



ScottishPower

Corporate Office

Your ref

Our ref

Date

26 September 2008

Contact/Extension

Mr Bill McKenzie
Senior Manager, Financial Issues
Distribution, Networks
Ofgem
9 Millbank
London
SW1P 3GE

Dear Mr McKenzie

Price Control Pension Principles Consultation Document

Response of the Trustees of the Manweb Group of the ESPS (the "Group")

1. This paper is a response to the above consultation paper on behalf of the Trustees of the Manweb Group of the Electricity Supply Pension Scheme ("ESPS") (the "Scheme"). As the trustees of one of the pension schemes funded under the current price control system, we believe we are "interested parties" to the consultation.

Overview

2. The Trustees would like to emphasise to Ofgem that, in their view, the principles contained in the last electricity price control review remain valid for this and future reviews. The Trustees are concerned that any alteration to the current pass-through system would be detrimental to Scheme members. Furthermore, the Trustees do not feel that the consultation document factors in sufficiently the significance of the current legal framework governing pension schemes in the UK and, in particular, the Scheme.

Interaction with Pensions Law Obligations

3. The Trustees must act within the parameters of the Pensions Acts 1995 and 2004, particularly the requirement for "prudence", and also those requirements specifically governing Groups within the ESPS under statute and the Scheme's governing documentation. As Ofgem will be aware, the Trustees and employer must also comply with various guidance documents and codes of practice issued by the Pensions Regulator. The Pensions Regulator has a number of powers it may invoke in relation to the Scheme, if the Trustees do not comply with its framework and legislation. These legal obligations are discussed in more detail below but Ofgem should note that, under the principles contained in the last electricity price review, the Trustees have been able to comply with pensions legislation and the framework set out by the Pensions Regulator. In the Trustees' view, a scheme specific approach to the recovery of costs assists both the Trustees and the employer in discharging these legal duties in an efficient and effective manner. Changes such as those posited in the Ofgem consultation document would

ScottishPower Avondale House, Phoenix Crescent, Strathclyde Business Park, Bellshill ML4 3NJ

inflame the potential for conflict between its regulatory system and the relevant pensions system.

4. We note that Ofgem's comments on the level of employer contributions required in some schemes, and the suggestion in the consultation paper that the assumptions within a pension scheme are set by scheme actuaries. In fact, it is the Trustees of the Group, with the agreement of the Employer, who set the actuarial assumptions within the Group, as required by the Pensions Act 2004. When setting the actuarial assumptions the Trustees must take actuarial advice and this advice must have regard to factors specific to the Group including the covenant of the sponsoring entity. It is important to note that the Trustees are required to act "prudently" when setting the actuarial assumptions and funding strategy in relation to the Group and this is emphasised by the Pensions Regulator's Code of Practice No. 3 (Funding Defined Benefits).
5. The legislation and Code of Practice require that the Scheme's funding position should be assessed on a "scheme specific" basis by both the Trustees and the employer. To this end, when considering the funding position at the 2007 valuation, the Trustees complied with all legislative requirements in assessing the particular circumstances of the Scheme, took actuarial advice, and, as required by their fiduciary duties and the Pensions Regulator, negotiated robustly with the employer to set the funding strategy for the Group going forward. As such, it is our view that any benchmarking of employer pension costs allowances by Ofgem – effectively, applying an averaging to these costs - would undermine the Trustees' ability to negotiate in this way and would not be in the best interests of the Group going forward.
6. Moreover, the funding position of the Group is currently assessed by the Trustees by having regard, among other things, to the covenant of the sponsoring employer. Should the current principles change, this could significantly impact the Trustees' assessment of the employer's strength going forward and the Trustees' tolerance to risk in both the funding and investment strategies of the Group. Stability of the regulatory background has provided much comfort to trustees of groups within the ESPS, allowing them to take more positive views on the strength of employer covenants within the industry. If that stability is to come under threat, the likely consequence will be more conservative investment strategies (i.e. strategies designed to achieve lower returns but at less risk of volatility) and more conservative funding strategies (i.e. providing higher funding targets and shorter recovery periods).
7. Furthermore, the points raised in the consultation paper in relation to the length of scheme recovery periods conflict with the current legislation and the Pensions Regulator's requirements for the Trustees. When agreeing a recovery plan with the Scheme employer, the Trustees are obliged by law to take actuarial advice on the appropriate length of the recovery period and notify the Pensions Regulator of it. The Pensions Regulator's Code of Practice indicates that deficits should be recovered "as quickly as the employer can reasonably afford" and therefore the suggestion of a generic recovery period is inconsistent with the Pensions Regulator's current requirements.
8. The requirement for prudence also extends to the trustees when formulating their investment strategy. Under the Pensions Act 1995, it is the Trustees who set the Group's investment strategy, although the Trustees also consult with the employer. The Trustees

take their investment duties very seriously and have established an investment sub-committee to formulate and monitor the Group's investment strategy and its suitability in respect of the Scheme's funding position, balancing anticipated reward with the risks involved.

Specific protections relating to the Scheme/Group

9. Finally, in conjunction with the legal requirements faced by the trustees of all UK pension schemes, the Group, like many other Groups within the ESPS, also contains a large number of "Protected Persons" whose benefits are governed by statute in the Electricity (Protect Persons) (England and Wales) Pension Regulations 1990. Due to the protected nature of these members' benefits, there are clear statutory obligations on both the Trustees and employer to provide benefits at a certain level. In addition, there is a specific restriction in the amendment power under the Scheme rules that effectively acts as a "no detriment" underpin to future as well as past benefits. This goes further than the statutory protections. It is therefore not possible to cut benefits within the Scheme to the same extent as has been undertaken in relation to some defined benefit schemes in other industries.

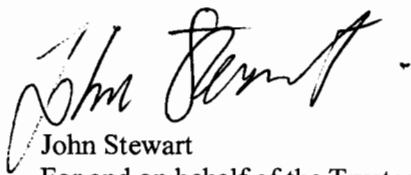
Operational Efficiency

10. The Trustees would emphasise that they are committed to managing the costs of the Group efficiently and have taken steps in recent years to monitor and improve the efficiency of the Group. Indeed the Trustees have recently been reviewing the Group's costs and processes, with a view to further improving efficiency.

Conclusion

11. We look forward to seeing the next stage in Ofgem's deliberations and expect this to reflect fully the legal context under which pensions are provided in the Group.

Yours sincerely



John Stewart
For and on behalf of the Trustees of ESPS Manweb Group