

**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")

**Gas Act 1986  
Section 23(1)(a)**

**Modification of Special Condition 3E (Mains and Services Replacement Expenditure) of the Gas Transporter Licence.**

Whereas:

1. Each licensee operates a gas distribution network and is the holder of a gas transporter licence (the "licence") granted or treated as granted under section 7 of the Gas Act 1986 (the "Act").
2. In accordance with section 23(2) of the Act, the Gas and Electricity Markets Authority (the Authority) gave notice on 29 August 2014 (the "Notice") that it proposed to modify Special Condition 3E (Mains and Services Replacement Expenditure) of the licence and by requiring any representations to the modification to be made on or before 26 September 2014.
3. In accordance with section 23(4)(b) of the Act, the Authority gave notice of its intention to make the modifications to the Secretary of State and has not received a direction not to make the modification.
4. Prior to the close of the consultation period in respect of the Notice, the Authority received 1 representation response. The response is non-confidential and has been placed on the Ofgem website.
5. The Authority has carefully considered the representation received in relation to the proposed modification. Its response to the representation is attached as Schedule 2 to this modification.
6. In accordance with section 38A of the Act, the Authority gives the following reasons for making the licence modification:
  - (a) to correct temporal designations in references to Formula Years for the purpose of determining revisions to PCFM Variable Values for the relevant Distribution Network relating to Repex T2 allowed expenditure ("RE values"), so that those references are consistent with the definition of Formula Year  $t$  given in Special Condition 1A (Restriction of revenue in respect of the Distribution Network Transportation Activity: definitions)
  - (b) to remove an incorrect specification in paragraph 3E.4 of Special Condition 3E, that in the Formula Year 2013/14 and 2014/15 the value for  $RE_t$  will equal zero, in the context of the corrections set out in subparagraph (a); and

(c) to make other minor drafting changes and corrections that are consequential to the changes referred to in subparagraphs (a) and (b).

7. The effect of the modification will be :

(a) to ensure that revised RE values for each licensee are correctly calculated with respect to particular Formula Years; and

(b) to improve the clarity of the wording used in the Special Condition 3E.

8. Where an application for permission to appeal the Authority's decision is made to the Competition and Markets Authority under section 23B of the Act, Rule 5.7 of the CMA's Energy Licence Modification Appeals Rules<sup>1</sup> requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-confidential notice setting out the matters required in Rule 5.2. The attached Schedule 3 provides a list of the relevant licence holders in relation to this modification. The meaning of "relevant licence holder" is set out in section 23(10) of the Act.

**Now therefore**

In accordance with the powers contained in section 23(1)(a) of the Act, the Authority hereby modifies Special Condition 3E (Mains and Services Replacement Expenditure) of the gas transporter licence of each licensee in the manner specified in Schedule 1 enclosed. All modifications to Special Condition 3E are shown in track changes. This decision will take effect on and from 27 November 2014.

This document constitutes notice of reasons for the decision to modify the gas transporter licence held by each licensee named above, as required by section 38A of the Act.

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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**  
**02 October 2014**

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<sup>1</sup> The rules were published by the Competition Commission in September 2012. On 1 April 2014, the Competition Commission was abolished and its functions transferred to the Competition and Markets Authority (CMA).

## Schedule 1: Modifications to Special Condition 3E

### Special Condition 3E. Mains and Services Replacement Expenditure

#### Introduction

3E.1 The purposes of this condition are:

- (a) to specify the basis on which the relevant Distribution Network's levels of allowed expenditure on Above Risk Action Threshold Tier 2 Mains (together "Repex T2") are to be determined; and
- (b) to determine any appropriate revisions to PCFM Variable Values for the relevant Distribution Network relating to Repex T2 allowed expenditure ("RE" values) ~~in~~ and the Formula Years to which those revised RE values relate for use in the Annual Iteration Process for the GD1 Price Control Financial Model as described in Special Condition 2B (Annual Iteration Process for the GD1 Price Control Financial Model).

3E.2 The  $RE_t$  value relating to a particular Formula Year represents the total amount of allowed expenditure (in 2009/10 prices) for all Repex T2 for that Formula Year, and RE values as at 1 April 2013 reflect forecast levels of Repex T2 at the outset of the Price Control Period.

#### Part A: Application of the mechanisms in this condition

3E.3 The application of the mechanisms set out in this condition provides for:

- (a) the determination of allowed expenditure amounts for Repex T2 for particular Formula Years which reflect actual levels of Repex T2 activity in the Formula Years concerned; and
- (b) the determination and direction of revised RE values so that, as a consequence of the Annual Iteration Process, the value of the term MOD as calculated for Formula Year  $t$  for the purposes of Special Condition 1B (Restriction of revenue in respect of the Distribution Network Transportation Activity Revenue) will result in an adjustment of the relevant Distribution Network's Base Distribution Network Transportation Activity Revenue in a manner that:
  - i. reflects allowed expenditure amounts determined under Part B of this condition; and
  - ii. takes account of allowed expenditure for Repex T2 for the purposes of the Totex Incentive Mechanism Adjustment as set out in Special Condition 3B (Determination of PCFM Variable Values for Totex Incentive Mechanism Adjustments) and in accordance with the methodology set out in Chapter 6 of the GD1 Price Control Financial Handbook.

**Part B: Determination of allowed expenditure for Repex T2 and determination of revisions to RE values**

3E.4 Subject to paragraph 3E.5 of this condition, a revised RE value for the relevant Distribution Network is to be determined for each Formula Year t-2 in accordance with the formula given in paragraph 3E.6 of this condition; ~~and in the Formula Year 2013/14 and 2014/15 the value of RE<sub>t</sub> will equal zero.~~

3E.5 The first Formula Year ~~for~~ in which the Authority will make a determination pursuant to paragraph 3E.4 a revised RE value is to be determined is Formula Year 2015~~4~~/16~~5~~.

3E.6 The formula referred to in paragraph 3E.~~4~~5 of this condition is:

$$RE_{t-2} = \sum_{n=1}^3 (L_{n,t-2} \times U_{n,t-2}) \times 1000$$

where:

$L_{n,t-2}$  means the length of Above Risk Action Threshold Tier 2 Mains in kilometres decommissioned in respect of diameter band n and Formula Year t-2 for the relevant Distribution Network, where the diameter bands are defined as set out in the following table, except that any diameter of mains not covered by the table or any mains measured in metric measurement is to be reported in the diameter band corresponding to the nearest imperial equivalent;

Diameter band n	Nominal internal diameter of mains decommissioned (inches)
1	>8<10
2	10 <=12
3	>12<18

$U_{n,t-2}$  means the specific matrix costs in respect of diameter band n and Formula Year t-2 for the relevant Distribution Network as set out in the relevant table in Appendix 1 of this condition; and

$\sum_{n=1}^3$  means the sum of the diameter bands n.

3E.7 ~~Subject to paragraph 3E.5, the Authority will, by 30 November in each Formula Year t-1, issue a direction in accordance with the provisions of Part C of this condition specifying the revised RE value for Formula Year t-2.~~

3E.8 The Authority may also revise the RE value for a Formula Year earlier than Formula Year t-2 (an “earlier Formula Year”), notwithstanding that the RE value concerned might have been previously revised, provided that:

- (a) the revision is necessary to reflect a review by the Authority of the values of the terms L, pertaining to the earlier Formula Year or to correct errors in relation to those values;
- (b) the revised RE value for the earlier Formula Year is calculated in accordance with the formula set out in paragraph ~~67~~ of this condition, but substituting the earlier Formula Year for each year designation ‘t-2’ in the formula; and









## **Schedule 2: Response to the Representation**

We received a representation from Northern Gas Networks on the 25<sup>th</sup> of September 2014 as a formal response to the statutory consultation Notice referred to in paragraph 2 of this modification. The representation composed of revised wording to Special Condition 3E of the gas transporter licence contained in Schedule 1 of the Notice.

The proposed revision was not accepted because it deviated from the method set in Special Condition 3E. Under the method, Tier 2A mains allowance is revised in the Annual Iteration Process. If we introduced the changes proposed in the representation, the mechanism laid out in the GD1 Financial Handbook on how this allowance should be revised would not be aligned with Special Condition 3E.

Further changes have therefore not been made to this modification of Special Condition 3E as a result of this representation.

### **Schedule 3: Relevant Licence Holders**

Each of below listed licensees is the relevant licence holder only in relation to its own licence.

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

Northern Gas Networks Limited

Scotland Gas Networks plc

Southern Gas Networks plc

Wales and West Utilities Limited