

### Price Control Pension Principles Consultation Document

1 The Association of Electricity Supply Pensioners was formed in 1994 to represent the industry's staff and pensioners in respect of pension matters and, particularly those matters in which the Scheme trustees have difficulty or are unable to properly deal with e.g. the differing decisions amongst the existing 22 Groups schemes which currently make up the Electricity Supply Pension Scheme (ESPS) and legal matters. The ESPS has 204,000 members.

2 We would remind you that the ESPS is a contributory scheme and that many of our members joined at a time when membership was compulsory and a condition of their employment.

3 Having examined your document, we are of the opinion that it has been unduly influenced by political hard right opinion which currently believes that employers have no obligation to provide adequate pension provisions for their staff because this expense is eventually reflected in the product costs. This notwithstanding that there is a high degree of final salary pensions provision continuing in the public sector to be fully funded by taxpayers.

4 In the electricity supply industry, we have provided a safe, continuous and, often taken for granted, reliable supply to our customers over many years through the original periods of private/Local Authority ownership, times of nationalisation and, most recently, in privatisation.

5 This kind of service has until now been based on a sound and continuous employee relations policy, including wages and salaries which have often been lower than those in private industry in order to recognise other benefits, such as continuity of employment and pensions the cost of which has been shared between employers and staff.

6 Unlike in other industries, many ESPS staff have worked in the industry all their working lives. We contend that the dedication of our staff has been the backbone of the service which the employers have, up to the present, been able to supply. None of this appears to come through in your document, which appears to concentrate solely on the consumer cost reduction possibly even at a cost of service reduction.

7 Apart from these important matters we recognise that further generating capacity is now urgently needed if supply rationing is to be avoided. It takes a number of years to plan, develop and build these facilities and there is now a real danger that they will not come on stream on time unless more capital is invested and unless staff morale is maintained. Estimates of the capital costs of this investment vary considerably. With the need to replace expired nuclear and coal-fired generating plant, additional environmental costs and the government's commitment to a 35% renewable obligation our companies will be faced with capital cost over the next 10 years in excess of £100 billion. This investment by our companies in non-regulated businesses will of course be a shareholder cost. There will however be significant regulated business costs in connecting this capacity to the network. It is difficult to see how the industry could meet these forward investment costs and meet the buyout costs of the 'in deficit' £22 billion ESPS.

8 Turning to your concentration on the increased cost of defined benefit pension schemes, of which this industry has several, we should remind you that your document has been issued at a time when the national economy is failing, investment returns have been reduced and employers are seeking to minimise their expenses by closing, selling off or abandoning pension schemes altogether. The short-term view that is projected in the document is inaccurate because pension schemes are long-term investors.

9 We deprecate the fact that some, less scrupulous non electricity supply, employers are currently taking steps to dispose of their pensions scheme and current liabilities whilst the best possible case can be made. In the longer term, when the economy improves, the current deficits will be reduced and may even disappear altogether. This is a truer and more realistic view than the short-term view which emerges from your document.

10 We are at a loss to understand what is meant by a cautious funding strategy. To our mind such a strategy would be one where the trustees attempt to meet liabilities by the restricting their investment to government stock or perhaps triple rated bonds. Such a strategy provides no scope for a real return on the assets and no growth in the fund value.

11 The ESPS has in excess of 204,000 members, 121,500 of whom are currently either pensioners or dependents in receipt of pension. The average pension, taken from these figures and from the Scheme's Annual Report for 2007/8, suggests a pension of £9,700 per annum or £186 per week for a lifetime's service in the industry.

12 As you will be aware, each of our 22 Group schemes has to be re-valued at three yearly intervals and this process has to satisfy current legislation, the requirements of the PPF procedures and the Scheme rules. Companies are also aware that they must be prepared to fund their pension group to meet the potential liabilities determined in accordance with the Electricity (Protected Persons) Regulations made under the 1989 Electricity Act.

13 Our trustees have to agree the technical provisions of these triennial reviews with employers. The employers, in the light of the present economic downturn, are proving to be highly resistant to agreeing terms of deficit repair which they consider not necessary for funding the schemes other than on an ongoing basis. They are also indicating their reluctance to confirm that they will continue the historic practice of paying RPI increases in pensions. (The Scheme rules only make such increases mandatory up to 5%.)

14 It seems logical that because of the membership differences between groups in the ESPS that actuarial assumptions should be on a group specific basis rather than a scheme wide basis and certainly not some much wider basis that might be promoted by the Pensions Regulator.

15 All these measures are designed to minimise the effect of pension expense on the industry's customers who, it must be remembered, include all our members.

16 We are particularly concerned about the paragraphs in the document which appear to indicate that Ofgem has some power over our scheme trustees. In paragraph 3.4 it is stated that: "If it is found that there are insufficient incentives (to companies selling their pension liabilities) one potential option might be for Ofgem to require sponsors and trustees to crystallise their liabilities by running a competition to buy out liabilities".

17 Ofgem has no power to require independent trustees to do anything. Trustees must act within the law and in the best interests of the trust. Ofgem's powers are restricted to dealing with employers' regulated businesses and the effects that their costs may have on customers. You will, we hope, recognise that this is nonsense and misleading as coming from a Government organisation of your standing. We look to you to correct this error in your next report.

18 We are concerned that two Government organisations are incurring considerable public expenditure on assessing the risk factors in our schemes in order to arrive at conclusions for their particular purposes namely, the PPF for levy purposes and Ofgem for tariff assessment. Surely public money could be saved by some co-ordination between these similar operations?

19 Your document also contains a number of inaccuracies including, in paragraph 3.6 where it states that EASL has “been involved in selling on their pension liabilities”. The present position is that the trustees have purchased an annuity to cover their current and future liabilities. The annuity remains as an asset in the Scheme.

20 Members have made a formal complaint about this process which is now with the Pensions Ombudsman. Until this matter is resolved, possibly in the courts, the matter can go no further. This may take some time!

21 Again by citing this company as a ‘buy-out’ example you also appear to have failed to understand the particular nature of EASL within the industry and the complex arrangements for inherited pension liabilities and other costs which do not apply elsewhere. Again we are surprised that you have not got your facts right with all the expensive facilities available to you.

22 We are very surprised to see that you may be considering reducing the “allowance” in your calculations for the employers’ expenses in connection with the PPF levy. As this is a compulsory payment which cannot be avoided it must be allowed in full. Similarly, where an employer decides to augment its pension fund, i.e. reduce future risk, in order to reduce the PPF levy, this should also be allowed in full either as a “pass through” or as a direct expense within the term under review.

23 It appears to us that your very complicated document can be boiled down to a small number of loaded questions. These are:

- a) Are the employing companies incurring excessive pension costs in the expectation that these will be met by increased customer tariffs?
- b) Should the present Ofgem procedures be changed to encourage energy companies to either reduce or sell off these liabilities?
- c) Is it appropriate to reconsider this in the current Ofgem short term review or in the longer term “RPI-x@20” Review?
- d) In carrying out its statutory function of protecting consumers from undue tariff increases, is it right for Ofgem to influence the internal personnel and staff relations procedures within all or specific energy companies?
- e) Are the present “pass through” arrangements from one review to the next operating satisfactorily or should they be tightened to prevent abuse of the process?
- f) Are there any “special” circumstances which may limit the extent to which procedures may be altered in the energy companies as opposed to the other competitive market employers?
- g) What are the factors to be taken into account when setting deficit repayment periods?
- h) Are the electricity employers allowing their pension schemes to be too conservative in their risk assessments?
- i) Would a transfer from DC to DB schemes in this industry benefit consumers and does Ofgem have any power to influence such a change?

24 Comments on some of these questions are already contained in the above paragraphs; however we would make the following additional observations:

- a) We are certain that our employers are not incurring additional pension liabilities with a view to passing them through to their tariffs; all our schemes and trustees observe the pensions legislation to the letter and the degree of risk incorporated into our schemes accords very favourably with other similar schemes. We believe that scheme specific assumptions allow group trustees to make efficient decisions regarding their scheme membership.
- b) Final salary pension schemes have been part of the personnel structure of our industry since before nationalisation in 1948 and have contributed to stable industrial relations and to continuity of regular and reliable supplies to customers; if this facility were to be withdrawn, sold off or abandoned staff morale would undoubtedly suffer and industrial consequences could follow, with repercussions on our customers;
- c) In the event of any “sale” of pension liabilities, considerable additional costs would be incurred not only in legal expenses from members’ attempts to prevent such sales, but also in the fact that employers would have to immediately fund such schemes to the “buy out” levels required by the Electricity (Protected Persons) Regulations. It needs considerable research to assess whether the financial market could in today’s environment finance a ‘buy-out’ of ESPS liabilities.
- d) In view of the long-term investment character of our schemes, we would hope that Ofgem would take the long-term view of deficit and regular support expenses; this could have a beneficial effect on customers as the economy improves and scheme deficits reduce with improved investment performance and scheme cost reduction possibly leading to surpluses;
- e) Ofgem is not legally competent to direct the decisions of independent trustees.
- f) We recognise that financial, political and legal pressures can be brought to bear on our employers to make such changes as replacing the few presently “open” DB schemes with, more risky, insurance style offerings. The ESPS already has provision for such schemes
- g) We are concerned regarding your principle that any surplus must be passed back to the customer. It needs to be understood that the pension is a contractual liability between the employee and the employer. Any surplus which is generated as a result of wise investment by trustees, acting for the employees, cannot automatically revert to the ‘customer’.
- h) Your approach to the disposal of surpluses must be constrained by existing court decisions regarding the disposal of pension fund surpluses. We would also point out that in Europe pensions are deferred salary and therefore the property of the employee and not for sequestration under any Ofgem formula. In the current financial market situation – and probably for many years – we recognise that the likelihood of any distributable surpluses is low.

21 We hope that this response will fully convey this Association’s response to your consultation paper and we look forward to the further consultative steps which you have outlined.