators (NWOs) are to attribute the deficit (or surplus) on their defined benefit (DB) pension scheme(s) between the established deficit, the incremental deficit and non-regulated activities. Each of these categories are funded differently in price controls. This methodology facilitates our 2009 commitment to fund NWOs' DB pension scheme deficits in price controls. We have worked with NWOs and their actuaries to develop this methodology.

We published an open letter consultation on this pension deficit allocation methodology on 17 December 2012. We have received and carefully considered the responses from stakeholders, which are available on our website[1].

Respondents were generally content with the draft methodology, as most had actively participated in its drafting through the Energy Networks Association. However, we did receive detailed comments on a few issues principally on providing greater clarity to ensure that the methodology does what is intended, consistent with discussions between the networks and ourselves. These issues were:

- evolution of the pre cut-off date regulatory fraction for the National Grid UK Pension Scheme
- the approach to adjusting for differences between pre and post retirement discount rates
- funding of established deficits beyond the notional 15-year funding period
- the application of updated regulated fractions.

We have addressed these issues, provided the necessary clarification and made minor consequential changes to the methodology and the reporting requirements. We have now finalised the methodology.

We will formally issue the methodology as an integral part of our new *Energy Network Operators' Price Control Pension Cost - Regulatory Instructions and Guidance: Triennial*

[1] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=130&refer=Networks

Pension Reporting Pack supplement[2] (Pension RIGs). The purpose of this document is to provide a framework to allow Ofgem to collect and NWOs to report triennially:

- accurate and consistent data on their DB pension schemes
- the attribution of the deficit (or surplus) on those schemes (and the constituent assets and liabilities) between -
  - the established deficit
  - the incremental deficit
  - non-regulated activities[3].

The pension deficit allocation methodology chapters of these Pension RIGs sets out the high-level procedures for applying the methodology to:

- the fifth electricity distribution price control (2010-15)
- the one year adapted rollover of the fourth transmission price control (2012-13)
- all RIIO price controls commencing 1 April 2013 for electricity and gas transmission and gas distribution network operators; and 1 April 2015 for electricity distribution network operators.

The pension data tables, which NWOs are required to submit, set out the information and attributions required together with information on each NWOs DB scheme to inform our triennial reasonableness review of pension costs.

These Pension RIGs are issued in accordance with the applicable licence conditions, ie Electricity Distribution standard licence condition 48, Electricity Transmission standard licence condition B15 and Gas Transporter standard special licence condition A40.

We and the NWOs are committed to working together to develop further the methodology (and the framework on which it is based) following implementation and submission of their first returns.

Yours faithfully,

Ian Marlee
Senior Partner, Smarter Grids & Governance: Transmission

[2] http://www.ofgem.gov.uk/Networks/Documents1/NWO%20Triennial%20Pension%20RIGS%20supplements%20v1.0%2012Apr13.pdf

[3] For a detailed explanation of these terms see the Pension RIGs document