



Making a positive difference
for energy consumers

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

Direct Dial: 020 7901 7000
Email: RegFinance@ofgem.gov.uk

Date: 9 November 2020

Dear Colleagues,

Revised pension allowance values and completion of 2020 reasonableness review

On 9 October 2020 we gave Notice¹ of our intention to direct revised pension allowance values as part of the 2020 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 sets out the revised allowances and completes the 2020 reasonableness review. We also confirm the recommendations, as set out in the Notice, to the NWOs on changes they may want to adopt before the next reasonableness review in 2023.

This decision does not affect the policy for administration and pension protection fund allowances for RIIO-2. Our approach for those areas will be considered on as part of the consultation process for the RIIO-T2 and GD2 price controls.

As part of the 2020 reasonableness review, we appointed the Government Actuary's Department (GAD) to review and produce a report of the NWOs' submissions. We asked GAD to provide a high-level view on the pension valuations methodology and assumptions, and how they have interpreted the consumer interest building on their reviews from 2014 and 2017. Link to GAD's full high-level review can be found at Appendix 3.

Summary of GAD's Review

GAD identified there are several notable changes on benefit design, investment strategy and the method and assumptions used to determine the NWOs' defined benefit pension costs at the most recent valuations. They did not have any major concerns, and it is accepted that some changes will occur between valuations.

¹ [Notice of our provisional revised pension allowance values and 2020 reasonableness review](#)

- Pension Costs – large changes but not considered unreasonable, although some areas for NWOs to consider;
- Considering consumer interest – All NWOs show some evidence, with most carrying out research and engagement with Trustees; and
- They found no concerns with the sectionalisation of the pension scheme following the sale of National Grid Gas Distribution to Cadent.

Responses to our Notice

There were two responses from the NWOs to our Notice, and these have been published on our website.² They identified minor errors in the tables set out in the appendices to the Notice letter. These errors have now been corrected, as reflected in the appendices.

We received no other responses, and so we have decided to make no further changes to the proposed allowances.

The next reasonableness review (in 2023): interpreting the interest of consumers and stranded surplus

We maintain the view, as set out in the Notice, that for the 2023 reasonableness review we will require continued and/or further evidence of how NWOs have interpreted the interests of consumers.

We also confirm that as part of future reasonableness reviews, we will conduct an initial review of any established surplus to identify whether a more detailed review is required. This more detailed review will occur as part of the close-out of RIIO-2, using the latest information available at that time. The review would take into account the mitigating actions a NWO has put in place to manage an unnecessary surplus, prevailing and forecast market conditions, the impact of any pension payment holidays (including the timing of those holidays) and the materiality of the surplus. If the review concludes an adjustment is required, it will be applied as part of the close-out of RIIO-2.

Our decision and completion of the 2020 reasonableness review

Our decision is to revise the pension allowances for each of the three years following this review according to the proposed values set out in the Notice with minor corrections following NWOs' responses. Appendix 1 sets out the revised pension allowances, and Appendix 2 shows the current established deficit and a comparison against the previous reasonableness review. Appendix 3 contains the link to GAD's full high-level review.

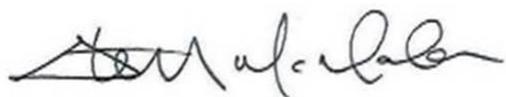
For electricity distribution, the revised allowances will be reflected as part of the Annual Iteration Process.

For gas distribution, electricity and gas transmission, and the electricity system operator, the allowances will be in the model that support our RIIO-2 final determinations. It will feed into the Price Control Financial Model, which we will include in the statutory licence consultation for RIIO-2.

If you have any queries in relation to this decision, please contact us by email to RegFinance@ofgem.gov.uk.

² <https://www.ofgem.gov.uk/publications-and-updates/notice-our-provisional-revised-pension-allowance-values-and-2020-reasonableness-review>

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Steven McMahon', written in a cursive style.

Steven McMahon
Deputy Director, RIIO Electricity Distribution and Cross Sector

Appendix 1 – Summary and analysis of revised pension allowances

Table 1.1 - Revised pension allowances RIIO -ED1 (£m, 2012-13 prices)

Licensee	Description	Licence term	2022	2023	2024	2025	2026	Average 2022-24 ¹
ENWL	PSED Revenue Allowance	EDE	10.8	9.4	-	-	-	10.1
NPgN	PSED Revenue Allowance	EDE	10.7	4.4	4.4	-	-	6.5
NPgY	PSED Revenue Allowance	EDE	5.2	2.1	2.1	-	-	3.2
WMID	PSED Revenue Allowance	EDE	34.8	34.8	23.4	-	-	31.0
EMID	PSED Revenue Allowance	EDE	36.3	36.3	24.7	-	-	32.4
SWALES	PSED Revenue Allowance	EDE	13.8	13.8	9.0	-	-	12.2
SWEST	PSED Revenue Allowance	EDE	24.2	24.2	17.0	-	-	21.8
LPN	PSED Revenue Allowance	EDE	16.4	16.4	16.4	16.4	2.1	16.4
SPN	PSED Revenue Allowance	EDE	13.6	13.6	13.6	13.6	2.0	13.6
EPN	PSED Revenue Allowance	EDE	5.9	5.9	5.9	5.9	2.0	5.9
SPD	PSED Revenue Allowance	EDE	24.7	24.7	24.7	24.7	0.2	24.7
SPMW	PSED Revenue Allowance	EDE	25.8	25.8	25.8	25.8	25.8	25.8
SSEH	PSED Revenue Allowance	EDE	-	(2.7)	(2.7)	(2.7)	(2.7)	(2.7)
SSS	PSED Revenue Allowance	EDE	21.0	21.0	16.0	16.0	16.0	19.3

Table 1.2 - Revised pension allowances RIIO-ET2 (£m, 2018-19 prices)

Licensee	Description	Licence term	2022	2023	2024	2025	2026	Average 2022-24 ¹
SHE - Transmission plc	PSED Revenue Allowance	EDE	(0.9)	(1.9)	-	-	-	(1.4)
SPTL	PSED Revenue Allowance	EDE	3.0	3.0	3.0	3.0	3.0	3.0
NGET TO	PSED Revenue Allowance	EDE	31.5	31.1	12.6	-	-	25.0
NGET SO	PSED Revenue Allowance	SOEDE	9.6	9.4	3.8	-	-	7.6

Gas

Table 1.3 - Revised pension allowances RIIO-GT2 (£m, 2018-19 prices)

Licensee	Description	Licence term	2022	2023	2024	2025	2026	Average 2022-24 ¹
NGGT TO	PSED Revenue Allowance	EDE	(11.0)	(11.0)	(11.0)	-	-	(11.0)
NGGT SO	PSED Revenue Allowance	SOEDE	0.7	0.7	0.5	-	-	0.6

Table 1.4 - Revised pension allowances RIIO-GD2 (£m, 2018-19 prices)

Licensee	Description	Licence term	2022	2023	2024	2025	2026	Average 2022-24 ¹
East	PSED Revenue Allowance	EDE	11.7	7.2	-	-	-	9.5
London	PSED Revenue Allowance	EDE	6.8	4.3	-	-	-	5.5
North West	PSED Revenue Allowance	EDE	6.6	3.1	-	-	-	4.9
West Midlands	PSED Revenue Allowance	EDE	7.4	5.1	-	-	-	6.3
Northern	PSED Revenue Allowance	EDE	4.7	4.7	13.2	13.2	13.2	7.5
Scotland	PSED Revenue Allowance	EDE	0.5	0.5	0.5	0.5	0.5	0.5
Southern	PSED Revenue Allowance	EDE	0.4	0.4	0.4	0.4	0.4	0.4
Wales & West	PSED Revenue Allowance	EDE	8.4	8.4	8.4	8.4	8.4	8.4

¹ ENWL, SHE Transmission, SSEH and Cadent (East, London, North West & West Midlands) - 2-year average, remainder 3-year average

Table 1.5 - Payment History Accounts (£m, 2012-13 prices)

Licensee	Description	Financial handbook term	2022	2023	2024	2025	2026
ENWL	Payment history	PPH	(6.2)	(6.2)	-	-	-
NPgN	Payment history	PPH	(1.3)	(1.3)	(1.3)	-	-
NPgY	Payment history	PPH	(0.6)	(0.6)	(0.6)	-	-
WMID	Payment history	PPH	11.4	11.4	-	-	-
EMID	Payment history	PPH	11.5	11.5	-	-	-
SWALES	Payment history	PPH	4.8	4.8	-	-	-
SWEST	Payment history	PPH	7.2	7.2	-	-	-
LPN	Payment history	PPH	(5.4)	(5.4)	(5.4)	(5.4)	1.1
SPN	Payment history	PPH	(4.2)	(4.2)	(4.2)	(4.2)	1.1
EPN	Payment history	PPH	(2.1)	(2.1)	(2.1)	(2.1)	1.0
SPD	Payment history	PPH	(0.5)	(0.5)	(0.5)	(0.5)	(0.0)
SPMW	Payment history	PPH	1.9	1.9	1.9	1.9	1.9
SSEH	Payment history	PPH	-	(2.7)	(2.7)	(2.7)	(2.7)
SSES	Payment history	PPH	-	-	(2.5)	(2.5)	(2.5)

Table 1.6 - Payment History Accounts (£m, 2018-19 prices)

Licensee	Description	Financial handbook term	2022	2023	2024	2025	2026
SHE - Transmission plc	Payment History	PPH	(0.9)	(1.9)	-	-	-
SPTL	Payment History	PPH	0.4	0.4	0.4	0.4	0.4
NGET TO	Payment History	PPH	(5.6)	(5.6)	(5.5)	-	-
NGET SO	Payment History	PPH	(1.7)	(1.7)	(1.7)	-	-

Table 1.7 - Payment History Accounts (£m, 2018-19 prices)

Licensee	Description	Financial handbook term	2022	2023	2024	2025	2026
NGGT TO	Payment History	PPH	(11.0)	(11.0)	(11.0)	-	-
NGGT SO	Payment History	PPH	0.7	0.7	0.5	-	-

Table 1.8 - Payment History Accounts (£m, 2018-19 prices)

Licensee	Description	Financial handbook term	2022	2023	2024	2025	2026
East	Payment History	PPH	3.3	3.3	-	-	-
London	Payment History	PPH	1.7	1.7	-	-	-
North West	Payment History	PPH	0.5	0.5	-	-	-
West Midlands	Payment History	PPH	0.5	0.5	-	-	-
Northern	Payment History	PPH	-	-	8.5	8.5	8.5
Scotland	Payment History	PPH	0.5	0.5	0.5	0.5	0.5
Southern	Payment History	PPH	0.4	0.4	0.4	0.4	0.4
Wales & West	Payment History	PPH	3.2	3.2	3.2	3.2	3.2

Appendix 2 – Summary of proposed Pension Scheme Established Deficit revenue allowances

Table 2.1 - Revised allowances following Ofgem 2020 Reasonableness Review (2018 -19 prices)

Price Control	Licensee	Licence term	Average 2017 Reasonableness Review (2018-19 prices)	Average 2020 Reasonableness Review (2018-19 prices)	Variance	Variance
			£m	£m	£m	Percentage
ED1	ENWL	EDE	13.4	11.7	(1.7)	-13%
	NPgN	EDE	12.8	7.5	(5.3)	-41%
	NPgY	EDE	6.2	3.7	(2.5)	-41%
	WMID	EDE	37.7	35.9	(1.8)	-5%
	EMID	EDE	36.9	37.6	0.7	2%
	SWALES	EDE	29.4	14.1	(15.4)	-52%
	SWEST	EDE	44.1	25.2	(18.9)	-43%
	LPN	EDE	42.8	19.0	(23.8)	-56%
	SPN	EDE	33.3	15.7	(17.5)	-53%
	EPN	EDE	19.4	6.8	(12.6)	-65%
	SPD	EDE	33.0	28.6	(4.3)	-13%
	SPMW	EDE	30.8	29.9	(0.8)	-3%
	SSEH	EDE	5.2	(3.1)	(8.4)	-160%
SSES	EDE	25.8	22.4	(3.4)	-13%	
	RIIO-ED1		370.9	255.1	(115.8)	-31%
ET2	SHE - Transmission plc	EDE	3.2	(1.4)	(4.6)	-144%
	SPTL	EDE	3.3	3.0	(0.3)	-9%
	NGET TO	EDE	36.6	25.0	(11.5)	-32%
	RIIO-ET2		43.1	26.7	(16.4)	-38%
	NGET SO	SOEDE	11.1	7.6	(3.5)	-32%
GD2	East	EDE	13.3	9.5	(3.9)	-29%
	London	EDE	8.1	5.5	(2.5)	-31%
	North West	EDE	9.4	4.9	(4.5)	-48%
	West Midlands	EDE	6.9	6.3	(0.6)	-9%
	Northern	EDE	4.8	7.5	2.7	57%
	Scotland	EDE	8.3	0.5	(7.8)	-94%
	Southern	EDE	12.6	0.4	(12.3)	-97%
	Wales & West	EDE	10.1	8.4	(1.7)	-16%
	RIIO-GD2		73.5	42.9	(30.5)	-42%
GT2	NGGT TO	EDE	33.7	(11.0)	(44.7)	-133%
	NGGT SO	SOEDE	1.8	0.6	(1.2)	-65%
	RIIO-GT2		35.5	(10.4)	(45.9)	-129%
	Total		534.0	321.9	(212.1)	-40%

*ENWL, SHE Transmission, SSEH and Cadent (East, London, North West & West Midlands) - 2-year average, remainder 3-year average

Appendix 3 – GAD’s High-level review of network operator’ costs

Full report

[https://www.ofgem.gov.uk/system/files/docs/2020/11/gads - ofgem 2020 high-level review of network operators pension costs 0.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/11/gads_-_ofgem_2020_high-level_review_of_network_operators_pension_costs_0.pdf)