

**To: National Grid Gas plc (with respect to its gas distribution networks)**

(Company Number: 02006000)

**Northern Gas Networks Limited**

(Company Number: 05167070)

**Scotland Gas Networks plc**

(Company Number: SC264065)

**Southern Gas Networks plc**

(Company Number: 05167021)

**Wales and West Utilities Limited**

(Company Number: 05046791)

(each a "licensee")

**THIS IS A 28 DAYS' NOTICE AS REQUIRED UNDER PART B OF SPECIAL CONDITION 2A (GOVERNANCE OF GD1 PRICE CONTROL FINANCIAL INSTRUMENTS) OF EACH GAS TRANSPORTER LICENCE ISSUED UNDER SECTION 7 OF THE GAS ACT 1986 ("the Act")**

1. Special Condition 2A (Governance of GD1 Price Control Financial Instruments) ("SC2A") of the gas transporter licence provides that the Gas and Electricity Markets Authority ("the Authority") will give notice of an intended modification of the GD1 Price Control Financial Instruments (the "Price Control Financial Model" and the "Financial Handbook"), if having carried out the assessment set out in Part A of SC2A, the Authority considers that the intended modification would not be likely to have a significant impact on the licensee or any of the other persons referred to in paragraph 2A.4 of SC2A.
2. The Authority considers that the intended modification of the PCFM and Financial Handbook, specified in paragraphs 3(a), 4(a) and (b) of this Notice, would not be likely to have a significant impact on the licensee or any of the other persons referred to in paragraph 2A.4 of SC2A, in particular because:
  - a) the amendments referred to in paragraph 3(a) of this Notice are minor modelling changes;
  - b) the amendments referred to in paragraph 4(a) of this Notice are minor corrections of omission to include the terms for NTS Exit Capacity (AEx) and Shrinkage Costs (ALSC) to the list in table 2.1 of paragraph 2.5 of chapter 2 in the GD1 Financial Handbook; and
  - c) the amendments referred to in paragraph 4(b) are not expected to change the actual level of deficit repair payments made, but rather align the Pension Scheme Established Deficit (PSED) with a value considered to be more reasonable by both the licensee and the Authority.

**PCFM Modifications**

3. The Authority proposes to modify the Price Control Financial Model (PCFM) referred to in paragraph 1 by:
  - a) amending the annual spread of the Legacy Allowed Revenue (LAR) calculation, which is currently hard coded, to:
    - spread the initial legacy revenue dynamically when the cost of debt has been updated; and
    - correct the Weighted Average Cost of Capital (WACC) used to spread legacy revenue.

The Authority's reasons for proposing the modifications (as per paragraph 3(a)) to the PCFM are to ensure the correct calculation of the term MOD. MOD values are used in the formula for Base Distribution Network Transportation Activity Revenue, set out in Special Condition 1B - Restriction of revenue in respect of the Distribution Network Transportation Activity, and are produced for each Distribution Network under the Annual Iteration Process.

**Financial Handbook Modifications**

4. The Authority proposes to modify the GD1 Financial Handbook referred to in paragraph 1 by:

- a) including the terms for NTS Exit Capacity (AEx) and Shrinkage Costs (ALSC) on the list in table 2.1 of paragraph 2.5 of chapter 2 of the GD1 Financial Handbook. A paragraph explaining the cost allowance relating to these two Variable Values has also been inserted; and
- b) amending chapter 3 of the GD1 Financial Handbook, to allow a mutually agreed deficit value to be substituted for the PSED, if the agreed value is considered by Ofgem and the licensees to be more appropriate.

The Authority's reason for proposing the modifications to the GD1 Financial Handbook as specified in paragraph:

- 4(a) of this Notice, is to correct the omission of these terms from the list in table 2.1; and
  - 4(b) of this Notice, is to reflect that there may be in some circumstances, a more appropriate value than the existing PSED to use for the purposes of the calculations in the Financial Handbook. This is to ensure that the value that Ofgem and the licensees consider to be the most appropriate is used.
5. All modifications referred to in this Notice have been highlighted in Appendices 1, 2 and 3 below, which consist respectively of:
    - a) an oak report setting out the modifications to the PCFM (Appendix 1);
    - b) a copy of the PCFM incorporating the modifications (Appendix 2); and
    - c) the GD1 Financial Handbook that has been modified (Appendix 3).
  6. Copies of this Modification and other documents referred to, in it are available on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).

#### **Now therefore**

7. In accordance with paragraph 2A.9 of SC2A, the Authority hereby gives 28 days' notice to the licensee that it proposes to make modifications to the GD1 Financial Instruments of the licensee as detailed in paragraphs 3 and 5 of this Notice.
8. Any representations on the proposed modifications to the PCFM may be made on or before the 15<sup>th</sup> August 2014, which is 28 days from the date of this Notice, to: Sanjay Vadhera, Regulatory Finance Team, Office of Gas and Electricity Markets, 9 Milbank, London, SW1P 3GE or by email to [Sanjay.Vadhera@ofgem.gov.uk](mailto:Sanjay.Vadhera@ofgem.gov.uk).
9. The proposed modification will take effect from 15 September 2014.
10. All responses will normally be published on Ofgem's website. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.



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**Ian Rowson**  
**Associate Partner, Regulatory Finance and Compliance**  
**Smarter Grids and Governance**  
**Duly authorised on behalf of the**  
**Gas and Electricity Markets Authority**  
**18<sup>th</sup> July 2014**