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Dear Bill

PRICE CONTROL PENSION PRINCIPLES CONSULTATION DOCUMENT

Thank you for giving us the opportunity to comment on your *Price Control Pension Principles Consultation Document* which was published on 7 August 2008.

In the attached appendix 1, we have commented against each of the key principles in Chapter 2 together with the associated questions posed in Chapter 3 and then provided a response to the application issues identified in Chapter 4.

We would, however, like to make the following overall key points.

- At DPCR4 we did not press some strong arguments in the interests of securing what we thought would be an enduring pensions settlement. If that settlement does not endure these arguments remain and would have to be re-introduced into the debate. The pension principles introduced by Ofgem in June 2003 provided such certainty over the longer term. We supported, and continue to support, this stance. In the December 2003 consultation document Ofgem made two statements which are relevant to the current consultation. In paragraph 7.65 Ofgem stated that “.....*the principles could then be applied in a straight forward fashion at future reviews.....*” and paragraph 7.67 “*In order to provide a methodology statement that will enable calculation of the pension costs for which allowance is to be made in setting future network price controls, Ofgem is developing a framework of rules that can be applied in all cases.*” From these statements clear messages were signalled to the markets concerning pension investment risk, not for the first round of price reviews, but for the long term. Whilst we understand the need to review the workings of the principles in light of experience we believe it is the detailed application of those principles that should be the primary focus rather than a fundamental review. Ofgem are not clear in the current document that it is only the workings that are being reviewed – in the summary of the document and in other sections Ofgem refer to potential changes to the principles. If this was not Ofgem’s intention, Ofgem need to make it clear to the markets as soon as possible that there has been no change to this balance of risk.
- Further Ofgem need to recognise that the employer covenant is an important part of the actuarial process. At the last valuation the trustees took account of the strength of the covenant in considering the actuarial assumptions and the length of the period for investment returns and deficit repair payments. The nature of the regulatory commitment is one element that contributes to the strength of the employer’s

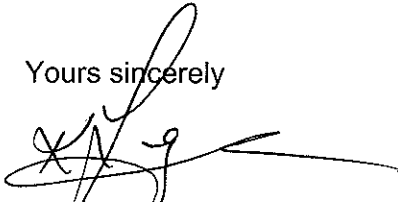
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covenant. In the long run this must help to minimise pension costs which is to the benefit of the customers. Any undermining of the strength of covenant by signalling possible changes to the employer's risk profile at DPCR5 or at RPI-x@20 will need to recognise the consequential impact that this may have on future funding rates.

- On assessing the efficiency of pension costs Ofgem need to continue to recognise the obligations of the company/schemes to employees with protected rights.
- The application of the second principle, relating to only including the liabilities of the regulated business, needs updating to take account of the increasing diversity of membership of some schemes. Indeed those schemes that no longer have any significant non-regulated businesses should expect to see the disallowed fraction reducing to zero over time.
- As Ofgem recognise, since June 2003 there have been a number of changes in the pension environment, in particular, post the Pensions Act 2004 full account needs to be taken of the independence of the scheme trustees and their duty to set actuarial assumptions in line with actuarial practice and taking into account guidance from the Pensions Regulator.
- We believe it is important that Ofgem consult with the Pensions Regulator to ensure that consistent interpretation of best practice is provided to the industry and its representatives.
- We are particularly concerned that there have been extra words added to the fourth principle which states that the latest full actuarial valuation report will be the basis for setting allowances based on the recommended cash funding rate in that report. We do not agree with the change to this principle and would submit that funding assessments for DPCR5 should take account of up to date market information and estimated actuarial assumptions at 31 March 2010 and 2013.

We look forward to discussing these points in more detail at Ofgem's workshop on 8 October 2008.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ken Linge', with a long horizontal flourish extending to the right.

Ken Linge
Finance Director