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(on behalf of SGN ISG)

To: riio3@ofgem.gov.uk

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Dear Ofgem team

RIIO-3 Draft Determinations Consultation (GD3)

This response is written on behalf of SGN's Independent Stakeholder Group. We have provided support and challenge to SGN as they developed their Business Plan and provided a comprehensive response to the Ofgem Call for Evidence on the Plan at the start of the year. We are pleased that Ofgem has acknowledged our contribution at a number of points in its Draft Determination.

In this cover letter we start with comments on the areas that we had particularly endorsed in our response to the Call for Evidence and then provide reflections on the overall package of costs and investment, in particular where these relate to safety, which is a primary concern for customers. Finally, we have attached responses to some of the specific questions raised by Ofgem where we have a particular view. Where we do not comment this should not be taken as agreeing with the SGN position.

There is much to welcome in Ofgem's Draft Determination and, in particular, we are very pleased that Ofgem has increased the **VCMA funding** in line with SGN's request. We had strongly supported a higher level of funding for VCMA given the ongoing cost of living crisis and the strong value that we have seen SGN delivering in this area and the leading role it has played on cross sectoral collaboration. We would have liked to see an upweighting of funding in Scotland recognising the particular challenges in that area but understand Ofgem's desire for a uniform approach. In addition, while we support the recognition of vulnerability as part of business as usual we would like to see some way of ring-fencing the baseline funding that is provided (ref GDQ11). These views are supported by SGN's vulnerability steering group.

We also warmly welcome the funding for the **SIUs** as we have been strong advocates of converting these to bio CNG to avoid the costs of shipping LNG by road, the associated emissions of doing so and also to demonstrate the role biomethane could play in particular remote communities as part of a circular economy. We hope that SGN can answer Ofgem's remaining questions around design costs. (ref GDQ21 and SGNQ12)

On other areas of the Plan that we had strongly endorsed based on the feedback from customers and stakeholders, there is perhaps more of a mixed picture.

In part this that reflects what we see as two cross-cutting concerns:

- In some areas where SGN had requested **reopeners / UIOLI** funding Ofgem has instead provided **baseline funding**. While on the face of it this is positive as Ofgem is endorsing the need for this work, it does have some potential downsides. The first is that including the cost of projects that go above and beyond BAU as part of benchmarking risks leaving SGN disadvantaged as they will appear inefficient. The second, which is of particular concern to us as an ISG, is that without a PCD for these initiatives there is a risk that they will be cut back when SGN is balancing priorities in GD3. This would not have been an issue with a reopener or UIOLI funding. While we are aware of the threshold Ofgem has set for PCDs we would ask Ofgem to consider this option for particular initiatives where it has moved funding to baseline, in particular on Remote Pressure Management and on Biomethane Improved Access Rollout (ref SGNQ9 and SGNQ11).

- On **innovation** we had been strongly supportive of most of the projects put forward although we acknowledged in our response that SGN had been looking for levels of funding through NIA and NZARD that exceeded that set out in the Business Plan Guidance. With a range of funding routes available for innovation (including also NZASP and SIF), each with different governance arrangements, we relied on Ofgem to determine the most appropriate funding for projects that were justified, noting in some cases (as is the nature of innovation) the projects were not yet fully developed. We highlight below particular projects that we are concerned have not been funded but also have a broader concern at the scale of cuts in this area, in particular the cuts to NIA funding (ref SGNQ17). We appreciate that Ofgem may require more detail in order to feel comfortable awarding funding, and this is an area where we are keen to ensure that the requirements are clear and SGN's justification is improved.

Turning now to specific elements of the Business Plan that we supported in our response to the Call for Evidence and how they fared:

Biomethane – As we flagged in our response on the Business Plan, increasing levels of biomethane has strong consumer support as a heat solution that is s available now, provides the same heat experience and involves no customer disruption. It is also consistent with circular economy principles. We also note the recent support from NESO in FES 2025 for increased levels of biomethane. However, as things stand, we are unclear how far the Draft Determination facilitates SGN's ambitions in this area.

The biomethane UIOLI allowance (for partial funding of connection costs) seemed at first sight to be simply an alternative to funding biomethane producers through the Green Gas Support Scheme. However, we understand discussions are ongoing around ensuring that the UIOLI does provide additional value by e.g. funding reinforcement work. The NZARD funding SGN was looking for to deliver its Improved Biomethane Access Rollout - which is aimed at addressing the problems that producers have in connecting and / or injecting at times of low pressure as well as avoiding the need for propanation – has been included in baseline. As set out above we would like to see a PCD to ensure delivery of this work. We would also welcome clarity about how additional unanticipated costs might be covered as this is an evolving area (ref SGNQ11 and GDQ20)

Hydrogen blending - we are aware that in its Business Plan Guidance Ofgem had said no baseline funding was available for hydrogen blending but in our response to the Call for Evidence we flagged that we saw initial preparatory work as important given that DESNZ took a 'strategic decision' to support hydrogen blending in distribution networks' back in 2023[1] and , perhaps more importantly, the moves at EU level which will mean blended gas could flow in over the interconnectors. As such we are disappointed that Ofgem have decided not to allow any NIA funding in this area until after DESNZ confirm their strategic decision. It is not clear what the rationale for this is as, in our view, industry (not just SGN) needs to better understand the practical implications of this likely future change – and indeed evidence from NIA projects

[1] https://www.gov.uk/government/publications/hydrogen-blending-in-gb-distribution-networks-strategic-decision

could help inform the final DESNZ decision. From a practical perspective, whilst decisions on hydrogen blending sit with Government, there is a risk of a delay if no progress is made on preparation ahead of implementation decisions.

Focus on MOBs – we highlighted this as an important theme as a quarter of SGN customers (across Scotland and the South) live in multi-occupancy buildings which present particular safety issues and can be challenging to deal with reactively in terms of unplanned interruptions. SGN have argued that due to the specific safety obligations relating to MOBs, urgent work is needed on these complex building archetypes. We are therefore concerned about the cuts to repex allowances for risers where we supported a more proactive approach and where we hope that SGN can provide the additional evidence that Ofgem is seeking (ref GDQ41)

We also strongly supported SGN's proposed MOB innovation looking at how to proactively move customers away from gas to low carbon heat solutions and avoid these repex costs. We flagged the need for this to be a collaborative effort across DNOs, heat networks, local authorities and DESNZ. Our understanding is that SGN have asked for NIA funding to support the development of such an approach and would have then planned to submit a NZASP re-opener to deliver a demonstration. While Ofgem has not funded this specific innovation project it remains a crucial issue (that NGN also flagged) and as such we would hope that Ofgem would set out a pathway for how it might be explored. We believe that, if conducted in a suitably collaborative way, including linking with RESP local area planning, this would be a significant step toward decarbonisation of heat across a key part of the GB housing stock. It could be well suited to the more programmatic approach that Ofgem is proposing for the SIF.

Ideally, we would like to see Ofgem joining up its thinking on these two angles on MOBs with, for example, some initial funding for the replacement of risers with subsequent funding through a reopener aimed instead at delivering an enduring low carbon solution.

Methane leakage reduction – We were pleased that Ofgem acknowledged our desire for more pace in this area which is seen by customers and stakeholders as an "obvious" priority given the safety, environmental and cost impacts. We were pleased that Ofgem have agreed funding for ALD and provided for a reopener to cover DPLA (where thinking is less advanced). We hope that Ofgem will maintain pressure for timely delivery of these programmes, including ensuring that leakage from above ground installations (which accounts for c20% of leakage) is in scope.

From the recent repex working group discussion we have a real concern that SGN are being significantly less ambitious than the other GDNs (on timing, scale and scope) and look to Ofgem to ensure they are adopting best practice. SGN have argued that they do not yet have the evidence to support a more ambitious programme. However they have indicated that they are reviewing their position and we look forward to a further update at our next meeting. We find this frustrating and would ask that Ofgem sets clear standards and also provides the flexibility in the uncertainty mechanisms to allow evolution of SGN's programme as the evidence becomes available.

We also welcome the commitment to further discussions with the HSE and the GDNs on the operational implications of ALD which will result in leaks being detected earlier than otherwise with potential implications for near term costs (hopefully offset by longer term savings) which we know is a genuine concern for SGN. (Ref GDQ2 and SGNQ13).

Understanding I&C customers – This has long been a priority issue for the ISG. While SGN has undertaken high quality engagement with domestic customers and SMEs, it has historically had a very limited understanding of the I&C customers connected to its network despite them consuming around 40% of gas. Understanding who these customers are, what their experience is of SGN and what their likely future energy needs are would seem essential input to future network planning[2]. As such we have strongly supported this innovation workstream – albeit we signalled in our response the need for evidence to be shared across GDNs and with DESNZ. We have also made clear the need for a clear delineation of SGN's different roles and are confident that what is proposed is appropriate for SGN as a regulated network. We see it as inconsistent that Ofgem places such a strong emphasis on understanding domestic customer views but rules out of scope work to better understand these larger customers whose decarbonisation plans will have a material impact on SGN's network planning and maintenance requirements. (ref SGNQ17 on NIA funding)

RESP engagement – In our response to the Call for Evidence we endorsed SGN's funding request to enable it to engage with the RESPs. Following challenge from us we considered SGN's articulation of its role as supporting the RESPs to be appropriate. It seems clear to us that these bodies will place additional demands on SGN in terms of data and engagement (with a number of separate RESPs). The recent Ofgem consultation on a new licence obligation on GDNs to collaborate with the RESPs would seem to confirm this.

From a discussion between the ISG chairs and NESO it would seem that NESO input had not been sought, and we would encourage Ofgem to do so. NESO have employed a significant number of people to deliver engagement and research activities across GB and GDNs will need access to equivalent resources in order to meet NESO's requirements. NESO's role as whole system planner can only be delivered if access is provided to high quality data from GDNs. It is anticipated that investment will be required in both resourcing and digital infrastructure in order to enable effective data provision. (Ref GDQ4).

Safety - Costs and Investment

Beyond the specific areas that we had endorsed in our response to the Call for Evidence, we are aware that safety remains customers' highest priority and that much of SGN's proposed investment is safety driven.

Amongst the investment cases which have been scaled back in the Draft Determination are several for which it appears that safety is the primary driver. While the reasons for exclusions in each case vary, the ISG is keen that the overall impact on safety (which remains customers' highest priority) and the associated risk to customers of not making these investments, is understood and articulated. We have therefore challenged SGN to fully articulate its perspective on the risks involved and to say exactly how any shortfall in the settlement would be addressed.

For SGN the Draft Determination has resulted in a reduction in expenditure compared to its Business Plan of around £1.1bn, a substantial figure. As an ISG, our primary concern is the impact on outcomes for customers. Around £650m of the overall reduction is represented by more challenging efficiency assumptions. The remainder of the reductions, around £550m arises broadly from decisions about workload and its costs, together with various modelling

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[2] A point also made by Grant Spence (Net Zero Energy Systems) in his response to the Ofgem Call for Evidence based on his work with SPEN in Wales - here

normalisations and assumptions. We note that that much remains to be finalised, and that companies have been invited to provide additional evidence and data in certain areas.

The ISG did not find it straightforward to identify exactly what cuts to investment were made just from reading the Draft Determination documents. We have therefore relied on SGN's analysis to an extent.

Clearly, delivery of the same outcomes at lower cost is good for customers. However, in some cases it may be the case that the result of cuts in proposed investment will represent worse outcomes for customers, either because something that customers have indicated they want and is of value to them is not delivered, or if it results in an increase in the risks that customers face. This could come about because of specific reductions in the scope of work assumed for GD3 or because SGN chooses, in the light of a general reduction in funding, not to progress activities. Our review of investment proposals within the Draft Determination has focussed on these potential impacts.

We do not comment here on the efficiency assumptions within the Draft Determination. Not having access to benchmarking data, the ISG is not in the best position to judge whether the level of efficiency challenge is justifiable. We note that the SGN has made representations that would, if implemented, moderate the efficiency challenge, and we understand that some errors in the Draft Determination have been identified and agreed. We do not comment on SGN's representations in this regard.

We do however comment on a number of methodological questions which touch on matters which have been a particular focus for us or appear to be material to SGN and thus its customers, including where significant investments have been rejected. The particular areas we have commented on in our response to Ofgem's questions are: (i) the normalisation of costs for progress in implementing the HSE's regulations on fatigue (GDQ36); (ii) Ofgem's engineering assessments and gaps in the data provided by SGN which we hope can be addressed (SGNQ16 and SGNQ5); (iii) NARMs and the need for further urgent work on baselining (OVQ4-6) and (iv) the inclusion of an 11-year payback criteria which risks driving a short term reactive approach, when in practice we expect the vast majority of the network to still be in use well beyond this point. We see the need for a more nuanced approach to investment given declining gas usage and see the 11-year payback requirement as too simplistic (GDQ5).

Repex continues to be a very significant driver of costs and bills and is critical to the delivery of outcomes that matter to customers, principally safety, but also reducing methane leakage. In our response to the Call for Evidence, we supported the need to maintain safety standards but identified a number of specific areas of challenge, including: the potential for increasing complexity of repex work, how SGN should respond to long-term expected declines in network usage, and the implications of observed rising repair rates. We have commented on Ofgem's views on repex complexity, where we are concerned at Ofgem's apparent over-reliance on ISG comments, (GDQ6) and also on the approach to Tier 1 workload adjustments (GDQ40).

As we set out in our response to the Call for Evidence, we did not undertake a detailed review of the business cases (EJPs and IJPs) for proposed investments, and we are not able to comment on whether Ofgem's views on them are justified. However, we are somewhat disappointed, taking Ofgem's comments at face value, about the extent to which there were deficiencies in these detailed justifications. It seems likely that the relatively compressed timelines for plan production were not helpful in this regard. We appreciate that work is ongoing by SGN to provide further data and/or otherwise improve their case for certain investments. We are encouraging SGN to make its evidence as robust as possible, in customers' interests. We then welcome Ofgem's scrutiny of these proposals, looking across the GDNs and in dialogue with the HSE.

This response is not confidential and may be published. If there are any points where additional clarification is needed please get in touch.

Yours faithfully

Maxine Frerk

Chair SGN's Independent Stakeholder Group

Ofgem questions

1. SGN Questions

Outputs we propose to accept

SGNQ3. Do you agree with our proposed design of SGN's South London Mains PCD?

The ISG is supportive of this important repex project and pleased that baseline funding has been included in the DD.

Outputs we propose to reject

SGNQ4. Do you agree with our proposal to reject SGN's cost to replace its fleet?

We have no comment on this specific decision but comment more generally on Ofgem's approach to ZEVs at OVQ3.

SGNQ5. Do you agree with our proposal to reject SGN's Local Gas Treatment PCD?

We did not review this proposal in detail. The rejection, as for several other proposals, is because of Ofgem's engineering assessment, due principally to lack of data in the Business Plan, which is disappointing. Given this we would not disagree with the rejection. It is not clear whether this decision will be reconsidered should SGN provide the relevant additional data, but we assume Ofgem would do so.

Business Plan Incentive (BPI)

SGNQ6. Do you agree with our view that SGN passed all of the minimum requirements and as such are considered to have passed Stage A of the BPI?

We have no comment on this.

SGNQ7. Do you agree with our assessment results for SGN against Stage B of the BPI?

Stage B of the BPI is calculated by reference to (i) comparatively assessed costs and; (ii) bespoke assessment. By far the largest impact in SGN's case is from the first of these. While it is possible to make an argument that the inclusion of comparatively assessed costs in the BPI represents a "double count" because the same data also informs efficiency benchmarking and thus the scale of catch-up efficiency, the ISG prefers to see it as simply strengthening the incentive on companies to offer up efficiency savings for the benefit of customers. We therefore have no strong concerns from a methodological perspective. However, we are not in good position to comment on the application of this aspect of the assessment, not having any sight of comparative cost data.

SGNQ8. Do you agree with our assessment results for SGN against Stage C of the BPI?

Ofgem's assessment under the BPI stage C felt harsh in places. Our position in our original response was that the Plan was ambitious in the areas that mattered most to customers. In particular on VCMA, where Ofgem was critical of the 650k target for households helped, we had been clear that this needed to be judged in the context of SGN's overall approach to vulnerability, the way it leads on collaborative projects and the relationships it is continuing to build with partners – all of which are hard to capture in a simple numerical commitment. We are also aware that when the target was set Ofgem had been proposing to revert to lower levels of VCMA funding and that SGN were wary about committing to a higher target without the funding. We have encouraged SGN to explore with its vulnerability steering group how best to evolve their approach (whether to help more people or provide deeper support to those they are targeting) in light of Ofgem's revised position.

We had also particularly commended the approach that SGN had taken to its consumer engagement and its innovative use of deliberative research which yielded much richer insights to underpin the Business Plan. We are disappointed that this positive aspect of SGN's Plan was not acknowledged as a part of the BPI.

Managing uncertainty

SGNQ9. Do you agree that SGN's Remote Pressure Management Strategy proposal should not be eligible for NZARD funding, and instead should be funded through baseline allowances?

We agree with the proposed funding route, subject to the comments in our covering letter about the impact on benchmarking and, crucially for us as an ISG, that SGN are held to account for delivery through a PCD, for example.

SGNQ10. Do you agree that SGN's Intelligent Gas Grid proposal should not be eligible for NZARD funding?

We agree that Intelligent Gas Grid (IGG) should not be eligible for NZARD funding and had ourselves proposed NZASP as enabling a reopener to be submitted if the final SIF findings demonstrate that there is sufficient value. We believe the IGG idea has the potential to deliver substantial benefits including, as Ofgem identifies, in reducing leakage and enabling biomethane connections. We are disappointed that SGN has not successfully made a case for the project. Ofgem has not signalled the potential for an alternative funding route but, given a better justified proposal (which we will press SGN to develop once the SIF project is complete), we believe that the NZASP should be available to be used.

Ofgem do not mention NZASP (or any alternative funding route) and we would be concerned if the project were totally ruled out at this stage ahead of the SIF project being completed. We would like to see the door left open for a future NZASP application, subject to a better justified proposal being developed.

SGNQ11. Do you agree that SGN's Biomethane improved access rollout proposal should not be eligible for NZARD funding, and instead should be funded through baseline allowances?

We understand Ofgem's reasoning. We have no objection to the use of baseline funding provided Ofgem addresses the concerns we raise in our cover letter about the impact on benchmarking and, crucially for us as an ISG, that SGN are held to account for delivery through a PCD, for example.

However, we also believe consideration should be given to how further unexpected costs arising from increases in demand for biomethane should be funded. We have been strongly supportive of SGN's initiatives to improve network access for biomethane producers. We note that it now appears more commonly accepted that biomethane could be an important interim step on the road to net zero. For example, biomethane features far more prominently than hitherto in NESO's June 2025 Future Energy Scenarios and also the Clean Flexibility Roadmap.

We believe that the current positive climate towards biomethane makes it likely that there will be a continued and increasing demand for connections and for producers to be able to increase their rates of injection. Given the continuing uncertainty around this market we would want SGN to be able to secure future funding (presumably through NZARD) to cover other initiatives such as reverse compression that may be required to meet future customer needs but that fall outside the scope of this specific proposal.

SGNQ12. Do you agree that, in its current form, SGN's SIU decarbonisation (design costs) proposal should not be eligible for NZARD funding?

We agree that the projects to decarbonise SIUs would not be eligible for NZARD funding due to the materiality being greater than £2M and therefore failing to meet the NZARD funding criteria. We agree that SGN should be encouraged to resubmit providing a more detailed breakdown of costs. Options thereafter would be to fund via the NZASP reopener or baseline allowances. We have challenged SGN to explain why design costs for the Oban and Campbelltown projects are much greater than for Wick and Thurso. It may be the case that this is related to needing to move the SIU facility out of the centre of Campbeltown.

The Campbelltown & Oban projects will have similar benefits to the decarbonisation of Wick & Thurso and will benefit from the learning gained at those SIUs, while also providing economies of scale from fleet efficiency maximisation.

SGNQ13. Do you agree with our proposal to reject SGN's submitted Other Distribution Mains and Services Re-opener?

Ofgem has stated that it expects operational workloads should not be affected by the introduction of ALD. On this basis it has rejected this re-opener which SGN identified to deal with the costs of replacing Tier 3 mains over 30m from a building identified by ALD as being in poor condition. While we understand the desire to focus ALD on prioritisation of the existing repex programme (and the requirements of HSE on condition monitoring), as an ISG we have been particularly keen on the environmental benefits ALD can deliver in terms of reducing methane leakage, and which may well result in additional work being identified (further from buildings). However, we would expect a proactive rather than reactive approach to reduce costs in the longer term.

In that context and given the relatively low amount of funding that SGN estimates will be needed, we are content with Ofgem's approach, subject to the further conversations that Ofgem has committed to have with industry and the HSE.

SGNQ14. Do you agree with our proposal to reject SGN's request for a bespoke River and Coastal Erosions - Asset Intervention Strategy re-opener?

Ofgem accepts that SGN may incur uncertain future costs for work to rectify or protect the network from climate related risks, including erosion. However, Ofgem considers that the Diversions Reopener, the scope of which was widened to include environmental factors in 2024, is adequate to deal with these. We are broadly comfortable with this approach but have a concern as to whether proactive work that SGN identifies as needed will be covered. We would welcome Ofgem clarifying its position on this.

SGNQ15. Do you agree with our proposal to reject SGN's request for a bespoke South London Medium Pressure Re-opener?

This was rejected on the basis that the distinction between this proposal and the proposal to include investment in base costs through the South London Mains PCD (ref SGNQ3) was not clear in the Business Plan. We agree. While we understand from SGN that there remains a possibility that costs will be greater than those provided due to external changes in legislation or regulation (for example, as a result of HSE policy changes or lane rental schemes), we believe that such matters are covered under other uncertainty mechanisms and so we are comfortable with Ofgem's rejection of a specific mechanism.

Innovation

SGNQ17. Do you agree with the level of proposed NIA funding for SGN?

While we understand that SGN did not follow the BPG as it should have done the resultant significant cut in NIA funding (from £30.7m to £6.2m) risks limiting future innovations that are important not just for SGN's customers but for all gas customers. We also note that in some areas (such as on hydrogen blending) Ofgem points to NZARD as the appropriate funding route but we are aware that there is a cap on overall NZARD spending set at GD2 levels (updated for inflation).

We hope that Ofgem will be open to receiving additional evidence around SGN's approach to innovation which might allow it to reduce the scale of the cut to NIA funding and / or to revisit the NZARD cap (ref also OVQ20).

Data and Digitalisation

SGNQ18. Do you agree with our proposed level of funding for SGN's data and digitalisation investments?

We are pleased that SGN have received the funding they requested in what is an increasingly important area.

2. Overview Questions

Introduction

OVQ1. We would welcome any views on the enduring role of the ISGs during RIIO-3 and for future price controls.

We strongly support an ongoing role for the ISGs in helping hold companies to account for delivery of their Business Plans and ensuring customer and stakeholder views shape ongoing decisions. We have played this role in GD2 and it has meant that we are well informed and were able to provide more effective challenge in the GD3 plan development process (without it threatening our independence).

In broad terms we would envisage a similar role for future price controls although a lessons learned exercise would make sense (including what has Ofgem found most helpful and what have the companies found most helpful).

We would also draw Ofgem's attention to the annual reports that we have produced through GD2 (in response to Ofgem's initial open letter on the enduring role). These are published on the SGN website[3] and we have always shared them with the Ofgem team but had no feedback. Reviewing these reports and those produced by other ISGs may help Ofgem clarify what it is looking for from the ISGs in their enduring role.

[3] https://www.sgn.co.uk/about-us/our-stakeholders/SGN-independent-stakeholder-group

Outputs and incentives Cross-sectoral outputs

OVQ2. Do you agree with our proposed position on the Environmental Action Plan and Annual Environmental Report ODI-R for RIIO-3?

We support the broad approach set out by Ofgem. However, we would note that as an ISG we only look at SGN's performance and hence the value of the Annual Environmental Report as an ODI-R is limited. For example, on EVs we have been sympathetic to the challenges that SGN have had in obtaining suitable vehicles but have only lately appreciated that Cadent have been able to make more progress in this space. We reference similar challenges with ALD / DPLA above. Judging how well SGN is performing, across the full range of environmental issues, really should be informed by an assessment of relative performance.

If Ofgem could look across the AERs and produce a consolidated report / league table that would give us much stronger ammunition with which to challenge SGN as part of our ongoing monitoring role.

OVQ3. Do you agree with our consultation position to create a new common mechanistic PCD for ZEV and associated infrastructure costs?

Ofgem has proposed a new PCD for Zero Emission Vehicles and requires companies to provide data to calibrate it. It has funded SGN's fleet replacement cost assuming an eight-year replacement cycle, rather than five years as proposed by Cadent.

We agree that Ofgem should encourage the rollout of Zero Emission Vehicles (ZEV) and associated Electric Vehicle (EV) charging infrastructure during RIIO-3. We are aware of the difficulties that SGN has faced during GD2 in securing appropriate low and zero emission vehicles and infrastructure to meet their operational needs. We have encouraged them to think innovatively about how to reduce emissions from operational transport. We are encouraged by Ofgem's stance on charging infrastructure. We agree with Ofgem's view that there is substantial variation between companies in relation to vehicle suitability and that market constraints may continue to impact availability during GD3. While a PCD, backed by detailed data on companies' current plans for ZEVs has the benefit of ensuring that customers do not fund unjustified expenditure, it is not immediately clear how it will help manage the associated uncertainty. We therefore stress the need, identified by Ofgem, to "define outputs with suitable flexibility". More detail on this would be welcome.

OVQ4. Do you agree with our proposed approach to measuring Baseline Network Risk Outputs and our application of the NARM mechanism?

We have no comment on the continued use of the NARM framework to measure and incentivise asset health outcomes, nor on Ofgem's proposal to improve standardisation, consistency and transparency in the implementation of the NARM framework with an overall objective to achieve a common methodology by 2031. In the meantime, establishing a suitable risk baseline for delivery of GD3 is important for enabling regulatory incentives to work as effectively as possible. We note that alignment of Baseline Network Risk Outputs and Baseline Costs is ongoing. At GD2 this process of alignment was not completed until well after the start of the price review period. We would urge, if possible, all parties to work towards completing this task as soon as practical. We note that the shift to using a long-term asset risk metric will have added considerable complexity to the alignment task, and we would welcome, at the Final Determination a clear commitment in relation to fixing the risk baseline.

While we recognise that the alignment process is not complete, we were surprised by the estimated interim BRNO figures for SGN's Southern region in Table 3 of the GD DD document (paragraph 4.39): the figure for disallowed volumes looks high and the figures do not cast across.

OVQ5. Do you agree with our proposed approaches to calculating the funding adjustments and to the application of penalties?

We have no concerns about the continued use of the NARM Funding Adjustment and Penalty Mechanism and the Clearly Identifiable Over or Under Delivery (CIO/UD) Mechanism. We are not able to comment on the specific deadband and threshold parameters.

OVQ6. Do you agree with our proposed approaches to improving the NARM framework?

Yes. See OVQ4 above.

OVQ8. Do you agree with our approach taken to review of the Climate Resilience strategies?

We have been supportive of SGN's approach to climate resilience, particularly that it has started to use climate scenarios linked to possible paths to net zero to inform its thinking. We agree with Ofgem that it has a good grasp of the potential risks to its network. Ofgem expects companies to continue to progress and report on their Climate Resilience strategies and intends to introduce a licence condition during GD3.

We are comfortable in general with the approach.

OVQ9. Do you agree with our views on the Workforce Resilience Strategies?

While we agree with the views set out, we were disappointed that Ofgem made only limited reference to equality, inclusion and diversity in its Draft Determination as Ofgem has an opportunity to encourage more focus by the networks on this issue (on which Ofgem has in the past been a strong advocate). More generally there was limited reflection on workforce issues which we see as key to deliverability of the Plan and where we would like to see evidence that Ofgem understands the particular challenges facing the gas sector.

OVQ15. Do you agree with our proposed design of the NZARD UIOLI?

The NZARD UIOLI is designed to "*fund early design and pre-construction work for net zero related projects and undertake small net zero facilitation projects.*" We agree it remains necessary to allow companies a mechanism to respond early to net zero developments and opportunities. As it is aimed at small, preliminary work packages, there is a £2m spend limit per project. SGN chose to argue that this limit should not apply in proposing a number of projects of greater scale.

We are content with the proposed design.

We note that there is also an overall cap on the NZARD UIOLI set in line with GD2 allowances (updated for inflation). However, we would note that in GD2 SGN also had specific PCDs for some projects that might otherwise have been covered by NZARD. Moreover, with NZARD now extended to include crucial new areas we are concerned that the overall scale of NZARD funding is insufficient. In particular, methane leakage innovations are now meant to be covered by NZARD, reflecting the decision at SSMD to remove the ODI-F for shrinkage and replace it with a UIOLI allowance which was then subsumed into NZARD.

Ofgem has also signalled that it expects support for engagement with the RESPs to be covered through NZARD (and NZASP). While we have argued that baseline funding should be provided for RESP engagement (to meet the new proposed licence obligation) – if this is not accepted then that represents a material additional call on the NZARD pot. In any event we recognise there is significant uncertainty around the scope of what is required for RESP co-ordination so can envisage NZARD/ NZASP funding still being needed. Linked to this we see a growing role for GDNs working with local authorities to produce local area energy plans. While this might be seen as part of the RESP co-ordination function, we would like to see it explicitly referenced as an area of engagement that we have consistently highlighted as needing more focus by SGN.

We urge Ofgem to look carefully at the appropriate level of NZARD funding against the different activities now in scope – rather than simply maintaining funding at GD2 levels.

OVQ16. Do you agree with our proposed design of the NZASP re-opener?

The NZASP re-opener is designed to allow companies to undertake design and pre-construction work that is too material for the NZARD UIOLI, and to progress small- to medium-sized net zero facilitation projects.

We agree with the proposed design, including the expansion of scope to cover RESP costs, although, as we argue above, we believe it would be preferable to include an initial allowance for such costs in baseline funding.

The value of NZASP as a reopener is that enables transformational projects to be brought forward mid period, rather than having to wait for the next price control. We are therefore a little concerned that Ofgem appears to be ruling out certain projects from NZASP funding at this stage in the process. While we recognise it may be helpful for Ofgem to signal if projects are squarely outside of the scope of NZASP but would be concerned if they were being rejected at this point on the basis of there being limited evidence, when the whole purpose of a reopener should be to provide an opportunity to put the full case forward in due course. SGN's Intelligent Gas Grid project (for which they requested NZARD funding but we suggested NZASP) is a case in point.

Innovation

OVQ20. Do you agree with our proposed NIA funding levels?

We are concerned that SGN's proposed NIA funding has been cut back significantly following the business plan assessment and do not see this as being in the interests of consumers (and the wider industry). We hope that SGN will be able to provide additional evidence to enable Ofgem to reinstate some of this funding to bring SGN more in line with others. See our response at SGNQ17

OVQ21. Do you agree with our approach to the future of gas-related workstreams?

Ofgem's current approach is to avoid funding any work related to hydrogen or blending. This is because the Government has yet to decide whether to allow hydrogen for heating or to implement distribution-level blending, and due to potential overlap with the Hydrogen Transport Business Model (HTBM). Funding remains available for areas of wider value, including decommissioning and biomethane.

We agree that it is important to protect consumers' money and to avoid substantial spending on an approach that may ultimately not be implemented. However, we are concerned that a blanket restriction risks slowing the transition and affecting certain sectors disproportionately.

For example, hydrogen's role in decarbonising some industrial sectors is likely to differ from its potential role in domestic heating. Gas Distribution Networks (GDNs) serve a diverse range of consumers, and we believe there is insufficient consideration of how decisions targeting one sector (such as domestic customers) may affect another (such as industrial demand).We are also concerned that, while the HTBM is expected to be the long-term mechanism for supporting hydrogen networks, it will take significant time to mature to a stage where it can provide the agile support needed for early development.

We also note that hydrogen blending is separate from any discussion of the HTBM with low levels of hydrogen being injected into the existing networks to provide a backstop offtaker and give confidence to hydrogen producers ahead of the market becoming more developed. Given the strong steer already provided by DESN*Z* in its strategic decision on blending in 2023 – and given also the prospect of blended hydrogen being imported from the EU, we see no case for delaying work on the practical implementation issues that will result.

For these reasons, we believe Ofgem should take a more nuanced approach, assessing funding requests on their individual merit and their potential impact on wider net zero objectives, while still taking account of forthcoming Government decisions.

OVQ25. Do you agree with our proposals to introduce a 'Programmatic Approach' to the SIF?

Yes and would urge Ofgem to ensure that that gas is covered as a part of this with emphasis on a collaborative approach across the GDNs and efforts to ensure that the key challenge areas highlighted across the GDN Business Plans are addressed.

OVQ26. Do you agree with our proposal to introduce a £50m deployment fund, utilising £50m from the total £500m SIF allocation?

There clearly is a need to fund deployment of innovation projects and we have seen SGN looking for funding from different sources to do this on eg remote pressure management, IGG and DPLA. It would be helpful to have clearer guidance on which funding route applies when. We assume the deployment fund is essentially for innovation projects that were not sufficiently far progressed to be included at all in the Business Plan. However, if the deployment fund represents a more tailored approach to funding innovation deployment (rather than say NZASP) then it could have a wider role, although in that case £50m across all sectors is probably insufficient.

OVQ29. Do you agree with our proposals to retain the core aspects of the SIF for RIIO-3?

Yes but we would encourage Ofgem to think about any distinct requirements on the gas side which feels like it gets less focus (and may not be so obviously attractive to innovators). A revised SIF must provide clear, consistent challenges and a stable scope for eligible gas network activities. The current model—where challenges are set annually and can change significantly from year to year—makes it harder for network companies to incorporate SIF funding into their innovation strategies across an entire price control period.

OVQ35. Do you agree with our proposals for the Cyber Resilience re-opener?

While the ISG has not covered cyber resilience in any detail as part of its work, we agree with this proposal. We have seen that customers are increasingly aware of the risks from cyber attacks and expect SGN to have the necessary safeguards in place as the nature of the threat evolves.

3. GD Annex Questions

Outputs and incentives Infrastructure fit for a low-cost transition to net zero

GDQ1. Do you have any views on our proposed approach for the GD-specific environmental commitments, costs and targets?

We agree with Ofgem about the need for a consistent approach to emissions reporting, while noting that SBTi guidance is still under development for the gas networks (and indeed is currently on hold).

GDQ2. Do you have any views on our proposed funding for the DPLA and ALD?

The ISG has consistently pushed for SGN, and the industry more widely, to do more to address leakage from gas networks given the crucial role of methane as a short-lived climate forcer and where reductions in leakage can actually reduce cumulative emissions in the atmosphere, avoiding the risk of us hitting climate tipping points. This was the rationale for the introduction of the Methane Pledge at the Glasgow COP and for various international initiatives since, focussed in particular on improved sensor technology and data analytics to better measure and monitor leakage[4]. We are therefore strongly supportive of the industry's ALD and DPLA initiatives, while urging them to accelerate action in this space. We continue to push SGN to make the most of this opportunity and, in particular, to extend its coverage and accelerate its implementation.

Following the discussions at the recent repex working group, we are concerned about SGN's lack of ambition in this area compared to other GDNs and are challenging them on this. For example, we understand that SGN has made no provision for fixed sensors which could be used for identifying leakage at above ground installations which account for c 20% of leakage and is a topic we have asked SGN about previously but that we were unaware that other GDNs were addressing.

We also understand that SGN would only be planning to survey their network over the course of 5 years, rather than annually. They have said that they intend to focus on non-PE pipes and to date they do not have the evidence to support a more extensive programme. However, we remain frustrated at the slow progress and have asked for a full update at the next ISG. They have indicated they are reviewing their position.

We would ask Ofgem to set clearer expectations around what it views as good practice in this area given the absence of any financial incentive now on shrinkage. We would also ask that Ofgem ensures that there is sufficient flexibility in the uncertainty mechanisms to enable SGN to expand its programme if the evidence becomes available (i.e. it is not simply about DPLA implementation).

Ofgem has proposed that ALD is funded through base allowances subject to it receiving additional data to show that costs proposed are efficient. This funding assumes that ALD roll-out will begin in 2026. SGN proposed in its business plan that ALD funding should be via NZARD. However, we are content with funding through baseline subject to the comments in our cover letter around benchmarking and the need for a PCD to ensure delivery. We would also propose that funding through NZARD still be allowed for elements that are not currently in SGN's Plan (such as fixed and hand-held sensors that other GDNs have included). Covering this

[4] https://www.globalmethanepledge.org/sites/default/files/documents/2023-11/UNEP%20CCAC%282022%29GMA%20BASELINE%20EMISSIONS%20REPORT%20-%20FULL.pdf

through NZARD is likely to result in more rapid implementation that waiting on the full DPLA NZASP reopener.

GDQ3. Do you agree with our proposed design of the 7 and 28 Day Repair Standards ODI-F, including the proposed performance targets and incentive rate?

We support these new standards which we would see as helping reduce methane emissions and the environmental impact of leaks where there is no immediate safety issue (which would otherwise be treated as an emergency repair on a much shorter timeline).

GDQ4. Do you agree with our proposal to enable the GDNs to submit RESP coordination and engagement activities through NZARD and NZASP?

As an ISG we have consistently stressed to SGN the importance of working with its stakeholders to secure the best possible solution for net zero energy delivery from a whole system perspective. Now that the organisational infrastructure has been established to enable such co-ordination, it is essential that the opportunities provided by it are used. This will require there to be adequate resources to undertake the detailed work and data provision that will be required, both within NESO's RESP function itself and, as importantly, within the stakeholders who will have a key role, including the GDNs.

We agree with Ofgem's position that investment proposals which clearly duplicate the work of NESO should not be funded. However, given that there is a predictable and known need for resources within the GDNs to enable the necessary co-ordination work, we believe that the costs of this work can and should be allowed for in advance. This will avoid unnecessary delays to progress. We understand from SGN, that co-ordination in multiple RESP regions will be required in their case and that the FTE costs of such co-ordination can be estimated with reasonable confidence. We have therefore encouraged SGN to better justify their proposed costs, and on this basis encourage Ofgem to allow for them as part of baseline.

NZARD and NZASP funding can then be used for any material new requirements as the RESPs develop their work programmes.

Secure and resilient supplies

GDQ5. Do you have any feedback on our approach to assessing non-mandatory repex workloads?

Amongst the investment cases which have been scaled back in the Draft Determination, there are several for which it appears that safety is the primary driver. While the reasons for exclusions in each case vary, the ISG is keen that the overall impact on safety (which remains customers' highest priority) and the associated risk to customers of not making these investments, is understood and articulated. We have therefore challenged SGN to fully articulate its perspective on the risks involved and to say exactly how any shortfall in the settlement would be addressed.

Cuts to investments in non-mandatory repex (bulk services, other distribution mains – those >30m from a building, and that which has been removed for not meeting the 11-year payback requirement, below) fall within this category. We note, for example, that the allowance for bulk services has been reduced to a "do minimum" level and have challenged whether this approach is in customers' best interests.

Although in general, the Draft Determination is clear about the paramount need to maintain a safe network even as usage declines, we continue to believe that there should be opportunities to do less at the margin and that a more nuanced approach to investment in the network will be necessary during and beyond GD3.

Absent guidance from Ofgem beforehand, SGN prepared their business plan using a limit on payback of new investment of 16 years, in line with the GD2 assumption. In the Draft Determination, Ofgem has set a pay-back period of 11 years. This limit has resulted in cuts to SGN's proposed investment in non-mandatory repex of c£29m. We understand that this limit has been applied to all investment proposals (ie capex as well) although that point is not very clear in the Draft Determination.

Earlier guidance on Ofgem's payback assumption would have been extremely helpful: SGN chose not to adjust it in the Business Plans despite the ISG's challenge.

Moreover, it is unclear as to why the 11-year period has been chosen, other than that it results in a cut-off in 2037, the same date as used at GD2. However, we would observe that there is now greater clarity that the gas networks will be needed well into the 2040s (as they cannot be decommissioned until all customers on that part of the network have moved away).

While we understand that, in practice, the 11 year payback has not had a massive impact on SGN investments in GD3, we are concerned about this leading to an overly short-term perspective (if the same 2037 cut-off were to be applied for GD4). A fuller explanation of the reasons for Ofgem's approach and discussion of the options would be welcome, including any thinking about the implications for investment beyond GD3. Having early clarity on expectations in GD4 and beyond will be important for companies' management of their network in GD3.

GDQ6. Do you have any comments on the proposed design of the Tier 1 Mains decommissioned PCD, including the position to retain the 3% cap on the upwards Allowance Adjustment Mechanism?

We have no comments on the proposed design. However, we believe that paragraph 3.77 of the Gas Distribution DD document was incorrect in implying that the ISG was able to conclude that "*much of the complexity and cost of delivering the final years of the IMRRP stems from earlier planning decisions made by the GDNs"*. We merely raised it as an issue to be examined.

There clearly could be valid reasons for more complex tasks being left until later (for example, if a focus on simpler tasks delivers a greater overall safety benefit). SGN provided useful evidence (including externally commissioned reports on the outcomes of fairly detailed technical assessment of past repex investment) alongside its Business Plan. However, the ISG remained concerned that customers may, to an extent be being asked to pay twice. This would be the case if a past regulatory determination was based on delivering work of an assumed level of complexity and SGN chose to deliver less complex work. As an ISG, we were not in a position to judge whether this had happened, and we also were unconvinced that the evidence provided by SGN proved that it had not. We raised the issue, mainly as a prompt to Ofgem to address it and called for it to make a judgement on this.

However, it is not clear from the Draft Determination if, or how, Ofgem has engaged with this particular point: the text could be read as suggesting over-reliance on our comment. We would therefore welcome reassurance that Ofgem has engaged with the evidence SGN provided. The Draft Determination recognises the difficulty making a judgement and opens the way for the provision of more evidence and collaborative work. The specification of what is needed is helpful. We have engaged with SGN on how they are intending to meet this request. However, evidence about past funding and investment decisions is unlikely to be complete and definitive: a measure of judgement will be needed and we look forward to a full exposition of that judgement in the Final Determination.

GDQ8. Do you agree with the proposed design of the Tier 1 Iron Stubs PCD?

We have noted the variation between companies in relation to their assumptions about "stubs not found", replacement methods and costs and have challenged SGN on this. We support Ofgem's proposal to gather more data before setting unit costs for the PCD. We have no comment on the design of the latter.

High quality of service from regulated firms

GDQ11. Do you agree with our proposed design of the VCMA UIOLI mechanism?

We are happy with the design of the VCMA UIOLI allowance and welcome the increased funding compared to Ofgem's SSMD.

We note the decision to treat certain activities as "business as usual" where the costs would be recovered through baseline funding. It is helpful to have a clear list of expected activities covered by baseline plus an obligation for reporting on this as part of the annual VCMA report. However, we remain concerned that, faced with competing pressures in GD3, baseline funding intended for vulnerability could be diverted to other areas or captured as efficiency saving. We would therefore like to see a licence obligation introduced requiring companies to deliver against these core "business as usual" obligations.

We have discussed this aspect of the Draft Determination with SGN's Vulnerability Steering Group (VSG), comprising experts in the field, who share our views.

GDQ12. Do you agree with our proposed design of the Customer Satisfaction ODI-F?

We note that CSAT connections will drop out if survey volumes are not met (which seems likely with fewer new connections). SGN have also highlighted that results may be impacted by connection charging changes. Given this there would seem to be a case for reducing the weight attached to connections reflecting the fact that they will be a less important aspect of customer service going forward.

GDQ13. Do you agree with our proposed design of the Disconnections Customer Satisfaction ODI-R?

We are pleased that Ofgem has introduced an ODI-R to ensure focus on this new aspect of customer service. However, we are aware of the key role of suppliers in this process and would encourage Ofgem to ensure that, as context, it looks also at the end-to-end customer experience.

GDQ14. Do you agree with our proposed design of the PSR Customer Satisfaction ODI-R?

We agree that this should reinforce the focus on PSR customers.

GDQ15. Do you agree with our proposed design of the Complaints Metric ODI-F?

We are content with the complaints metric ODI-F. We would reiterate that in the comments we made in relation to the unintended consequences of using complaint volumes as a driver (which Ofgem referenced in the Draft Determination) we were absolutely not suggesting that SGN was failing to properly report complaints, simply highlighting a theoretical risk.

GDQ16. Do you agree with our proposed design of the PSR Customer Complaints ODIR?

We agree that this should reinforce the focus on PSR customers.

GDQ17. Do you have any views on the proposed approach to setting unplanned interruption targets for both non-MOBs and MOBs through the Unplanned Interruptions ODI-F?

Ofgem was critical of SGN's lack of ambition in proposing MOBs performance targets for Interruption to Supply. We are aware of the circumstances in GD2 that led to an extended interruption in two specific instances, and hence SGN's concerns about the level at which such targets are set, In our response to the CfE we said: "*A minimum service standard of 23 days (for Scotland) is unlikely to be viewed as reasonable by customers but a markedly lower figure would leave SGN carrying too much risk. We discussed the fact that GSOP already provided a strong incentive in these cases and also what scope there was for Ofgem to provide exemptions in exceptional cases".* We would reiterate our suggestion that Ofgem might set a more stretching target as it has done but then allow some route for exceptional events to be excluded as applies in other parts of RIIO.

We would also note that the difficulties in managing unplanned MOB interruptions is another reason for us pressing SGN to join up its thinking around MOBs more generally (including riser repex and the challenges around decarbonising these buildings). We would encourage Ofgem to reflect on some of these wider issues in considering how to handle this particular incentive.

GDQ20. Do you agree with the introduction of the proposed Biomethane Connections UIOLI, including with the proposed scope and funding caps?

We have been strongly supportive of SGN's initiatives to improve network access for biomethane producers. We note that it now appears more commonly accepted that biomethane could be an important step on the road to net zero. For example, biomethane features far more prominently than hitherto in NESO's June 2025 Future Energy Scenarios and also in the DESNZ Clean Flexibility Roadmap. We believe that the current positive climate towards biomethane makes it likely that there will be a continued and increasing demand for connection and for increased injection rates.

However, from the Draft Determination documents it would appear that the UIOLI is simply intended to cover the connection costs for producers as an alternative funding stream to the Green Gas Support Scheme. If so, it would not appear to be providing any additional support to facilitate connections / increased injection rates. We understand that discussions are ongoing about how to make sure that the UIOLI does add real value (eg through funding of necessary reinforcement work). More clarity on this would be helpful at Final Determinations.

We are not able to comment on whether £20m per GDN at £1m per connectee is enough.

We also note (as set out in our cover letter and SGNQ11) that this does not address the specific funding that SGN were looking for to deliver their Improved Biomethane Access Rollout where specific actions had been identified (and piloted in GD2) to facilitate connections and injection rates including pressure management and requirements around propanation. We are content that this is now included in baseline but would welcome it being set as a PCD. We would also expect NZARD to still be available for any new requirements in period, in particular with rising ambitions in this area.

Ofgem notes the wider feedback from developers about the need for streamlined processes which we would endorse but are unconvinced that individual EAPs are the best way to report on a collaborative effort. Given the increased profile given to biomethane in FES 2025 we would ask Ofgem to take a more active role in following up on progress in this area.

GDQ21. Do you have any views on our proposed design of the Heat Policy Re-opener?

This re-opener is broadly the same as at GD2, albeit the trigger will now be Authority-only. It is necessary given the potentially significant impact of future policy decisions including that relating to hydrogen for heat. We have no comment on the design but would expect Ofgem to consult with companies about how and when the reopener would be triggered.

GDQ22. Do you agree with our proposed scope of the HSE Policy Re-opener?

Ofgem has not changed the scope of this re-opener. The Draft Determination identifies a number of examples of cost which will not be within scope. Some of these exclusions respond to proposals by SGN including, certain MOBs maintenance costs, costs of work identified as necessary as a result of surveys of Complex Distribution Systems, and the rectification of legacy safety disconnections. Ofgem's view is that costs of MOBs maintenance and CDS may be funded in a different way but that legacy safety disconnection costs ought not to be funded because customers have already paid for it. We agree customers should not pay twice but are not clear whether there has in fact been a change in the HSE's expectations around disconnections which is now driving higher costs. We hope that Ofgem will clarify this in its Final Determination.

This highlights that, in terms of the re-opener, it may not only be formal rule changes that will impact future costs but also material changes in the way the HSE interprets and enforces the rules. However, too broad a re-opener leaves customers taking too much risk. We expect Ofgem to discuss with the HSE how a balance might be achieved.

GDQ23. Do you agree with our proposed design of the Tier 2A Volume Driver?

We agree in principle that a volume driver for Tier 2A mains makes sense while there remains a lack of clarity about the revisions to the Tier 2a risk action thresholds by GDNs. We have no specific comment on its design. We note that at the time of the Draft Determination, SGN had not finalised either the new threshold or provided updated workloads and costs. We understand from SGN that it is on track to provide this data, including an Investment Justification Pack. We have not reviewed this in detail but have challenged SGN generally to fully consider the potential options.

GDQ24. Do you agree with the scope of our Diversions Re-opener?

We agree, subject to the question raised above about proactive work linked to climate resilience.

GDQ25. Do you agree with our proposed design and unit rates for the Safety Disconnections Volume Driver?

The volume of safety-related disconnections is generally quite uncertain and so this volume driver ensures that customers pay only for what is actually delivered. We agree with the design. We note the significant variation in unit cost estimates: we have in the past challenged SGN to better understand its disconnection costs, particularly as the volume of disconnections is likely to increase in future. We agree that collaborative work to derive a unit cost rate is needed and are disappointed that Ofgem has not made more progress on this as part of its parallel work on disconnections.

While this volume driver is only expected to cover domestic disconnection we would encourage Ofgem to look, as part of its future work, at the treatment of I&C disconnections which we would expect to see increasing and where the costs are both more material and more variable.

GDQ26. Do you agree with the proposed design of the New Large Load Connections Re-opener, including our proposal to include general reinforcement projects in its scope?

The New Large Load Connections Re-opener is necessary to fund uncertain future costs associated with new demand with maximum offtake capacity greater than 1,500 scm/h. It is unchanged from GD2. Ofgem considers that the re-opener will be adequate to cover general reinforcement to increase capacity and reliability. The need for such work arises from general changes in the volume and location of demand on the network. Ofgem rejected GDN's proposals to include such investments in base funding. In SGN's case c£28m has been excluded. While we can accept Ofgem's logic that general reinforcement work can be thought of as equivalent to that required for a new load, the former cannot be subject to a size qualification based on demand offtake capacity. We think Ofgem should offer further clarity on whether and how general reinforcement work will be judged to have qualified under the scope of the re-opener. Subject to this concern, we are comfortable with the proposal.

GDQ27. Do you agree with our proposal to retain the RIIO-GD2 scope of the Specified Streetworks Costs Re-opener?

We agree.

GDQ29. Do you agree with our proposal to reject SGN's proposed pass-through for Joint Office of Gas Transporters services?

We agree. These costs appear to be largely under GDNs' control.

GDQ31. Do you agree with our proposal to not introduce a CDS Re-opener and instead fund any resubmitted workloads through NARM, if approved?

We are supportive in principle of repex work on Complex Distribution Systems where justified, although we noted in our response to the Call for Evidence that we were unclear what was involved. We are unsure whether NARM is a workable way of funding this given the uniqueness of these particular sites and the uncertainty of costs associated with them.

Normalisation and workload adjustments

GDQ36. Do you agree with our proposed approach to pre-modelling normalisations and adjustments?

Ofgem has made a normalisation adjustment in assessing costs for differential progress amongst GDNs in implementing the HSE's fatigue regulations. We have no comment on this in principle. The ISG previously challenged SGN to search for cost-effective solutions and ancillary benefits, for example in the use of downtime by emergency staff. Since the Business Plan SGN, in collaboration with other GDN's have made further progress towards defining a requirement which will fully comply with the new regulations, including the requirement for a maximum 12-hour shifts. Since the regulations commenced in 2021, GDNs have been working toward a 16-hour standard, which the HSE had indicated was acceptable pro tem. Ofgem has recently determined additional allowances as a result of a GD2 re-opener request and we have challenged SGN to clarify their position as regards the costs already being incurred and when further future costs are expected. Greater clarity about this at the Final Determination, especially as to how the GD3 allowances relate to the recent re-opener and about Ofgem's assumptions on SGN's progress and on the effect of the normalisation on SGN and other GDNs would be welcome.

GDQ40. What are your views on our proposed workload adjustments to cost drivers?

SGN have made a case to us that the pipe diameter mix assumptions and the implied lay-to-abandon ratios in their Business Plan are in line with historic performance, whereas for other GDNs there are significant divergences between forecast and historic figures. While there may be good reason for variation between historic and forecast figures, the evidence that SGN has shared with us suggests that there is a good case for Ofgem examining this issue again. Noting that we are not competent to form an expert judgement on these issues, we agree with Ofgem's comments and support its intention to engage with the industry on these matters before the Final Determination.

GDQ41. Do you agree with our approach to non-regression benchmarking analysis?

Ofgem has used non-regression benchmarking to assess costs and set allowances for: MOBS, repex diversions, streetworks, Statutory Independent Undertakings, growth governors, and smart metering. We make no comment on the decision to use non-regression benchmarking for these items but comment below on the outcomes in some cases.

Statutory Independent Undertakings (SIUs)

The ISG have supported the objective of decarbonising the SIUs and we are encouraged by the positive comments from Ofgem on the project to switch from LNG to locally sourced Biomethane (CNG) at the Wick & Thurso sites. The needs case has been recognised and Ofgem have agreed that £16m capital costs proposed for these projects can be covered by a reopener during this price control period, while £45m operating costs have been allowed for in full in the baseline. This initiative will provide benefits to the community, security of supply and net zero objectives. The project will also provide critical learning to be applied to other SIUs. See also our response to SGNQ12 in relation to SIU design costs at two other sites, Campbelltown and Oban.

Multi-Occupancy Buildings (MOBs)

The most striking single exclusion for SGN in the Draft Determination relates to MOBs: £249m of investment, the majority of that proposed, has been rejected most of which (£229m) was because data justifying the proposals was not provided and but also because of a difference in interpretation of the Building Regulations in relation to the replacement of PE risers (£9m) and because of uncertainty of costs relating to complex distribution systems (£4m).

Ofgem has helpfully specified the kind of data that would be required to secure a reinstatement of at least some of its proposed investment at Final Determination, and we understand SGN are working to provide that data. We have challenged SGN as to whether in fact the required data is available, especially in relation to medium-rise buildings of three to five stories (and given some ongoing lack of clarity around safety requirements). It is clearly right for customers that investment in MOBs is justified by good evidence, but should it not prove possible to provide such data in the short term then we would be keen that Ofgem consider a re-opener as a way of releasing funding once the evidence base is clear.

The ISG is keen that opportunities for net zero gains presented by the need to replace risers are taken - for example, by instead removing gas from the building altogether. We are persuaded that SGN could be best placed to lead such initiatives, involving other stakeholders, rather than simply replacing risers as a matter of course. However, with minimal funding for MOBs in GD3, there is a risk such forward thinking is de-prioritised. One possibility might be to make re-opener funding for riser replacement dependent on the exploration of all options, including those not involving gas supply.

We also note that Ofgem's decision in relation to Cadent's MOBs proposals – also poorly justified - is to "only allow reactive works to replace risers that have failed in service, and which cannot be repaired." We are unclear whether this decision reflects specific aspects in Cadent's Plan. However, we would be extremely concerned if this was a principle applied to SGN, once it has provided the evidence asked for. While a "fix-on-fail" approach looks attractive as way of saving cost in the short term, it seems to raise unduly the level of risk faced by customers both from a safety perspective and also because of the challenges that can arise in reactively managing repairs (as noted in relation to the targets for unplanned interruptions – GDQ17). It also does not seem consistent with trying to achieve the complex objective of decarbonising energy provision in multi-story buildings in the most effective and efficient way. We have challenged SGN to justify a proactive approach addressing Ofgem's concerns.

We note that Ofgem consider the impact of future building regulations to be within the scope of the HSE re-opener (discussed below) and agree with this approach.

GDQ44. Do you agree with our assessment of technically assessed costs and bespoke outputs?

Ofgem has used a technical assessment for costs of cyber security, Advanced Leakage Detection, Digital Platform for Leakage Analytics, iron stubs, large rechargeable LTS diversions, PSUP capex and major projects. We have no comment on the decision to use technical assessment in these cases. We have commented above on the outcome of the Draft Determination assessment of costs for ALD/DPLA and iron stubs, and major projects. We have no comment on the determination of costs in the other categories, nor about Ofgem's decision relating to SGN's one bespoke output.

GDQ46. Do you agree with our proposed TIM sharing factor?

We are content with this proposal, which broadly continues the current arrangement incentivising the networks to deliver efficiency savings while enabling customers to share in those savings within the price control period.

Finance Annex

Regulatory Depreciation

FQ24. What are your views on our proposal to accelerate depreciation for new assets only in GD and is there any further evidence you would like us to consider before we reach a final decision?

We do not generally comment on the financial parameters underlying the Plan as this is outside the remit of the ISG. However, these assumptions are significant for customers because they drive a significant proportion of customer bills. We note Ofgem's decision to accelerate depreciation only on new assets in GD3, resulting in a more moderate price increase for gas customers than under other more aggressive options outlined at SSMD.

Although as an ISG we have not generally engaged on financial matters, we have discussed this specific issue in the context of the deliberative consumer research that SGN undertook which we see as supporting a level of accelerated depreciation. As such we are content with Ofgem's proposal.

However, we also note that the Government plans to publish a call for evidence later this year to explore gas network investment and affordability. Customers and stakeholders will welcome clarity from Ofgem as to whether (and if so, how) the outcomes of this review might result in revisions to the GD3 settlement.