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Date: 30 March 2012

Dear James,

## **Initial Assessment of RIIO-GD1 Business Plans**

SGN welcome the opportunity to respond to Ofgem's initial assessment of the RIIO-GD1 business plans.

We are fully supportive of the RIIO philosophy. In particular, we believe that enhanced stakeholder engagement, outputs-led regulation with a range of supportive incentives and a greater focus on innovation will ensure that the Gas Distribution Networks are able to play an active role in the move to a low-carbon economy. We submitted a Business Plan in November 2011 based around those principles.

Given our commitment to RIIO, we were disappointed with Ofgem's initial assessment of our Business Plan. The high level 'traffic light' assessment of our Business Plan did not, in our view, take full account of a number of key issues. For example, Ofgem identified us as relatively high cost for a number of activities (and hence a red 'traffic light') but recognised that further work was needed to consider appropriate cost drivers and company specific factors.

This is a critical issue for us as effective comparative cost assessment can only be undertaken when company specific factors are taken in to account. In our Business Plan submissions we provided arguments for sparsity adjustments in Scotland and urbanity and labour productivity adjustments in Southern. Where appropriate we provided external professional review of the logic of our proposals and the evidence to determine their validity.

We have also clarified some simple misunderstandings via the 'Q&A' process e.g. the perceived variation in governor unit costs between Scotland and Southern and double counting of reinforcement expenditure.

We appreciate the time that Ofgem staff have given to providing further feedback in the broad areas of asset strategy (both repex and asset integrity), cost efficiency, innovation and financeability. Following constructive discussions we now better understand Ofgem's concerns. We have also worked with the other GDNs on the repex Tier 2 threshold and on options for the treatment of uncertain costs around smart meters.

We expect our 27 April Business Plan re-submission will address Ofgem's key concerns and clarify our initial submission in areas such as gas holder decommissioning, fuel poor network extensions and our proposals around environmental outputs. Whilst we note that repex and the GDNs approach to cost benefit analysis are propriety issues for Ofgem, as discussed above, a further priority is to ensure that the impact of regional factors is adequately addressed in Ofgem's assessment of all GDNs' business plans.

Please call or e-mail me if you have any further questions.

Yours sincerely,

Malcolm J. Burns  
**Senior Regulation Manager**