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1 September 2015

Dear Mick,

SGN response to Ofgem consultation on minded to position for the review of costs associated with the RIIO-GD1 enhanced physical site security uncertainty mechanism

Thank you for the opportunity to respond to your minded to position for the review of costs associated with the RIIO-GD1 enhanced physical site security uncertainty mechanism that you published on 31 July 2015.

As a gas distribution network (GDN), our response focuses upon the RIIO-GD1 enhanced physical site security uncertainty mechanism. We have chosen not to respond to those aspects of your minded to position that relates to the TPCR4 enhanced physical security upgrade programme or the RIIO-T1 enhanced physical site security uncertainty mechanism unless it specifically relates to our assets.

Assessment of Costs

We welcome Ofgem's recognition that we have provided VFM1 reports for the majority of our sites, and that our costs represent value for money with no material inefficiencies being identified. We consider this fairly reflects the good quality and reliability of our submission and the detail we have provided to substantiate our submission to Ofgem. We also note that Harnser's report to Ofgem recognises this by proposing that only £1m of costs should be disallowed from our original submission due to the small level of inefficiencies that have been identified.



[REDACTED]

We therefore consider the reasons for Ofgem disallowing £13m of our costs requires further explanation and we set out below our further justification of these costs for Ofgem's further consideration.

Site J Facility

We are disappointed that Ofgem's minded to consultation disallows our entire funding request for the upgrading of our Site J facility. Ofgem notes the reason for this decision is that it does not feel we have considered all of the potential options for the upgrading of Site J [REDACTED].

[REDACTED]

[REDACTED] We will not be able to meet Ofgem's proposed output of ensuring all sites are CNI compliant, as required by DECC by the end of RIIO-GD1, unless this facility is significantly upgraded and the funds for undertaking this are approved by Ofgem at this reopener window. Furthermore, the costs [REDACTED] [REDACTED] are unlikely, on their own, to qualify for funding under future reopener windows as they will not exceed the materiality threshold stipulated within the RIIO-GD1 Final Proposals. If Ofgem's current minded to position does not change, we therefore face the very real prospect of not receiving any funding for our Site J facility for the remainder of RIIO-GD1.

[REDACTED]

In terms of undertaking the upgrades that are now required to our Site J facility, we have considered a number of options in deciding the best option for ensuring CAT3 compliance and best value for money for our customers.

The options we have considered are summarised as follows:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



Technical Variations

As part of our uncertainty mechanism reopener submission, we highlighted that additional construction requirements can only be established after site specific design and surveys are completed.

We would like to re-emphasise again that historically, construction projects of this scale are not completed to base cost. Consideration must be taken into account that any potential Technical Variations will not result in the sum of money required to trigger the threshold in the 2018 reopener window. We therefore consider our position on an appropriate allowance for Technical Variations is an accurate reflection on the known risks documented within our submission. As can be seen from the Enhanced Physical Security Reopener Application produced by Harnser, SGN is continually described as being 'cost effective' and 'value for money'. It is our opinion that these Technical Variation costs represent factual clarity of what it will take to successfully and efficiently deliver physical site security upgrades.

The proposed reduction in Technical Variation costs to 5% per site or £3.3m for all sites, is a significant value considering the level of risk associated with the current outstanding unknown factors. We previously submitted prices to Ofgem as requested to efficiently deliver physical site security upgrades based on a standard design and installation, and noted these are still subject to the required survey work and completed G17 design. This survey work can generally take between 90-120 days to complete, and therefore we would not have been able to achieve this with the time constraints required to submit in the May 2015 reopener window.

We would be supportive of the recommendation made by Harnser in their Enhanced Physical Security Review, which suggests Technical Variances should be reduced as physical site security enhancements progress and further experience is gained as to the requirements of surveys and G17 design.³

² Harnser Enhanced Physical Security Review Report, Section 7.2.1, GCC/ARC Building Costs, Page 38.

³ Harnser Enhanced Physical Security Review Report, Section 7.2.2, Technical Variations, Pages 38-39.

Operating costs and central overheads

We would like to propose an additional review of the post-delivery support agreement for ongoing maintenance and additional overhead costs.

This is the only occasion where our costs have been described as 'high' by either Harnser or Ofgem. We have reviewed these costs and can confirm that these are accurate based on the package of maintenance we have proposed.



Proposal to introduce an output commitment in relation to enhanced physical security

In principle, we agree with Ofgem's proposal to introduce an output commitment as indicated in its minded to consultation.

However, Ofgem must ensure it allows companies sufficient funding under the enhanced physical site security uncertainty mechanism to upgrade all CNI sites, and we currently do not consider this is the case.



Should you require any further information with regards to our response then please do not hesitate to contact either myself at paul.mitchell@sgn.co.uk or Mike Bedford at mike.bedford@sgn.co.uk .

Yours sincerely,

Paul Mitchell
Regulation Manager

