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27th April 2016.

Ian Rowson
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Ofgem
9 Millbank
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Dear Ian,

Second Consultation on Ofgem's policy for funding Network Operators' Pension Scheme Established Deficits

Thank you for the opportunity to respond to the consultation regarding the policy for funding Network Operators' (NWOs') established pension deficits. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

In our response to the first consultation, we welcomed the intent of the proposals to provide certainty of deficit funding and to remove incentives that give rise to adverse behaviour by NWOs and trustees. We stated our belief the proposals should have a beneficial impact on the cost of capital rather than protecting against adverse impacts. We raised concerns that elements such as the proposed reduction in scope of the reasonableness review and the absence of an explicit prohibition on shorter deficit funding periods may not represent customers' best interests.

We, again, raise concerns about aspects of the proposals that appear not to represent customers' best interests:

- **The scope of reasonableness review should not be reduced; and**
- **The indicative further deficit repair period should be the higher of 15 years and the value given by the pre-existing annual level of deficit funding by consumers.**

Additionally, an impact assessment would be beneficial to demonstrate the value of these proposals to customers and allow a more considered response from stakeholders.

The scope of reasonableness review should not be reduced:
We believe the scope of the reasonableness review as currently performed should not be reduced. We agree focus should be placed encouraging NWOs to pursue benefits and liability management initiatives that represent best practice in other sectors but this focus should not replace comparisons of approaches and assumptions. Comparisons may be useful in identifying those using practices that

are out of step with others and that may be detrimental to customers' interests. Commensurate with the certainty of deficit funding provided by these proposals, we believe Ofgem has a responsibility to customers to demonstrate whether the levels of deficit funding are not detrimental to customers' interests.

The indicative further deficit repair period should be the higher of the values considered:
It has been proposed that the indicative further deficit repair period should be the lower of period based on existing levels or 15 years. Instead, we recommend it should be the higher of those values.

We agree the ring-fencing arrangements, underpinned by legislation, provide for enhanced employer covenants and the quality of the covenants suggests it is appropriate to fund deficits over longer periods than would be appropriate for schemes that do not benefit from these regulatory protections. We also support the intent that funding arrangements must not place undue burden on any particular set of customers, especially since the deficits cannot be reliably linked to any particular set of customers. These factors support the indicative further deficit repair period being the higher of the values considered.

We suggest it is inappropriate to set the indicative further deficit repair period to the lower of the values considered because, in some instances, the lower value will be derived from the existing arrangements which these proposals seek to improve. Further, our recommendation would mitigate concerns we previously raised that shorter funding periods were not explicitly prohibited. Shorter funding periods bring an increased risk of stranded surpluses, fewer opportunities for de-risking and the difficulties in recovering stranded surpluses.

An impact assessment has not been presented:
An impact assessment would be beneficial to stakeholders to allow a more considered response. It is necessary these proposals are not assessed in isolation but whether they represent customers' best interests overall. For example, paragraph 2.57 states:

> *"We recognise that a governance-based approach may have a less direct influence on NWO behaviour but we believe a reliance on financial rewards and penalties for the complexities of pension liability management is more likely to be counter-productive for consumers."*

Without an impact assessment, it is difficult for stakeholders to assess whether this assertion is justified.

We hope you find our comments helpful and look forward to engaging with you on the development of this policy. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning
Head of Network Regulation, Forecasting and Settlements