

Distribution and transmission network companies, suppliers, pension scheme trustees, consumers and their representatives; and other interested parties

Your Ref:
Our Ref:
Direct Dial: 020 7901 7416
Email: RegFinance@ofgem.gov.uk

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Dear Colleagues

Revised pension allowance values and completion of 2017 reasonableness review

On 13 October 2017 we gave Notice¹ of our intention to direct revised pension allowance values as part of the 2017 reasonableness review for network operators (NWOs). This review determines the revenues that the RIIO network companies can recover to fund their established pension deficits for the next three years. This letter confirms the revised allowances and completes the 2017 reasonableness review.

Appendices 1 and 2 set out the revised allowances that will take effect from 1 April 2018. We received four responses from the network companies, but none of these gave any representation on our provisional revised allowances. We have made no changes to the provisional revised allowances set out in the Notice. The total average annual pension allowance for the next three years will reduce from £551 million to £498 million, a net reduction of £53 million.

We also confirm our recommendations to the NWOs on changes they may want to adopt before the next reasonableness review in 2020.

As part of the 2017 reasonableness review we appointed the Government Actuary's Department to review the NWOs' submissions and how they have interpreted the consumer interest. We are publishing their report with this letter.

Responses to our Notice

The four responses from the NWOs to our Notices have been published on our website. All responses support the proposed revised allowances, but they have raised some points of clarity and caution.

National Grid Gas (NGG) and Cadent say that administration and pension protection fund (PPF) costs have not increased due to the sale of four of the gas distribution networks, and the subsequent sectionalisation of their pension scheme. They also consider their forecast costs are efficient compared with other NWOs. However, they recognise we are constrained in taking a forward-looking approach to these costs. They said they would not challenge the revised administration and PPF allowances.

¹ [Notice of our provisional revised pension allowance values and 2017 reasonableness review](#)

We agree that revising administration and PPF allowances based on forecast is not part of the scope of this reasonableness review. The financial handbook² allows for an adjustment to future allowances where efficient actual expenditure is greater than the current allowance.

NGG and Cadent are also concerned that for RIIO2 we propose to adopt the same approach for administration and PPF allowances for transmission and gas distribution NWOs that applies to electricity distribution NWOs.

As part of this reasonableness review, we are not making any decision on the policy for administration and PPF allowances for RIIO2. Our approach will be consulted on as part of the RIIO-T2 and GD2 price controls.

ENWL support our new emphasis on consumer led pension strategies, but highlighted the need for caution over requiring an authoritative and collective consensus between NWOs.

In our supporting letter to the Notice we said that an authoritative and collective consensus would be highly desirable and that developing consumer-led strategies would not be straightforward. We also recognised that there would not be a "one-size fits all" approach to managing pension schemes. Therefore, we expect the NWOs to collaborate with each other in the areas where there may be a collective consensus. We gave an example that consumer attitudes to risk may not differ between NWOs.

UKPN consider that for the next reasonableness review we should provide more guidance on the phasing of pension payment history (PPH) allowances.

We consider that it is for the NWO to propose the phasing of PPH allowances and we will consider this as part of our overall reasonableness review. The financial handbook allows us to determine different profiles to those proposed by the NWO if we consider it to be in the best interest of consumers.³ We do not consider there is a need for any further guidance on this.

UKPN also highlighted a concern on one point in relation to stranded surpluses on the basis that it could be inadvertently misleading. They thought we implied that underpayments of future service contributions by existing members, through a contribution holiday, could essentially increase the established deficit. They highlighted that this would not be the case, as any ongoing accrual would be classed as incremental deficit and this would not impact consumers.

None of the NWOs' pension schemes currently have stranded surpluses⁴ and we would expect NWOs to manage their schemes in a way that avoids this in the future.

We agree with UKPN that existing members' current contributions relate to the ongoing accrual of new pension liability. However, if a stranded surplus occurs one way of recovering any surplus that has been funded by consumers is to have a contribution holiday for existing members to offset the stranded surplus. This would allow the return of any overfunding back to consumers.

Our decision and completion of the 2017 reasonableness review

We confirm that we will revise the pension allowances, as set out in our Notices, for each of the three years following this review. The revised pension allowances are set out in Appendix 1.

² [Latest price control financial handbooks for RIIO Network Operator licensees](#)

³ See paragraph 3.49 of [Latest price control financial handbooks for RIIO Network Operator licensees](#)

⁴ See paragraphs 3.43-3.46 of [Latest price control financial handbooks for RIIO Network Operator licensees](#)

We also confirm that we will revise the administration and PPF allowances, as set out in our Notices, for each of the three years following this review. The revised administration and PPF allowances are set out in Appendix 2.

We also maintain our recommendations set out in the supporting letter to the Notices with regard to the changes the NWOs may want to adopt before the next reasonableness review in 2020.

We are also not making any changes to the discount rate for payment history allowances proposed by the NWOs.

If you have any queries in relation to this decision, please contact Mick Watson (RegFinance@ofgem.gov.uk or 020 7901 7416).

Yours faithfully,



Geoff Randall
Associate Partner, RIIO Networks

Appendix 1 – Summary of revised Pension Scheme Established Deficit revenue allowances

Table A1.1 - Revised pension allowances RIIO -ED1 (£m, 2012-13 prices)

Licensee	Description	Licence Condition	Licence term	2019	2020	2021
ENWL	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	11.6	11.6	11.6
NPgN	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	11.1	11.1	11.1
NPgY	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	5.3	5.3	5.3
WMID	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	32.6	32.6	32.6
EMID	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	31.9	31.9	31.9
SWALES	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	25.4	25.4	25.4
SWEST	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	38.1	38.1	38.1
LPN	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	36.9	37.1	36.9
SPN	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	28.7	28.8	28.7
EPN	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	16.6	16.9	16.8
SPD	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	28.5	28.5	28.5
SPMW	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	26.6	26.6	26.6
SSEH	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	12.9	0.7	-
SSES	Pension Scheme Established Deficit revenue allowance	CRC 3C	EDE	25.4	25.4	16.1

Table A1.2 - of which payment history accounts (£m, 2012-13 prices)

Licensee	Description	Licence Condition	Financial handbook term	2019	2020	2021
ENWL	Payment history	CRC 3C	PPH	(5.4)	(5.4)	(5.4)
NPgN	Payment history	CRC 3C	PPH	(0.9)	(0.9)	(0.9)
NPgY	Payment history	CRC 3C	PPH	(0.4)	(0.4)	(0.4)
WMID	Payment history	CRC 3C	PPH	4.5	4.5	4.5
EMID	Payment history	CRC 3C	PPH	4.4	4.4	4.4
SWALES	Payment history	CRC 3C	PPH	1.5	1.5	1.5
SWEST	Payment history	CRC 3C	PPH	1.7	1.7	1.7
LPN	Payment history	CRC 3C	PPH	13.0	13.0	13.0
SPN	Payment history	CRC 3C	PPH	9.3	9.3	9.3
EPN	Payment history	CRC 3C	PPH	8.4	8.4	8.4
SPD	Payment history	CRC 3C	PPH	3.3	3.3	3.3
SPMW	Payment history	CRC 3C	PPH	2.7	2.7	2.7
SSEH	Payment history	CRC 3C	PPH	7.5	0.7	-
SSES	Payment history	CRC 3C	PPH	-	-	-

Table A1.3 - Revised pension allowances RIIO-T1 (£m, 2009-10 prices)

Licensee	Description	Licence Condition	Licence term	2019	2020	2021
SHE - Transmission plc	Pension Scheme Established Deficit	6D	EDE	2.7	2.1	-
SPTL	Pension Scheme Established Deficit	6D	EDE	2.5	2.5	2.5
NGET TO	Pension Scheme Established Deficit	6D	EDE	27.9	27.9	27.9
NGET SO	Pension Scheme Established Deficit	7C	SOEDE	8.5	8.5	8.5
NGGT TO	Pension Scheme Established Deficit	5C	EDE	25.7	25.7	25.7
NGGT SO	Pension Scheme Established Deficit	6C	SOEDE	1.4	1.4	1.4

Table A1.4 -of which payment history accounts (£m, 2009-10 prices)

Licensee	Description	Licence Condition	Financial handbook term	2019	2020	2021
SHE - Transmission plc	Payment History	6D	PPH	1.4	1.9	-
SPTL	Payment History	6D	PPH	0.5	0.5	0.5
NGET TO	Payment History	6D	PPH	(0.7)	(0.7)	(0.7)
NGET SO	Payment History	7C	PPH	(0.2)	(0.2)	(0.2)
NGGT TO	Payment History	5C	PPH	1.7	1.7	1.7
NGGT SO	Payment History	6C	PPH	0.1	0.1	0.1

Table A1.5 - Revised pension allowances RIIO-GD1 (£m, 2009-10 prices)

Licensee	Description	Licence Condition	Licence term	2019	2020	2021
East	Pension scheme deficit revenue allowances	3C	EDE	10.2	10.2	10.2
London	Pension scheme deficit revenue allowances	3C	EDE	6.1	6.1	6.1
North West	Pension scheme deficit revenue allowances	3C	EDE	7.1	7.1	7.1
West Midlands	Pension scheme deficit revenue allowances	3C	EDE	5.2	5.2	5.2
Northern	Pension scheme deficit revenue allowances	3C	EDE	3.8	3.7	3.5
Scotland	Pension scheme deficit revenue allowances	3C	EDE	6.3	6.3	6.3
Southern	Pension scheme deficit revenue allowances	3C	EDE	9.6	9.6	9.6
Wales & West	Pension scheme deficit revenue allowances	3C	EDE	7.7	7.7	7.7

Table A1.6 - of which payment history accounts (£m, 2009-10 prices)

Licensee	Description	Licence Condition	Financial handbook term	2019	2020	2021
East	Payment History	3C	PPH	(0.4)	(0.4)	(0.4)
London	Payment History	3C	PPH	(0.3)	(0.3)	(0.3)
North West	Payment History	3C	PPH	(0.3)	(0.3)	(0.3)
West Midlands	Payment History	3C	PPH	(0.2)	(0.2)	(0.2)
Northern	Payment History	3C	PPH	-	-	-
Scotland	Payment History	3C	PPH	0.5	0.5	0.5
Southern	Payment History	3C	PPH	0.9	0.9	0.9
Wales & West	Payment History	3C	PPH	0.5	0.5	0.5

Appendix 2 – Summary of revised administration and PPF allowances

Table A2.1 - Revised administration and PPF Revised allowances (£m, 2009-10 prices)

Licensee	Description	Licence Condition	Licence term	2019	2020	2021
East	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.6	0.6	0.6
London	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.3	0.3	0.3
North West	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.4	0.4	0.4
West Midlands	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.3	0.3	0.3
Northern	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.7	0.7	0.7
Scotland	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.5	0.5	0.5
Southern	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.7	0.7	0.7
Wales & West	Pension scheme administration and Pension Protection Fund Levy	3C	APFE	0.8	0.8	0.8
NGGT TO	Pension Scheme Administration and Pension Protection Fund levy	5C	APFE	1.5	1.5	1.5
NGGT SO	Pension scheme administration and Pension Protection Fund Levy	6C	SOAPFE	0.1	0.1	0.1
SPTL	Pension scheme administration and Pension Protection Fund Levy	6D	APFE	0.1	0.1	0.1
NGET TO	Pension scheme administration and Pension Protection Fund Levy	6D	APFE	1.3	1.5	1.3
NGET SO	Pension scheme administration and Pension Protection Fund Levy	7C	SOAPFE	0.4	0.5	0.4