

## To the Company Secretary:

Southern Gas Networks PLC  
(Company Number: 05167021)

### **Directions issued by the Gas and Electricity Markets Authority to Southern Gas Networks plc under the Special Conditions of its gas transporter licence in respect of the Annual Iteration Process for the GD1 Price Control Financial Model which will take place by 30 November 2013**

#### **WHEREAS**

1. Southern Gas Networks Ltd ('the licensee') is the holder of a gas transporter licence ('the licence') granted under section 7 of the Gas Act 1986 that includes Special Conditions.
2. For the purposes of this direction:
  - (a) the expression "Formula Year t" has the same meaning as is given for it in Special Condition 1A (Restriction of revenue in respect of the Distribution Network Transportation Activity: definitions) and references to Formula Year t-1 are to be construed accordingly; and
  - (b) Formula Year t is the Formula Year that commences on 1 April 2014 and ends on 31 March 2015 ('Formula Year 2014/15').
3. Special Condition 2B (Annual Iteration Process for the GD1 Price Control Financial Model) requires the Gas and Electricity Markets Authority to:
  - (c) carry out the Annual Iteration Process for the GD1 Price Control Financial Model; and
  - (d) direct the value of the term MOD for Formula Year t,  
by 30 November in Formula Year t-1.
4. The following Special Conditions provide for the Authority to direct revised PCFM Variable Values for the licensee for the purpose of the Annual Iteration Process for the GD1 Price Control Financial Model which forms part of Special Condition 2A ( Governance of the GD1 Price Control Financial Instruments) of the licence:
  - (e) Special Condition 1D (NTS Exit Capacity Cost Adjustment) in respect of 'AEx' values;
  - (f) Special Condition 1F (Revenue adjustments for performance in respect of gas Shrinkage and environmental emissions) in respect of 'ALSC' values;
  - (g) Special Condition 3A (Legacy price control adjustments) in respect of 'LAR' values, (and the component term values 'PAR', 'TAR', 'FAR', 'CAR', 'SAR', 'IFIAR' and 'IAEAR') and 'LRAV' values, (and the component term values 'FRAV', 'CRAV', 'MRAV' and 'SRAV');
  - (h) Special Condition 3B (Determination of PCFM Variable Values for Totex Incentive Mechanism Adjustments) in respect of 'ALC', 'AOC', 'ACO' and 'ARE' values;
  - (i) Special Condition 3C (Specified financial adjustments) in respect of 'EDE', 'APFE', 'TTE', 'TGIE' and 'CDE' values;
  - (j) Special Condition 3D (The Innovation Roll-out Mechanism) in respect of 'IRM' values;
  - (k) Special Condition 3E (Mains and Services Replacement Expenditure) in respect of 'RE' values; and
  - (l) Special Condition 3F (Arrangements for the recovery of uncertain costs) in respect of 'IAECCB', 'IAEPPS', 'IAELLC', 'IAESW', 'IAESM', 'IAECA' and 'IAEFP' values.
5. Each of the Special Conditions referred to in paragraph 4:

- (m) sets out the basis on which any revisions to relevant PCFM Variable Values are to be determined; and, where applicable,
  - (n) specifies the price control financial methodology in accordance with which revisions to the relevant PCFM Variable Value(s) are to be determined and the chapter of the GD1 Price Control Financial Handbook containing that methodology.
6. In accordance with requirements set out in the Special Conditions referred to in paragraph 4, on 14 November 2013 the Authority gave notice of the revised PCFM Variable Values that it proposed to direct by 30 November 2013 in Formula Year t-1 and specified that any representations concerning the proposed values should be made by 28 November 2013.
  7. The reason for this direction is to revise the PCFM Variable Values as used in the Annual Iteration Process for the GD1 Price Control Financial Model (as each of those terms is defined in Special Condition 1A). The Annual Iteration Process is used to calculate values for the terms MOD, that are used in the formulae set out in Special Condition 1B (Restriction of revenue in respect of the Distribution Network Transportation Activity).
  8. The Authority received no representations
  9. Schedule 2 to this direction shows the complete PCFM Variable Values Table (as that item is defined in Special Condition 1A) including the values revised under this direction (in bold font) and the values that have not been revised under this direction

**NOW** the Authority pursuant to the provisions of the Special Conditions referred to in paragraphs 3 and 4, **HEREBY DIRECTS** that:

- the PCFM Variable Values referred to in paragraph 4 are to be revised as shown in Schedule 1 to this direction; and
- the term MOD for the licensee for Formula Year 2014/15 is to take the value £(2.8)m.

This direction constitutes notice of the reasons for the Authority's decision pursuant to section 38A of the Gas Act 1986



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Ian Rowson

**28 November 2013**

**Associate Partner, Regulatory Finance, Duly authorised on behalf of the  
Gas and Electricity Markets Authority**



IAESM	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAECA	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAEFP	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision

Component term values used to determine the values for LAR and LRAV in the table above:

PAR = 0.2  
 TAR = -  
 FAR = 0.2  
 CAR = 2.1  
 SAR = -  
 IFIAR = 0.8  
 IAEAR = -  
 FRAV = (0.5)  
 CRAV = 0.3  
 MRV = -  
 SRV = -

## Schedule 2 to Direction issued by the Gas and Electricity Markets Authority to Southern Gas Networks PLC dated 28 November 2013

PCFM Variable Values Table for Southern Gas Networks Ltd with values revised under the direction shown in bold font

Input												
Southern												
Parameter	Licence condi	Units	Term	Constant	Annual values							
PCFM year ending	WWU issues	log.xlsx		31 Mar 2015	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021
PCFM Variable Values Table												
Allowed percentage cost of debt	3C	annual real %	CDE		2.92%	<b>2.72%</b>	2.72%	2.72%	2.72%	2.72%	2.72%	2.72%
Actual load related capex	3B	£m 09/10 prices	ALC		-	-	-	-	-	-	-	-
Actual other capex	3B	£m 09/10 prices	AOC		-	-	-	-	-	-	-	-
Actual controllable opex	3B	£m 09/10 prices	ACO		-	-	-	-	-	-	-	-
Actual replacement expenditure	3B	£m 09/10 prices	ARE		-	-	-	-	-	-	-	-
Allowed uncertain costs (Enhanced physical site se	3F	£m 09/10 prices	IAEEPS		-	-	-	-	-	-	-	-
Allowed uncertain costs (Specified street work cost	3F	£m 09/10 prices	IAESW		7.7	7.6	7.5	7.4	7.3	7.2	7.1	7.1
Allowed uncertain costs (Connection charging bou	3F	£m 09/10 prices	IAECCB		-	-	-	-	-	-	-	-
Allowed uncertain costs (Fuel poor network extens	3F	£m 09/10 prices	IAEFP		1.6	1.9	1.9	1.9	2.0	2.0	2.1	2.1
Allowed uncertain costs (Central agent)	3F	£m 09/10 prices	IAECA		-	-	-	-	-	-	-	-
Allowed uncertain costs (Smart metering roll out c	3F	£m 09/10 prices	IAESM		-	-	-	-	-	-	-	-
Allowed uncertain costs (Mains and services replac	3E	£m 09/10 prices	RE		-	-	-	-	-	-	-	-
Allowed uncertain Costs (Large load connection cc	3F	£m 09/10 prices	IAELLC		-	-	-	-	-	-	-	-
Allowed innovation roll-out mechanism	3D	£m 09/10 prices	IRM		-	-	-	-	-	-	-	-
NTS Exit Capacity costs	ID	£m 09/10 prices	AEx		45.0	46.7	46.7	46.7	46.7	46.7	46.7	46.7
Shrinkage costs	1F	£m 09/10 prices	ALSC		13.3	13.1	13.0	12.7	12.5	12.3	12.1	11.6
Tax liability allowance adjustments - gearing/intere	3C	£m nominal	TGIE		-	-	-	-	-	-	-	-
Tax liability allowance adjustments - driven by tax	3C	£m 09/10 prices	TTE		-	-	-	-	-	-	-	-
Pension scheme administration and Pension Protec	3C	£m 09/10 prices	APFE		0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Pension scheme deficit revenue allowances	3C	£m 09/10 prices	EDE		10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Legacy price control allowed revenue adjustment	3A	£m 09/10 prices	LAR		<b>3.2</b>							
Legacy price control RAV additions adjustment	3A	£m 09/10 prices	LRAV		<b>(0.3)</b>							

