

**To: Electricity North West Ltd
Northern Powergrid (Northeast) Ltd
Northern Powergrid (Yorkshire) Plc
London Power Networks Plc
South Eastern Power Networks Plc
Eastern Power Networks Plc
SP Distribution Plc (SPD)
SP Manweb Plc
Scottish Hydro Electric Power Distribution Plc
Southern Electric Power Distribution Plc
Western Power Distribution (East Midlands) Plc
Western Power Distribution (South Wales) Plc
Western Power Distribution (South West) Plc
Western Power Distribution (West Midlands) Plc**

Direction under Part C of Standard Licence Condition 46 (Regulatory Instructions and Guidance) of the Electricity Distribution Licence to make modifications to the Regulatory Instructions and Guidance

Whereas –

1. Each of the companies to whom this Direction is addressed (together the "licensees") is the holder of an electricity distribution licence granted or treated as granted under section 6(1)(c) of the Electricity Act 1989 (the Act).
2. The Gas and Electricity Markets Authority ("the Authority"¹) gave Notice² on 27 June 2017 ("the Notice") that it proposed to make changes to the Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology ("the Pensions RIGs"). The Notice required any representations on the proposals to be made on or before 24 July 2017.
3. Prior to the consultation period closing the Authority received five responses. All non-confidential responses are published on our website. Our response to these comments is set out in Schedule 1.
4. Schedule 2 to this Direction provides a link to the following documents, which make up the Pension RIGs and incorporate modifications made in light of consultation responses:
 - (a) the Pensions RIGs guidance document, and
 - (b) the Pensions RIGs supporting excel template.
5. The Authority considers it necessary to modify the Pensions RIGs in the manner indicated in order to reflect the decision it made on Ofgem's policy for funding Pension Scheme Established Deficits³. As part of this decision, we said we would make consequential revisions to the Pension Deficit Allocation Methodology and modify the relevant Price Control Financial Handbook⁴ chapter for all sectors.

¹ The "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Office of Gas and Electricity Markets (Ofgem) supports the Authority in its day to day work.

² <https://www.ofgem.gov.uk/publications-and-updates/notice-modify-regulatory-instructions-and-guidance-held-network-operators>

³ [Decision on Ofgem's policy for funding Pension Scheme Established Deficits](#)

⁴ [Modification of the financial instruments as defined in the special conditions held by Network Operators Licensees](#)

Now therefore -

6. In accordance with the powers under Part C of Standard Condition 46, the Authority hereby issues the modified Pensions RIGs in the form specified in the documents that can be accessed via the hyperlink in Schedule 2. Licensees are required to report in accordance with these modified Pension RIGs for the purpose of regulatory reporting for the 2017 and future triennial reasonableness reviews.
7. This modification will take effect on 28 July 2017.
8. This document constitutes notice of the reasons for the Direction as required by section 49A of the Act.



Ian Rowson
Associate Partner, RIIO Finance
Duly Authorised on behalf of the Gas and Electricity Markets Authority
28 July 2017

Schedule 1: Summary of comments and our response to those comments

Serial	Issue	Raised by	Action
1	Page 5 - Contents - Section 3. Valuation – underneath this heading is a sentence that seems to have been bookmarked and should be removed	NPg	Deleted
2	Page 6 – Contents and page 64 – Section 18. Scheme datasets – remove the heading Purpose	NPg	Deleted
3	Page 6 – Contents and page 65 – Section 19 – this table and the instructions are deleted should the section be retained?	NPg	Chapter 19 now deleted from guidance and subsequent chapter references updated.
4	Page 19 – in the heading are the words “Worked Examples: Asset and liability reconciliation” need deleting	NPg	Removed
5	Page 28 – footnote 6 is against the wrong heading should be against heading “Employer contributions towards deficit”	NPg	Amended
6	Page 34 - in the left hand box under 7.2. Establish deficit there are some square brackets that should be removed	NPg	Deleted
7	Page 70 – Table 21.11 the first row “Proposed payment history, PPH” suggests a cell reference of row 79 on table 1.5. This row is called “Total Proposed EDE” and is blacked out?	NPg	Table 20.1 (Table 21.1 of the consultation) in the Pension RIGs first row amended to read 'Total Proposed EDE'
8	Tables 1.5 and 1.6 these do not comply with the colour coding on the cover pack and have a number of rows completely blacked out making the numbers impossible to read, some of these blacked rows have instructions that suggest entries should be input, for example, row 28, 69, 73 and 78.	NPg	Amended colour coding where necessary to be consistent with the colour key in the 'Pension Pack Cover' tab
9	We urge Ofgem to issue each licensee with a workbook populated with the licensee's data to 2015-16. In this way licensees can be confident that their interpretation is consistent with Ofgem's requirement.	ENWL	It is the responsibility of the Licensee to submit accurate information and to have in place the appropriate data assurance.

Serial	Issue	Raised by	Action
10	Template - the check cell in cell D40 in the P1.2 and P2.2 tables returns "OK" if the deficit from the reconciliation (D39) is greater than that from the assets and liabilities (D21). Similarly, the check in cell D64 returns "OK" if the liabilities from the reconciliation (D63) are lower than those entered above (D20). We suggest these are replaced by formula similar to that in D80.	ENWL	Replaced the formulae in cells D40 and D64 with formula similar to that in D80.
11	Template - the description in cell B99 should refer to "(a) to (m)" rather than "(a) to (l)"	ENWL	Amended
12	Template - the inputs in the 'Paragraph 6.20 adjustments' worksheet of the RIGs table workbook only allows the entry of one pre-retirement discount rate and one post-retirement discount rate in relation to the previous valuation. The format of the worksheet template therefore only seems to cater for valuations that use discount rates that do not vary by term. The amended worksheet needs to set out the pre and post retirement discount rates for each of the three years since the last valuation, which vary by term.	ENWL	Added columns so data can be included for the three years since the last valuation.
13	Context – the final paragraph in this section infers these RIGs apply retrospectively ie for DNOs it applies back to 01/04/2015. The RIGs changes cannot apply retrospectively and we seek clarity on the meaning of this paragraph.	UKPN	This paragraph has been removed.
14	Paragraph 1.5 refers to "this supplement" – it is unclear what document this is referring to.	UKPN	Paragraph 1.5 amended to read 'The pension supplement one and two of this guidance.....'
15	Table 1.1 – the commentary in rows 3(a) and 4(b)(b) will likely be the same document. With this in mind it would be sensible to caveat 4(b)(b) to clarify that licensees can signpost the previously submitted commentary rather than have to resubmit it.	UKPN	We accept that Licensees may reference where information has been provided before as part of a triennial review, but do not consider it necessary to make this explicit in the Pensions RIGs.
16	Paragraphs 21.1/21.5/21.10 use caveats such as "should" and "aim" – these can be removed. We have not reviewed the remainder of the chapter for equivalent wording but if you agree that these words can be removed then the whole chapter should be reviewed to ensure consistency.	UKPN	These paragraphs have been amended as suggested and a 'should' has been removed from paragraph 20.6 (21.6 in the consultation)

Serial	Issue	Raised by	Action
17	Paragraph 21.16 – insert “below” after “(a) to (d)” to ensure clarity on which sub-paragraphs are being referred to.	UKPN	Added
18	Paragraph 21.19 has a cross reference to cell G47 – we believe this should be C47.	UKPN	Amended to C47
19	Using paragraph 21.28 as an example it includes a definition of ABV (“ABV means...”) which is then repeated in Appendix 1 (the definitions and interpretations). As with other RIGs, words should only be defined once. Our preferred solution would be for definitions to be removed throughout chapter 21 and replaced with a signpost to appendix 1. This avoids the risk of two different definitions for the same term.	UKPN	Definitions for the following have been removed from Chapter 20 and are now only in Appendix 1: - Asset backed value (ABV); and - Licensee obligation (LO).
20	We note the inconsistency in the inclusion of the colour key (e.g. reminding user that yellow are data entry cells) in some tabs but not others. We support the inclusion of this in each tab.	UKPN	The tables have been amended and the colour key only appears in the 'Pension Pack Cover' tab. The previous inclusion in some tabs was in error.
21	Our actuarial advisers have highlighted that the inputs in the 'Para 6.20 adjustments' worksheet of the RIGs template only allows the entry of one pre-retirement discount rate and one post-retirement discount rate in relation to the previous valuation. The format of the worksheet template therefore only seems to cater for the valuations that use discount rates that do not vary by term. We attach a file which includes an updated 'Para 6.20 adjustments' worksheet, which has been amended by our actuarial advisers. The amended spreadsheet sets out the pre and post-retirement discount rates for each of the three years since the last valuation, which vary by term. This more accurately reflects the approach that was adopted at the previous valuation and leads to the adjusted investment returns for the Pre and Post Cut-off date sub funds being calculated more appropriately than the current template allows.	WPD	See serial 12
22	The formatting in rows 69:73 of table P1.5 appears incorrect for years 2018-19 to 2026-27, with some rows which require inputs currently blacked out.	WPD	If cell C6 is set to 2017-18 these cells are not blacked out.

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23	It would be helpful to have it clearly signposted at the top of PDAM tables P1.5 and P1.6 that all values should be in 2012/13 prices.	WPD	This has been made clearer by stating this in bold in cell B3.
24	Para 3.2 of the Handbook states that the allowances should be in 2012/13 prices but there is no mechanism to convert the 2016 Established Deficit (PSED) in Row 156 of P1.1 into 2012/13 prices before it flows into Cell C15 on P1.6. To ensure a consistent approach across network operators, it would be helpful to include this conversion in the tables.	WPD	We recognise the benefit of this, but this could cause an unnecessary delay, which may have a negative impact on carrying out the 2017 reasonableness review (for example if it required re-consulting with all licensees). Therefore, we have not changed the template, it is the responsibility of the Licensee to submit accurate information and to have in place the appropriate data assurance.
25	Further, it would be helpful to include an optimal mechanism in the worksheet to calculate a flat PPH using the Vrr value and an input for PHDRy. The mechanism would work in the same way as the PBAPA calculation. The outputs could then feed into the Illustrative test for PPHy in the Vrr sheet if the flat profiling option is selected.	WPD	At this stage we do not consider it necessary to make this change. We recognise the presentational benefit of this, but this could cause an unnecessary delay, which may have a negative impact on carrying out the 2017 reasonableness review (for example if it required re-consulting with all licensees).
26	We note that there maybe a need to refine the tables, especially P1.5 and P1.6, once network operators have used the tables to complete the 2017 PDAM submissions, and we may provided further feedback after the PDAM submission.	WPD	Paragraph 1.19 sets out the process that allows Licensees to identify errors.
27	The reference to "Dun and Bradstreet Failure Score" in row 44 of PDAM Table P1.4 (and 2.4) is no longer relevant, and should be replaced with "Experian Insolvency Risk" for the 2015/16 reporting year and beyond.	NG plc	Tables P1.4 and P2.4 amended to reflect change. Also para 19.11 of the Pension RIGs amended to reflect change
28	The MM/YYYY reference to "Date scored" in row 45 of PDAM Table P1.4 (and 2.4) is not valid as both Dun and Bradstreet and Experian use an annual average of failure or insolvency risk scores measured over the year.	NG plc	Reference to date and the row deleted. Also references to row numbers in the Pension RIGs Chapter 19 amended to reflect this change.

Schedule 2: Modified Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology

The modified Pensions RIGS can be found [here](#). This includes the Pensions RIGs guidance document and the Pensions RIGs supporting excel template, which are shown as version 2.0.

<https://www.ofgem.gov.uk/publications-and-updates/direction-make-modifications-pensions-regulatory-instructions-and-guidance-riio-network-operator-licensees>