

**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)

(the "licences")

**NOTICE UNDER SECTION 23(2) OF THE GAS ACT 1986**

The Gas and Electricity Markets Authority (the Authority) hereby gives notice pursuant to section 23(2) of the Gas Act 1986 (the Act) as follows:

1. The Authority proposes to modify the gas transporter licences held by the licensees granted or treated as granted under section 7 of the Act by amending Special Condition 3E (Mains and Services Replacement Expenditure). Schedule 1 contains the text of Special Condition 3E with proposed amendments shown in track changes.
2. The reasons the Authority proposes to make this licence modification are:
  - (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).
3. The effects of the proposed modifications shown in Schedule 1 will be:
  - (a) to ensure that revised RE values for the licensee are correctly calculated

with respect to particular Formula Years; and

(b) to improve the clarity of the wording used in the condition.

4. A copy of the proposed modification and other documents referred to in this Notice have been published alongside this Notice and are available on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).
5. Any representations with respect to the proposed licence modifications must be made on or before 26 September 2014 to: Sanjay Vadhera, Regulatory Finance, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to [Sanjay.Vadhera@ofgem.gov.uk](mailto:Sanjay.Vadhera@ofgem.gov.uk).
6. 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.
7. If the Authority decides to make the proposed modification it will take effect not less than 56 days after the decision is published.

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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**

**29 August 2014**

## Schedule 1

### 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 **2a** Mains (together "Repex **T2a**") are to be determined; and
- (b) to determine any appropriate revisions to PCFM Variable Values for the relevant Distribution Network relating to Repex **T2a** 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<sub>t</sub> 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.

NGN believe the above statement to be incorrect and should read:

At the start of the price control period the value in the Price Control Financial Model for all years of RIIO-GD1 for the RE term is nil. Forecasted cost values of Repex Tier 2a have been included in final proposal Totex Repex Allowances (in 09/10 prices). The purpose of the RE term is to true up the Tier 2a cost allowances so it reflects actual workload instead of forecast, as such the RE term will be a variance to adjust the allowance to the required number. This difference then flows through fast and slow money via the totex incentive mechanism.

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

~~3E.2~~3E.3 The application of the mechanisms set out in this condition provides for:

- (a) the determination of allowed expenditure amounts for Repex **T2a** for particular Formula Years which reflect actual workload levels of Repex **T2a** 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 T2a 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.3~~ 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 ~~t 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 2015/16. As an example the annual iteration process in November 2014 will establish a value for RE that relates to 2013/14 formula year. The MOD value associated with the Annual Iteration Process gets charged in the following formula year i.e 2015/16. Thereafter the same timing convention continues i.e. a 2 year lag between year of expenditure and year of adjustment via the MOD term.

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

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

Minus the original cost allowance for Repex Tier 2a allowances

where:

$L_{n,t-2}$  means the length of Above Risk Action Threshold Tier ~~2~~ 2a 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.5~~ 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.6~~ 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
- (c) the revised RE value for the earlier Formula Year is specified in a direction issued in accordance with the provisions of Part C of this condition.

### **Part C: Procedure for direction of revised RE values by the Authority**

~~3E.7~~ 3E.9 Any revised RE values determined by the Authority in accordance with Part B of this condition will be directed by the Authority by 30 November in each Formula Year t-1, or, in respect of any direction under paragraph 3E.8 of this condition, by 30 November of the Formula Year in which the direction is to be made.

~~3E.8~~ 3E.10 Before issuing any directions under paragraph ~~3E.7 or 3E.89~~ of this condition the Authority will give notice to the Licensee of all of the values that it proposes to direct.

~~3E.9~~ 3E.11 The notice referred to in paragraph 3E.10 will:

- (a) state that any revised RE values have been determined in accordance with Part B of this condition; and
- (b) specify the period (which will not be less than 14 days from the date of the notice) within which the Licensee may make any representations concerning the determination of any revised RE values.

~~3E.10~~ 3E.12 The Authority will have due regard to any representations duly received under paragraph 3E.11 of this condition, and give reasons for its decisions in relation to them.

~~3E.11~~ 3E.13 Where the Authority directs any revised RE values for earlier Formula Years under paragraph 3E.8 in Part B of this condition, the effect of using those revised RE values in the Annual Iteration Process for the GD1 Price Control Financial Model will, subject to a Time Value of Money Adjustment, be reflected in the calculation of the term MOD for the relevant Distribution Network for Formula Year t and, for the avoidance of doubt, it will not have any retrospective effect on a previously directed value of the term MOD.

~~3E.12~~ 3E.14 Subject to paragraph 3E.5, ~~if~~, for any reason in any Formula Year t-1, the Authority does not make a



1	161	161	161	161	161	161	161	161
2	312	312	312	312	312	312	312	312
3	520	520	520	520	520	520	520	520

**Distribution Network specific matrix costs (£ per metre, at 2009/10 price levels) for Above Risk Action Threshold Tier 2 Mains: Distribution Network: NGGD WM**

	Specific matrix costs (£ per metre)							
<u>Diameter band</u> <del>nDiameter band</del> #	<u>2013/14£</u> =1	<u>2014/15£</u> =2	<u>2015/16£</u> =3	<u>2016/17£</u> =4	<u>2017/18£</u> =5	<u>2018/19£</u> =6	<u>2019/20£</u> =7	<u>2020/21£</u> =8
1	170	170	170	170	170	170	170	170
2	329	329	329	329	329	329	329	329
3	548	548	548	548	548	548	548	548

**Distribution Network specific matrix costs (£ per metre, at 2009/10 price levels) for Above Risk Action Threshold Tier 2 Mains: Distribution Network: Northern Gas Networks Ltd**

	Specific matrix costs (£ per metre)							
<u>Diameter band</u> <del>nDiameter band</del> #	<u>2013/14£</u> =1	<u>2014/15£</u> =2	<u>2015/16£</u> =3	<u>2016/17£</u> =4	<u>2017/18£</u> =5	<u>2018/19£</u> =6	<u>2019/20£</u> =7	<u>2020/21£</u> =8
1	143	143	143	143	143	143	143	143
2	259	259	259	259	259	259	259	259
3	419	419	419	419	419	419	419	419
<u>For each GDN I would suggest displaying in this table what the cost allowances were that were included within final proposals Totex Repex Allowances</u>								

**Distribution Network specific matrix costs (£ per metre, at 2009/10 price levels) for Above Risk Action Threshold Tier 2 Mains: Distribution Network:**

**Scotland Gas Networks plc**

	Specific matrix costs (£ per metre)							
<u>Diameter</u>	<u>2013/14£</u>	<u>2014/15£</u>	<u>2015/16£</u>	<u>2016/17£</u>	<u>2017/18£</u>	<u>2018/19£</u>	<u>2019/20£</u>	<u>2020/21£</u>

