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Dear Mr McKenzie

Re: Price Control Pension Principles

The trustees of the National Grid Electricity Group of the Electricity Supply Pension Scheme and the National Grid UK Pension Scheme welcome the opportunity to comment on Ofgem's consultation on the adapted rollover. As there is an alignment of interests between both sets of trustees, this response has been prepared jointly.

The key issue for the trustees in this consultation is the length of the recovery plan that Ofgem is proposing in options 2 and 3 for the treatment of pension costs.

The trustees are very disappointed that Ofgem's 'minded to' position is to apply a fifteen year deficit funding period for the transmission networks, despite an existing regulatory precedent of ten years established during TPCR4.

The trustees continue to believe that a recovery period of no more than ten years remains appropriate. Following Ofgem's publication of the EDPCR5 final proposals, the Pensions Regulator has published specific guidance on this issue for schemes subject to economic regulation, an extract is shown below:

'…The average recovery period for all private sector schemes for the most recent phase analysed by the regulator was 8.3 years. Our wider expectations of trustees of pension schemes sponsored by regulated companies is that:

- Their primary duty is to ensure they achieve appropriate levels of security to underpin the benefits of the members of the scheme;
- The assumptions underpinning any scheme funding target and recovery plan should be specific to the circumstances of the particular scheme and sponsor;
- They are comfortable with the level of dependency on employer covenant to underpin the risk inherent in both the funding target and investment strategy, and the additional sponsor credit risk on any recovery plan;
- They have considered what mitigation, e.g. in the form of contingent assets, there should be for any greater risk members are exposed to; and
- They are comfortable that members are being treated fairly in terms of their claim on company cash flows compared with other creditors and providers of equity capital, given the scheme's position as an unsecured creditor.

In light of this guidance from the Pensions Regulator, the trustees have the following comments on Ofgem's proposed fifteen year recovery plan:

1. From the perspective of the trustees, Ofgem's 'minded to' position implies a potential 17 year recovery plan rather than a fifteen year recovery plan, as both schemes are conducting formal valuations in 2010 and the regulatory funding of the deficit would not start until 2012.

2. A 17 year recovery plan is not consistent with market practice and is significantly in excess of the 10 year trigger used by the Pensions Regulator in deciding whether to subject recovery plans to additional scrutiny.

3. Recovery plans are by their very nature scheme and circumstance specific. As a result, there is no justification for using a fifteen year recovery plan in Transmission simply because it was used in Electricity Distribution.

4. The Pensions Regulator would expect an extended recovery plan to be supported by a contingent asset arrangement and we, as trustees, anticipate that such an arrangement would need to be in place for us to consider any such agreement. We understand from the company that there can be a significant cost involved in the provision of contingent assets (for example letters of credit).

5. The covenant of the employer remains of paramount importance in assessing the appropriate prudence of the valuation as a whole and the recovery plan in particular. The trustees expect there should be alignment between the trustees wanting a strong covenant, and Ofgem ensuring the company is adequately funded.

The last point is key to the trustees' views on the appropriateness of any assumed recovery plan. Both Ofgem and the Pensions Regulator have highlighted that the assumed and actual length of any recovery plan can be different. However, the trustees view regulatory recovery of pension costs as an important part of the overall employer covenant and a mismatch between our actual recovery plan and regulatory allowances would, in our view, create the potential for the non recovery of legitimate pension costs and a weakening in the strength of the covenant.

We feel that fifteen years is excessive given the maturity of the schemes and we note that a company's willingness to pay, as well as its ability to pay, is an important consideration when evaluating a covenant. Consequently, we feel that a fifteen year recovery plan from Ofgem risks damaging perceptions of the employer covenant and it also removes flexibility in failing to recognise specific circumstances of the particular scheme and sponsor.

As a result of the above, we do not believe that the proposal to use a fifteen year recovery plan for the "adapted" rollover is consistent with the length of any actual recovery plan implied by the Pension Regulator's guidance. Furthermore, given the possible effect on the employer covenant, we do not feel that any proposal that involved a recovery plan longer than ten years would be in consumers' long term interests.

Yours Sincerely,

Jim Robson
UK Pensions Manager
(On behalf of Trustees)