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E14 4PU

11 February 2022

Dear Jon,

**Re: Consultation on the closeout methodologies for RIIO-GD1**

We write in response to the above titled consultation published on 14/01/2022. SGN broadly support these close out methodologies, however, we would like to comment on the following two areas.

Firstly, regarding the proposed methodology for the FPNES, no claim for allowances will be made for Scotland GDN's over delivery per the agreement relating to our Voluntary Contribution in November 2017. We will also return the allowances for under delivery in Southern noting that, as this under delivery was driven by Covid, that no penalty will be imposed.

Secondly, we do have concerns on the methodology for the Shrinkage and Environmental Emissions Incentive. SGN are of the opinion that it is not necessary to proceed with adjustments to either the year 8 RIIO-GD1 outturn volumes or the RIIO-GD2 baseline system pressures and MEG values. We consider that the proposed changes are unwarranted and that the position agreed and set out in the RIIO-GD1 and the RIIO-GD2 licences should be maintained. Should Ofgem disregard this, and move away from the licence, then, and in the absence of any reasonable alternative, we would choose option B over option A.

We are happy to discuss this response further at your convenience.

Yours sincerely,

Mike Bedford  
Director of Corporate Finance and Regulation

## **Annex 1: Consultation questions**

### **Question 1: Do you agree with our proposed approach to financial methodologies?**

SGN agree with the principal of the proposed methodology and the use of the RIIO-GD1 PCFM as a means for adjustments to flow through to the RIIO-GD2 legacy MOD term.

We would also highlight that in 2022/23 tariffs we have fed through an adjustment. The origin of this adjustment was a NTS booking capacity oversight which we were unable to change at the time and generated an increased NTS incentive reward in 2020/21. This was communicated to Ofgem at the time, and it was agreed that the GD1 close-out mechanism was the preferred methodology to return these funds.

### **Question 2: Do you agree with our proposed methodology for the iron mains risk reduction programme?**

Yes. We agree that performance should be considered against the risk removed primary output, which SGN exceeded in both its networks. It is also right to note the wider benefits of this work, including a significant improvement in safety that continues to be delivered, as well as the substantial reduction in methane emissions and the benefits to the general public that arise through less disruption as emergency repair work continues to reduce.

### **Question 3: Do you agree with our proposed methodology for the FPNES?**

Yes. However, SGN will not make a claim for allowances for SGN Scotland's over-delivery as per the agreement made in our Voluntary Contribution in November 2017. In line with the proposed close out methodology we also agree to return the allowances for under delivery in Southern, noting that, as this under delivery was driven by Covid, that no penalty will be imposed.

### **Question 4: Do you agree with our proposed methodology for capacity utilisation?**

Yes. SGN met its requirements in full and this was reported through the regulatory reporting pack and the Network Output Measures (NOMs) performance report covering the period of RIIO-GD1.

### **Question 5: Do you agree with our proposed methodology for the reliability output?**

Yes. SGN fully met its requirements and this output has demonstrably improved outcomes for our customers.

### **Question 6: Do you agree with our proposed methodology for the Shrinkage and Environmental Emissions Incentive?**

No, we do not. We do not believe any further action is required as there is a clear differentiation between the RIIO-GD1 Incentive, and the modified incentive developed for RIIO-GD2.

Regarding the objective to maintain a link between the RIIO-GD1 and RIIO-GD2 (ODI-F) incentives, SGN believe that due to the fundamental changes to the financial mechanisms of both incentives, any link between the two would be tenuous and unnecessary. SGN would also point to the inherent link that already exists between the RIIO-GD1 incentive and the RIIO-GD2 (ODI-R). This reputational incentive means that SGN must maintain the excellent work carried out in RIIO-GD1 to efficiently manage all elements of leakage (methane) reduction, that we will be accountable to our stakeholders for our performance, and as such, this negates the requirement for any further adjustments.

SGN strongly disagree with the proposal detailed in Option A: *"The RIIO-GD1 2020-21 shrinkage outturn position is adjusted so that it is based on the average pressure and gas conditioning values recorded from 2017-18 to 2019-20, rather than the outturn position from Year 8 of RIIO-GD1. The RIIO-GD2 methodology remains as per the current licence mechanism."* Implementing this would require a change to a Licence condition, agreed in 2012/13 for the RIIO-1 price control period without appropriate and prior notification.

SGN also have considerable reservations related to the proposal detailed in Option B: *“The RIIO-GD2 year 1 baseline value is adjusted so that it is based on the RIIO-GD1 Year 8 outturn position, rather than the average pressure and gas conditioning values recorded from 2017-18 to 2019-2020, as stated at Final Determinations, and as implemented in Special Condition 7.10. The RIIO-GD1 methodology remains as per the current licence mechanism.”* These changes will most certainly significantly affect business plans already set at final determination for the current price control period.

Also, SGN would contest the Authority’s assertion that *“there was no observable Covid-19 impact on RIIO-GD1 Year 8 performance”*. Regarding Average System Pressures, two of SGN’s three Local Distribution Zones (LDZ’s) saw significant variations from historical performance. As we expect demand profiles to return to pre-pandemic *“historical trends”* during the RIIO-GD2 price control period it will render any five-year baseline set on those 20/21 outturn pressures unmerited and unrepresentative. Additionally, if all elements of leakage reduction activities are considered, the impact of the pandemic restrictions on SGN’s iron mains replacement programme were significant and observable, substantially weakening performance against the Environmental Emissions Incentive (EEI) in the final year of RIIO-GD1.

SGN do recognise that the Authority stated in the Final Determination that the 3-year average baseline values would be used *“in the closeout of the RIIO-GD1 incentive”*. When SGN sought further clarity on how this was to be achieved in February 2021, we were informed that this was still to be decided and the Authority would provide clarity *“in due course”*. We are now nearly 1/5<sup>th</sup> of the way through the RIIO-GD2 price control period. As a result, SGN have already implemented strategic operational decisions on how to best manage the distribution network in cognisance of the 3-year baseline originally proposed. It is our firm view that making these changes now is too late, will generate inefficiencies and is not in the customers’ interest.

SGN are of the opinion that it is not necessary to proceed with adjustments to either the year 8 RIIO-GD1 outturn volumes or the RIIO-GD2 baseline system pressures and MEG values. We consider that the proposed changes are unwarranted and that the position agreed and set out in the RIIO-GD1 and the RIIO-GD2 licences should be maintained. Should Ofgem disregard this and move away from the licence then, and in the absence of any reasonable alternative, we would choose option B over option A.

**Question 7: Do you agree with our minded-to position in respect of the pre-RIIO-GD1 period, i.e., to correct the provisional adjustment and align the treatment of net interest on derivatives with the policy intent of the clawback mechanism as set out in the 2009 Open Letter? If not, please explain why.**

We do not believe we have all the details of this close out issue and therefore do not feel we are in a position to comment further.

**Question 8: As regards clawback during RIIO-GD1, which of options one and two do you consider to be more appropriate? Please explain why.**

We do not believe we have all the details of this close out issue and therefore do not feel we are in a position to comment further.

**Question 9: Do you agree with our proposed methodology for disposals?**

Due to the fact that the disposals in the PCFM model for RIIO-GD1 were not variable inputs, we therefore agree that adjustments need to be made through closeout to the opening RIIO-GD2 RAV balances in line with the RIIO-GD1 5-year delay policy.