

# RIIO GD2 Business Plan Appendix

## Gas Holder / Land Strategy

### December 2019



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## 1 Background

This appendix sets-out the gasholder and land strategy for GD2 following the formation of an unregulated property company known as SGN Place.

This impacts on GD2 as the surplus gasholder sites have been transferred to SGN Place so that entity is now responsible for gasholder demolition and land remediation.

SGN Place is under a legal obligation to deliver gasholder demolition and land remediation on these sites on behalf of the SGN regulated business (though the regulated output remains the responsibility of Scotland Gas Networks and Southern Gas Networks) and bears the cost and risk of that activity together with changes in land value, if any, against the transfer value.

## 2 Transfer of risk / reward

To de-risk the regulated business in relation to gasholder demolition and environmental liabilities 59 sites have been transferred to an unregulated company, SGN Place. Historically property has been disposed of from either the SGN regulated business or the unregulated SGN Commercial Services (SGNCS). In future, the majority of disposals will be made from SGN Place (SGNP).

Property development and planning activities sit better outside the regulated business given the cost and risk associated with these activities and therefore the gas customer should not be exposed to these costs and risks.

## 3 Working with Ofgem to achieve consent

To formalise the process of transferring non-operational assets between the regulated and unregulated business, we have worked closely with Ofgem to develop a consent that sets out amongst other things, how transfer prices are determined, RAV adjustments, contractual obligations and reporting.

Set out below are the terms of the consent issued to Southern Gas Networks by Ofgem in January 2016, initially for the disposal of six freehold properties to SGNCS. Ofgem has since confirmed that this consent can act as a framework for the bulk transfer of the majority of non-operational gas holder sites to SGN Place.

### Terms of the consent:

On 26 March 2015, Southern Gas Networks gave notice as Licensee to the Gas and Electricity Markets Authority (Ofgem) of its intention to dispose of the following six freehold properties to SGN Commercial Services Ltd:

1. Bromley, Kent;
2. Camberley, Surrey;
3. Kennington, London;
4. Rotherhithe, London;
5. Tunbridge Wells; Kent; and
6. Wandsworth, London.

In response to Ofgem requested on 7 April 2015 and 8 May 2015, Southern Gas Networks provided further information to Ofgem, including confirmation that *'the disposals would provide for ongoing access to the properties by the Licensee pending redevelopment of the properties.'*

Ofgem issued consent to the transfer on 21 January 2016 ('the 2016 consent'). The consent contained the following key terms:

12. *Disposals made under this consent must not:*
  - a. *Cause the licensee to breach any requirements under health and safety or other legislation...*

...

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14. ...the Licensee must engage a Chartered surveyor with appropriate experience to provide a Market Value... and provide that Chartered Surveyor with all the information that is pertinent to the valuation of the property, (including the results of any other recent valuations) that is held by:
- a. the Licensee; and
  - b. all members of Scotia Gas Networks Ltd group...  
For the purposes of this paragraph, the Licensee must obtain confirmation from the Board of Scotia Gas Networks Ltd that all members of the Scotia group have provided all such information that they are aware of to the Licensee.
- ...
18. The terms of each disposal must impose contractual requirements on Commercial:
- a. to complete any remediation works that the Licensee had been required to complete with respect to the property under any licence or price control requirements which were not completed before the disposal (which may be achieved by imposing contractual requirements on a subsequent acquirer);
  - b. not to sell any of the properties to an Associate of the Licensee, as that term is defined in Standard Special Condition A37 (Availability of Resources) of the Licence, without prior consent from the Authority; and
  - c. to provide the Licensee with the information it needs to comply with the conditions set out in this consent.
19. The Licensee must obtain indemnities from Commercial in respect of any incremental costs relating to the development of the Licensee's pipe-line system that arise as a result of any of the disposals.

## Application to SGN Place

As set out earlier, the same approach has been taken for the properties transferred to SGNP as for the properties transferred to SGNCS. The terms of the 2016 consent were applied as follows:

Paragraph	Subject	Action
-	Access	<ul style="list-style-type: none"> <li>The disposals will provide for ongoing access to the properties by the Licensee pending redevelopment of the properties</li> <li>It is intended to grant a 999-year lease to the Licensee in respect of areas containing live infrastructure</li> </ul>
12	Health and Safety	<ul style="list-style-type: none"> <li>A robust process is in place for the handover of sites from the regulated business to SGN Place</li> <li>SGN Place will provide for a more consistent approach to be adopted to the future management of health and safety at redundant sites across the network, bringing them under a single management framework and drawing on the specialist skills and experience of the estate's management and security teams.</li> </ul>
14	Valuations	<ul style="list-style-type: none"> <li>See Section 4. below</li> <li>The Board of Scotia Gas Networks Ltd will provide confirmation that all members of the Scotia group have provided the Licensee with all the information that is pertinent to the valuation of the property, including the results of any other recent valuations.</li> </ul>
18	Contractual requirements	<ul style="list-style-type: none"> <li>Each disposal will impose contractual requirements on SGN Place to complete any remediation works that the Licensees had been required to complete, which may be achieved by imposing contractual requirements on a subsequent acquirer such as a third-party developer</li> <li>SGN Place will seek best value for each property and is therefore unlikely to wish to sell any properties to an Associate of the Licensee, but should this arise will seek Ofgem's prior consent</li> </ul>
19	Indemnities	<ul style="list-style-type: none"> <li>SGN Place will indemnify Licensees in respect of any incremental costs relating to the development of the Licensee's pipe-line system that arise as a result of any of the disposals, and specifically in respect of any relocation of plant and equipment belonging to the Licensees where such relocation is required in order to dispose of or develop the site (but not where relocations arise from network modernisation or rationalisation)</li> </ul>

## 4 Independent valuations for each site

The value of each property transferred from the regulated business to SGN Place is calculated as follows:

Transfer value = Red Book Value<sup>1</sup> – estimated costs of holder dismantling<sup>2</sup> – estimated cost of ground remediation to statutory level<sup>2</sup>

### Notes

1. The Red Book Value has been produced assuming that the holder has been removed and that the property has been remediated to a level compliant with statutory requirements
2. Where the costs of holder demolition and statutory remediation have been funded by customers already in GD1, these values have not been deducted for RAV adjustments

### Transfer value

The valuation of the sites to SGN Place and the consideration for the transfer is provided in Table 1 below. Where relevant, adjustments will be made to the transfer value to ensure that where customers have already funded any cost of sale, the RAV adjustments will take this into account.

**Table 1: Transfer value**

Number of sites	Total Red Book Value	Ground remediation costs <small>Commercial Confidentiality</small>	Holder dismantling costs <small>Commercial Confidentiality</small>	Transfer value
59	£73,298,250	-£17,132,721	-£54,556,227	£1,609,302

**Table 2: Transfer value Scotland network**

Number of sites	Total Red Book Value	Ground remediation costs <small>Commercial Confidentiality</small>	Holder dismantling costs <small>Commercial Confidentiality</small>	Transfer value
Scotland - 12 sites	£1,958,000	-£1,878,703	-£5,232,795	-£5,153,498
Add Back Unused GD1 Allowance	-	£580,421	£2,900,000	£3,480,421
RAV Adjustment	-	-	-	<b>-£1,673,077</b>

**Table 3: Transfer value Southern network**

Number of sites	Total Red Book Value	Ground remediation costs <small>Commercial Confidentiality</small>	Holder dismantling costs <small>Commercial Confidentiality</small>	Transfer value
Southern - 47 sites	£71,340,250	-£15,254,018	-£49,323,433	£6,762,799
Add Back Unused GD1 Allowance	-	£7,546,820	£3,220,000	£10,766,820
RAV Adjustment	-	-	-	<b>£17,529,619</b>

In terms of RAV adjustment, as we are proposing to offset the holder demolition and land remediation costs that customers have not funded in GD1 from the sales proceeds, we are not requesting allowances for holder demolition or land remediation in GD2 for sites transferred to SGN Place.

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## 5 Network Director sign-off

### **Operational sites retained by regulated business**

Whilst some operational gas plant remains on these sites, the sites are predominantly surplus former gasholder sites. Our Network Director signed-off the transaction on the basis that any parts of these redundant sites that are still used by the operational business would be transferred to SGN Place, but 999-year leases put in place for retained areas where operational gas plant such as a gas governor is located.

The regulated business has security of tenure through the 999-year lease process, but this has been adopted rather than retained freehold as the legal process for potential plant rationalisation in the future is more efficient. However, SGN Place will be responsible for the costs of any gas plant rationalisation and this will require the agreement of the regulated business regarding location and specification of any changes.

As part of this process, the Network Director has requested that six sites remain in the regulated business.

## 6 GD1 high-level summary

### Gasholder dismantling

In GD1, Ofgem funded a phased dismantling programme of 50% of our regulated gasholders (55 gasholders) over the 8-year period, with the remainder to be demolished in GD2. To date (December 2019), we have dismantled 49 gasholders and forecast to have completed 55 by March 2020, therefore delivering this GD1 output. The only remaining gasholders in the regulated business in GD2 will be Provan 1 & 2 (frames only).

A high-level financial summary of GD1 spend to date and remaining forecast is detailed in Table 2.

**Table 4: GD1 spend forecast**

GD1 (2018/19 prices)	13/14 £m	14/15 £m	15/16 £m	16/17 £m	17/18 £m	18/19 £m	19/20 £m	20/21 £m	Total £m
Scotland	0.00	0.66	1.28	0.34	1.92	0.20	0.41	1.24	6.05
SGN Place Adj for Scotland	0.00	0.00	0.00	0.00	0.00	0.20	0.00	0.00	0.20
Southern	3.24	4.97	9.49	3.29	4.71	2.28	1.25	0.74	29.97
SGN Place Adj for Southern	0.00	0.00	0.00	0.00	0.00	3.28	0.00	0.00	3.28
<b>Total</b>	<b>3.24</b>	<b>5.63</b>	<b>10.78</b>	<b>3.64</b>	<b>6.63</b>	<b>5.97</b>	<b>1.66</b>	<b>1.97</b>	<b>39.51</b>

### Land remediation

For land remediation, Ofgem did not define the number of sites on which it expected us to address the statutory risk in GD1. We were required to report on the number of sites, the area of land, the routine site monitoring costs, the statutory land remediation costs and the non-statutory remediation costs. The work undertaken to December 2019 has resulted in the statutory risk being addressed on 166 sites totalling 228.5 acres across both our Scotland and Southern networks. We estimate that there are a further 42 sites that will be considered off-risk by the end of GD1.

A high-level financial summary of GD1 spend to date and remaining forecast is detailed in Table 3.

**Table 5: GD1 spend to-date/remaining forecast**

<b>GD1 (2018/19 prices)</b>	<b>13/14 £m</b>	<b>14/15 £m</b>	<b>15/16 £m</b>	<b>16/17 £m</b>	<b>17/18 £m</b>	<b>18/19 £m</b>	<b>19/20 £m</b>	<b>20/21 £m</b>	<b>Total £m</b>
<b>Scotland</b>	0.46	0.63	0.47	0.78	0.93	0.89	1.43	0.61	6.20
<b>SGN Place Adj for Scotland</b>	0.00	0.00	0.00	0.00	0.00	3.49	0.00	0.00	3.49
<b>Southern</b>	0.06	1.09	2.41	2.79	2.08	0.69	0.55	1.06	10.73
<b>SGN Place Adj for Southern</b>	0.00	0.00	0.00	0.00	0.00	7.28	0.00	0.00	7.28
<b>Total</b>	<b>0.52</b>	<b>1.72</b>	<b>2.88</b>	<b>3.57</b>	<b>3.01</b>	<b>12.35</b>	<b>1.98</b>	<b>1.67</b>	<b>27.70</b>

We have also incurred £7.42m of land remediation costs in respect of non-holder sites during GD1 to date.

## 7 GD2 Investment

### Gasholder dismantling

Gasholders 1 & 2 at Provan were listed by Historic Environment Scotland (HES) after significant consultation in 2018. We therefore have an obligation to maintain these structures in GD2 because dismantling is no longer an option.

The specific work being proposed in GD2 has not taken place since 2000 (i.e. 19 years ago). When the gasholders were operational, our policy was to conduct these works every 7 to 10 years. We therefore believe these works are justified.

The £8.65m (opex) costs estimate submitted in our business plan that fulfils this requirement have been provided by Commercial Confidential, a specialist contractor for civil and structural engineering. Commercial Confidential was instructed to undertake a feasibility study into the refurbishment of the guide frame structures and provide some preliminary costing advice.

The scope of works included are scaffolding both column-guided steel frame structures (largest in the SGN portfolio), surface preparation and painting (primer, undercoat and topcoat) to provide a corrosion protection with an expected durability of up to 25 years. No alternative options have been considered apart from 'do nothing' which was disregarded.

Success of this project will be governed by looking after our infrastructure for the safety of our employees and contractors but also demonstrating to the local authority and to HES that we take seriously our duties as owner of a listed structure(s).

A high-level financial summary of proposed GD2 spend is detailed in Table 4.

**Table 6: Summary of proposed GD2 spend**

GD2 (2018/19 prices)	21/22 £m	22/23 £m	23/24 £m	24/25 £m	25/26 £m	Total £m
Scotland	3.78	4.83	0.01	0.01	0.02	8.65
Southern	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>3.78</b>	<b>4.83</b>	<b>0.01</b>	<b>0.01</b>	<b>0.02</b>	<b>8.65</b>

### Land remediation

We are applying for GD2 funding to manage our identified statutory contaminated land risks that remain in the regulated business. The process of site investigation, monitoring, risk assessment and remediation is detailed in our Site Assessment and Remediation procedure and broadly follows the principles defined by the Environment Agency (and adopted by SEPA) in Model Procedures for the Management of Land Contamination (CLR 11) and the CIRIA document Contaminated Land Risk Assessment - A guide to good practice (C552). Funding for this work will come from shareholders or from site sales.

The land remediation costs of £23.42m (opex) in GD2 take into account the investment required to relocate gas plant prior to the remediation works being undertaken on sites in the regulated business. These costs are based on the site-specific costs provided by the respective Asset Engineering Managers and Advisian costs.

In respect of the actual remediation costs environmental consultants Commercial Confidential were appointed to review existing site data and historical site plans across our portfolio. They used their experience of assessing former coal gas production works and knowledge of the processes that typically determine the existence of statutory risk.

These remediation cost estimates have recently undergone the scrutiny of our external auditors. In addition to

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this, all projects will undergo a competitive tender process. Where appropriate, we would expect the market to adopt innovative techniques to make cost savings.

A high-level financial summary of proposed GD2 spend is detailed in Table 5.

**Table 7: GD2 proposed spend**

<b>GD2 (2018/19 prices)</b>	<b>21/22 £m</b>	<b>22/23 £m</b>	<b>23/24 £m</b>	<b>24/25 £m</b>	<b>25/26 £m</b>	<b>Total £m</b>
<b>Scotland</b>	1.67	2.12	1.65	1.33	1.45	8.22
<b>Southern</b>	2.07	4.31	4.45	2.29	2.08	15.20
<b>Total</b>	<b>3.74</b>	<b>6.43</b>	<b>6.10</b>	<b>3.62</b>	<b>3.53</b>	<b>23.42</b>