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Dear Mr Hull

**Response to Transmission Price Control Review Second Consultation Document December 2005**

I attach a response from the Trustees of the Lattice Group Pension Scheme to your second consultation document.

If you have any queries on the response please do not hesitate to contact me.

Yours sincerely

**John Lovell**  
Scheme Secretary



# **Response from the trustees of the Lattice Group Pension Scheme to Ofgem's TPCR Second Consultation Document dated December 2005**

## **1. Introduction**

In August 2003, the Trustees of the Lattice Group Pension Scheme (the Trustees) commented to Ofgem on the section *Treatment of pension fund costs* in Ofgem's consultation document *Developing network monopoly price controls – Initial conclusions*.

As National Grid Gas plc (NGG) is currently in consultation with Ofgem on the Transmission Price Control Review, the Trustees wish to express their view on Ofgem's Second Consultation paper issued in December 2005.

This response represents the views of the Trustees in relation to our role as trustees of the Lattice Group Pension Scheme (the Scheme). It is not a response on behalf of NGG or any company which participates in the Scheme.

We would confirm that our response is not confidential.

## **2. Background**

We provided a background to the history of the Scheme in August 2003 and have set this out (updated) below for ease of reference

The Scheme is an approved occupational pension scheme established with effect from 1 April 1982. However, the Scheme also holds the assets and liabilities of the previous pension arrangements of those undertakings involved in the UK Gas Industry for both staff and industrial employees; this includes benefits accrued in respect of employees since the 1930s. This is a long history but for the purposes of this response two examples are set out below.

1. In June 1958 the Gas Manual Workers Pension Schemes were established to provide benefits for industrial workers. There were thirteen Schemes in total, one for each Area Gas Board. The assets and liabilities of these thirteen schemes are now retained within the Scheme.
2. In the recent past the Trustees had to consider the benefits and legislation relating to rights accrued by certain members since 1947.

This is intended to demonstrate that we need to take a very long-term view of pension issues including, the most important, the financial covenant of the employers.

The Scheme has two main benefit sections; the Defined Benefit Section providing contracted out salary related benefits and the Defined Contribution Section providing money purchase benefits; members of this section are not contracted out of the state second tier pension by reference to the Scheme. The Defined Contribution Section was established with effect from 1 April 2002. The Defined Benefit Section was effectively closed to new entrants from that date.

The Defined Benefit Section is by far the larger of the two in terms of assets and liabilities and our comments in this response apply to this Section.

The Scheme is administered by an equal number of Trustees half appointed by the company and half by the Members. Agreement from the majority of both types of Trustees is required to make decisions including any changes to the Trust Deed and Rules. The chairman of the Trustees does not have a casting vote.

In addition, the Scheme must undertake its next triennial actuarial valuation as at 31 March 2006. In accordance with the Pensions Regulator's guidance we have already commenced planning for this process including dialogue with representatives of the sponsoring employers. NGG is the largest sponsoring employer in the Scheme and so the regulatory treatment of pension cost will have a direct impact on our discussions with it.

### ***Position Statement***

In August 2003 we responded to Ofgem's Consultation paper on these issues. That response contained a position statement which we believe is worth repeating here:

*The Trustees' duty is to administer the Scheme in accordance with the Trust Deed and Rules and in particular to pay the promised benefits to members. Our principal duty applies to all members i.e. contributing members, members with deferred pension entitlements and members in receipt of a pension. However, we recognise that we have a secondary duty to other stakeholders, such as the employers.*

*We consider that our members have, over the previous decades, made personal decisions regarding their financial wellbeing based upon the benefits provided under the Scheme and we would not welcome any proposals that weaken either those aspirations or the employers' covenant.*

### **3. General**

From the Consultation Paper, we believe that Ofgem intends to put in place a regime in respect of pension costs for NGG, under which, subject to certain adjustments, cash pension costs are essentially “passed through” to consumers. Under this regime, if NGG pays more into its pension schemes than Ofgem assumed when a price control was set, the additional amount is recovered from consumers in subsequent price control periods. In the event of less being paid, this would be returned by NGG to consumers in subsequent periods.

In general, we support such a regime, because it should provide support for the Scheme, through a mechanism which enables NGG to recover its pension costs. However, we are concerned that the effect of one of Ofgem’s proposed adjustments in particular, that proposal in respect of members of the Scheme who formerly carried out activities transferred to Centrica, could work to substantially weaken the mechanism, an effect which we would oppose as being contrary to the interests of the members of the Scheme.

### **4. Specific responses**

We respond to paragraphs 9.35 to 9.48 and Appendix 10 of the consultation document using the document’s heading and numbering.

#### **Paragraph 9.38**

We welcome Ofgem’s acknowledgement of the effect that the Pensions Act 2004 and Guidance from the Pensions Regulator will have on the future funding of Defined Benefit pension plans.

The new funding regulations and Guidance place an onus on Trustees to agree a robust funding plan with the sponsoring employers and seek to repair deficits over a relatively short time frame. In doing so, Trustees will be expected to take proper account of the risks of the Scheme and the strength of the employers’ covenant. The new funding regulations and approach of the Pensions Regulator represent the policy requirements of the Government to better protect the benefits of members of UK Occupational Defined Benefits schemes and we consider that this must directly impact on Ofgem’s approach to the pass through of pensions costs.

Perhaps the most obvious example is the period over which deficiency contributions are recovered. The Pensions Regulator has made it clear in his Guidance that recovery periods in excess of 10 years will cause him to investigate the Recovery Plan and Statement of Funding Principles further. It is likely therefore to prove difficult for trustees to agree longer recovery periods (for example to reflect periods agreed as part of a PCR process) and so clarification from Ofgem on this area would be helpful e.g. that recognition of deficiency contributions for PCR purposes will not be over periods of longer than 10 years.

#### **Paragraphs 9.43: point 4, 9.47, paragraph 10.6 of Appendix 10**

These paragraphs concern allowance for costs properly attributable to the relevant price controlled business and also make specific reference to not making a regulatory allowance for costs associated with members whose activities transferred to Centrica. We commented on this in August 2003.

We believe that such an approach could, under certain circumstances, have the effect of weakening the employers' covenant in the future. Clearly we would, in principle be opposed to such an approach, as being contrary to the interests of the members of the Scheme. In support of our position, we would highlight the integrated nature of British Gas before Centrica left. In that organisation, there would have been relatively few employees who did not, or had not, previously carried out activities which would not still be regulated today. These Scheme members will have based decisions on their pension benefits in the light of their understanding of the nature of the company at that time. From our perspective we hope that Ofgem recognises the history of British Gas and the Scheme and the decisions made, by all classes of our membership, and that in any areas of doubt that Ofgem allows NGG's pension costs to be recoverable.

In this context, we welcome the statement, made in paragraph 10.7 of the Appendix, that Ofgem will continue to take a proportionate and pragmatic approach to the application of its principles, having regard to the quality of data available and the extent of analysis required, which might be of particular significance in the case of NGG.

#### **Appendix 10 – para 10.2**

We welcome Ofgem's comments that they will not challenge assumptions that are in line with prevailing best actuarial practice. However, we would draw Ofgem's attention to the changes brought about by the Pensions Act 2004 which generally require the Trustees to agree assumptions with the employer based on advice from an actuary. Ofgem may wish to clarify this aspect by, for example, adding the words "having taken into account current Defined Benefit funding regulations and the Pensions Regulator's Guidance" after the words "actuarial best practice".

**Appendix 10 – para 10.13**

We are concerned that a median return is proposed rather than a case by case basis and wonder about the practicalities of identifying “comparable UK pension funds”.

**Appendix 10 – para 10.21**

A material failure of stewardship as described would undoubtedly result in some form of action against the Trustees most likely via the Pensions Ombudsman or the Pensions Regulator. We would suggest that these offices are better placed than Ofgem to consider whether a material failure of stewardship has occurred.

January 2005

