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Copy to Mick Watson

15 June 2017

Dear Ian,

Response to statutory consultation on proposals to modify the ED1, ET1 and GD1 Price Control Financial Handbooks in relation the Pensions (Chapter 3)

This letter sets out our response to Ofgem's statutory consultation regarding the proposed modifications to the ED1, ET1 and GD1 Price Control Financial Handbook (Chapter 3) in relation to Pensions. Our response covers our regulatory licensees, namely, Scottish Hydro Electric Power Distribution plc, Southern Electric Power Distribution plc, Scottish Hydro Electric Transmission plc, Scotland Gas Networks, and Southern Gas Networks. We also note Ofgem's earlier decision on 7 April in relation to its policy for funding Pension Scheme Established Deficits and have separately conveyed our views to Ofgem. Our primary points in relation to this consultation are set out below.

Clarity of Practical Application of Ofgem's Reasonableness Review

As we outlined in our previous responses to Pensions consultations, we believe there still resides a degree of ambiguity and uncertainty around how a reasonableness review will be undertaken in practice despite the revised drafting of Chapter 3 in the Financial Handbook. We continue to be cautious regarding some areas of assessment and believe Ofgem should consider the implementation of their pensions policy pragmatically particularly given it's the first review using this 'new' approach. For example, it is still unclear as to what extent Ofgem will be able to assess the appropriate behaviour of how customers are considered by the company in their engagement with Trustees. Ofgem has not explicitly set out how this will be done while also not ruling out utilising their previous approach to benchmarking actuarial assumptions, investment and de-risking strategies, and scheme member benefits. In the absence of this drafting in the Financial Handbook, there appears to be a risk that this will become the default methodology for quantifying adjustments. We acknowledge Ofgem intend on using a more balanced view of Pensions governance bearing in mind the difference between schemes and pension management strategies. Therefore, we hope Ofgem applies this 'new' approach in the spirit in which it was intended regardless of whether it has been effectively translated into Chapter 3 of the Financial Handbook.

Treatment of Pension Scheme Surplus

We accept that customers should not bear costs 'unfairly' which extends to any scheme surplus. As unlikely as a 'non-temporary' scheme surplus seems, and the mitigating steps available to avoid such a surplus, we acknowledge that Ofgem's approach is not unreasonable. However, this has not been appropriately reflected in the narrative in the Financial Handbook and we believe Ofgem should amend the wording to allow sufficient flexibility to addressing this in practice while recognising a final solution is not perhaps required at this stage.

Timetable for Reasonableness Review

As we have consistently stated, we are not supportive of the intention to bring forward the reporting requirements unnecessarily for any of the Pensions Reasonableness reviews either for 2017/18 or beyond. The current proposed dates of 7 July for the Scheme Valuation dataset and 31 August for the Pension Deficit Allocation Methodology is inconsistent since Ofgem will not utilise any of the information before the 31 August information is submitted. Given the external and internal demands as well as the time of year and impending implementation of RIIO Accounts, we see a real benefit and strongly prefer the submission date to not be earlier than 31 August for all pension information.

Further Points in Relation to Drafting

We have not reiterated the points made in the Energy Networks Association (ENA) letter sent to Ofgem in relation to this statutory consultation but we are supportive as a party to that letter. In addition to this, the truncated algebra set out in Chapter 3 and the number of data sources is relatively complex and is therefore subject to a degree of interpretation differences and may have unintended consequences. We believe it would be clearer if Ofgem set out the algebra in steps similar to that of other chapters to avoid any complications.

RIGs Development

We are currently in discussion with Ofgem through the ENA in relation to the development of the Pensions RIGs and as such this response does not reflect any of our views in relation to their current RIGs drafting. Our formal comments in relation to Pension RIGs will be set out in a separate response to the relevant statutory consultation at the appropriate time.

We would be more than willing to discuss our views set out in this letter and our previous responses to pension's consultations.

Yours sincerely,



Steven Kennedy
Scottish and Southern Energy Networks



Mike Bedford
SGN