

Mr. Bill McKenzie,
Senior Manager, Regulatory Finance (Networks)
Office of Gas and Electricity Markets
9 Millbank
LONDON
SW1P 3GE

10 September 2009

Dear Mr. McKenzie

Price Control Pension Principles - Second Consultation Document

I submitted the Association's views on your earlier consultation document. This letter comments on your letter of 31 July and a more detailed attachment is also enclosed. As before I have no objection to the publication of our views subject to removal of my personal contact details.

We are appalled that pension costs are being specially targeted by OFGEM in the current round of items for consideration. Obviously, in the present economic downturn all institutions which rely on savings and investments have been seriously affected and asset values are probably at their lowest point at the present time. It has been observed that the Government's policy of quantitative easing is a significant factor in restricting improvements in schemes' asset values.

Pension benefits, whether actually being paid or being funded for the future, are part of a company's wage bill and are in recognition of the efforts that are being made or have already been made by its staff to support the business. We would therefore expect such costs to be accepted as a normal part of the business expenses and be subject to the "pass through" arrangements" which OFGEM has operated previously.

Our pension schemes have statutory support, are contributory, and are administered by combined employer/employee groups of trustees in accordance with the Trust Deed, the Pensions Acts and with the advice of experts in the law and investments. We welcome the fact that your report finds no fault with the stewardship of these schemes and that existing pension liabilities will be funded and will not be put at risk.

We take issue with your approach to future pensions because:

- a) the closure of many final salary schemes and the general discouragement of workers to take up and pay for future pensions is bound to cause many to rely in the future on State benefits and this will result in an unsustainable burden for future generations; and

- b) existing schemes are certain to benefit from the impending economic up-turn and therefore their present financial positions should not be taken as any guide for the next five years and certainly not 10 years. Any upturn will result in a reduced burden being incurred by the respective businesses and this will be reflected in future reduced customer costs.

You appear to believe that employers can exert greater control of pension costs even though many have legal and moral obligations to their present and past employees. As we pointed out following your last report, pension scheme trustees operate within a legal framework and OFGEM has no right or duty to interfere with their duties and responsibilities. Any attempt to alter the pension arrangements for members of existing schemes, as you suggest, may be both illegal and damaging to the businesses concerned.

We welcome your initial conclusion that we expose network companies to less risk than comparable regulated companies under the current application of your pension principles.

It is true that our trustees have not attempted to seek full buy-out funding levels when dealing with the electricity employers; pension schemes are a partnership between the two parties and, as such there is an understanding of each side's financial position. This helps to reduce and spread employer costs in an equitable manner over a realistic period. Also deficit payments are being spread over periods agreed with employers and this too leads to reduced customer costs.

Whilst we understand that you may not seek to direct NWOs in making their pension arrangements, the tenor of the latest document does rather leave this impression. The suggestion of setting benchmarks for various costs, including employment costs, enhances this view. Benchmarks are used by trustees to measure income from investments but are not suited to the measurement of expenses because of the likely number and complexity of explanations for differences, which you would find difficult to evaluate and verify.

Your suggestion that unprotected active members could be asked to make higher contributions could only be achieved within the requisite scheme rules and might easily be regarded as a reason for workplace disruption which would not benefit customers in the long run. This Association would actively campaign against such measures if they were introduced at the instigation of OFGEM.

There is a further untruth in your document where you indicate that any future surpluses might not be shared with sponsors. There is a well-established process for this to be done on a two thirds (employer) and one third (members) basis. This stems from *Laws and Mayes v National Grid*, in which the House of Lords supported the process, [2001] UKHL 20.

You have mentioned that our schemes have tended to invest their capital in a slightly more conservative manner than UK plcs generally; this stems from the regrettable fact that most of our schemes have now been closed to new members for some time and are therefore more mature than their wider UK counterparts. Actuarial and investment advisers, who must by Law be consulted by trustees, have prompted trustees to match their investments with their liabilities; this has resulted in a greater bond type investment with less long-term risk. The Employers have, of course, participated in these decisions and agreed the rightness of the approach. We hope that OFGEM is not now going to second guess this advice.

Repayment of deficits has to be a matter for agreement between the trustees and the employer and in many cases long-term repayment periods have been agreed in our schemes. We see no objection to the ten-year period that you appear to suggest provided that the

employer is sound and open about its finances and is unlikely to liquidate or sell off its franchise.

Your provisional allowance for pensions in DPCR5 of £1.4bn is obviously totally inadequate as is the ongoing amount of £0.5bn. You obviously know this and are attempting to intimidate the employers into taking more of these costs into their profits. Whilst this may satisfy OFGEM's need to justify its existence, it may also prove to be an incentive for some companies to dispose of their regulated businesses, thus further reducing competition in the industry. If press speculation is to be believed, this may already be happening. Surely it would be more pragmatic to raise these figures to a more realistic level and to recoup any betterment by subsequent adjustments?

This letter summarises our views. The attachment responds in more detail.

Yours sincerely,

Dr Neville Wrench

Chairman