

PRIVATE & CONFIDENTIAL

Mr William McKenzie
Senior Manager Financial Issues
Regulatory Finance
OFGEM
9 Millbank
London
SW1P 3GE

10 December 2013

Dear Bill,

Reasonableness Review of Energy Network Operators Pension Costs

Thank you for drawing our attention to the open letter regarding the 2014 pensions reasonableness review. Thank you also for allowing us an extension to the response date; our comments regarding the terms of reference are as follows –

Governance relationship with Trustees and NWOs –

It is important that Ofgem recognise the different roles and duties of the company and trustees:

- Companies do take into account the interests of differing stakeholders and this will include recognition of consumer interests as they are a key stakeholder group.
- It is important to acknowledge the role of trustees as stewards of our pensions schemes. Whilst trustees consult with sponsoring companies when undertaking valuations, they have significant power and control over the final decisions made. Also, it is important that Ofgem recognises that the Trustees have no legal obligation to consider consumer interests in setting funding or investment strategy.
- We understand you may request additional data in relation to the valuation negotiation process. We believe that Ofgem may have difficulties reviewing the valuation process as, for good reasons, both the Trustees and Company may not wish to disclose their strategy and negotiating approach to third parties.

As a result we believe it is unreasonable that Ofgem says it may draw adverse inferences from the non-provision of information by the trustees of any scheme. The inferences can only impact licensees yet trustees have no duty towards Ofgem.

Additional information requests -

Employer Covenant -

With regard to the employer covenant report, we will request this from the Trustees. However, as this is a Trustee document prepared for their purposes, we believe that Ofgem should not draw adverse inferences should they decide not to provide us with a copy.

Neutral estimates –

It should be noted that neutral estimates are prepared by the Scheme Actuary for the Trustees and as such are not available to the Company during the negotiation process. The company would therefore not have had the opportunity to comment on the reasonableness or otherwise of the neutral estimate prepared by the Scheme Actuary.

Value at Risk -

We recognise that a Value at Risk analysis can be useful in assessing the risk inherent in different investment strategies etc. However, there would be practical issues that would need to be addressed before Ofgem could make comparisons between schemes. For instance, different schemes will naturally exhibit different levels of risk depending on the level of maturity of the scheme's liabilities. Differences in the level of contributions and structure of the recovery plan will also impact on the level of value at risk at the end of the funding period. It would be helpful if Ofgem could provide further clarification on the scope it intends to give the consultants relating to the review of this measure.

Second Stage Review

We would appreciate more clarity regarding the circumstances under which a second stage review would be required. We note that under section 2.4, that there is a possibility that the second stage review may be undertaken concurrently with the initial stage. We believe the current position is clear that there would be no second stage review unless the first stage had indicated that a company's pension costs were inefficient, or there had been a material failure of stewardship. The last GAD review did not, in the published report, find any inefficiencies. Despite this, Ofgem then issued further questions, after the final GAD report had been published, the outcomes of which resulted in proposed adjustments to allowances for many NWOs. Please could you draw our attention to any consultation which has resulted in a change to the circumstances under which a second stage review would be required/supplementary questions would be allowed.

Proposed Timetable/Process

We are concerned that the timetable does not allow adequate time for companies to respond to draft outcomes and meet with Ofgem if necessary. The timetable is short and it is not clear when any second stage review would be carried out. Given that the final report is published on 14 December 2014, we would ask for clarification on how you will set allowances and how any second stage review will impact.

Thanks.

Kind regards

Yours sincerely,



Richard Lee