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Hannah Nixon  
Senior Partner for Distribution  
The Office of Gas and Electricity Markets  
9 Millbank  
London SW1P 3GE

September 21, 2012

Dear Hannah,

**Regarding: July 27, 2012 Initial Proposals**

Borealis Infrastructure has been following developments regarding RIIO-GD1 with interest. As you can appreciate we are regularly briefed by Scotia Gas Networks. It is Borealis' opinion that there remains a gulf between Ofgem and SGN which both parties should strive to close prior to Ofgem's Final Proposals.

Borealis' opinion is influenced by our investment management experience in three mature utility markets (Canada, UK and USA) as well as our extensive due diligence review of other utility markets including Australia, Europe and Latin America.

Borealis is of the opinion that the Initial Proposals are unduly challenging for SGN in three respects, namely significant cuts in the totex submission of two of the United Kingdom's most efficient gas networks, a financing proposal that results in weak credit ratios and an incentive proposal with limited potential to stimulate material innovation.

SGN have demonstrated to Ofgem's team that for SGN the financial ratios derived from the Initial Proposals based upon financing and totex performance in line with the Initial Proposals results in weak financial ratios particularly in the early years of the next determination. As rating agencies generally focus on expected performance over a three year time horizon the proposals merit further consideration by Ofgem. This could be addressed through recognition that the proposals would likely result in a BBB rated network based on performance and gearing consistent with Ofgem's Initial Proposals which in turn warrants a cost of debt allowance in keeping with a BBB rating rather than a blended A/BBB index and an equity risk premium commensurate with such a rating.

The proposal for SGN's totex is excessively challenging. As a director of SGN I can assure you that safety is at the core of SGN's operations and business planning. It is my understanding that Ofgem has given minimal consideration in its assessment of relative totex costs to the fact that five of the eight GDNs failed to meet the 97% emergency response standard in recent years, as compared to the two SGN networks which achieved the standard each year including in Scotland which experienced the most adverse winter weather. I ask Ofgem to consider amending the benchmarking analysis to include the experience of the three GDNs which met the standards under all operating conditions when adjusting operating and capital costs for the five networks that failed this license condition as all networks should achieve this safety standard even in severe winters. I also request that Ofgem consider SGN's position that higher contract labour rates in



Southern England and the sparsity effect of low population density in Scotland be factored into the benchmarking analysis.

The incentive proposals offer minimal incentives to stimulate the innovation and investment required to develop a more sustainable energy network. SGN has made several proposals to promote the industry-wide connection of green gas to the grid and we remain disappointed with Ofgem's limited incentives in this area. SGN would also like Ofgem to reconsider greater incentives in relation to raising the awareness of the dangers of carbon monoxide.

In conclusion Borealis would like Ofgem to consider our thoughts on financing, totex allowances and incentives thereby proposing a more balanced package consistent with Ofgem's statement during RIIO-GD1 that a good performing gas network should be able to earn a double digit real RORE.

I trust that we can find common ground on these topics prior to Final Proposals.

Best regards

A handwritten signature in blue ink, appearing to read "Sebastien Sherman", followed by a long, horizontal, wavy line that extends to the right.

Sebastien Sherman  
Senior Vice President