

## 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**

#### **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.
2. For the purposes of these directions:
  - (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 2015 and ends on 31 March 2016 ('Formula Year 2015/16').
3. Special Condition 2B (Annual Iteration Process for the GD1 Price Control Financial Model) requires the Gas and Electricity Markets Authority to:
  - (a) carry out the Annual Iteration Process for the GD1 Price Control Financial Model; and
  - (b) 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:
  - (a) Special Condition 1D (NTS Exit Capacity Cost Adjustment) in respect of AEx values;
  - (b) Special Condition 1F (Revenue adjustments for performance in respect of gas Shrinkage and environmental emissions) in respect of ALSC values;
  - (c) 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);
  - (d) Special Condition 3B (Determination of PCFM Variable Values for Totex Incentive Mechanism Adjustments) in respect of ALC, AOC, ACO and ARE values;
  - (e) Special Condition 3C (Specified financial adjustments) in respect of EDE, APFE, TTE, TGIE and CDE values;
  - (f) Special Condition 3D (The Innovation Roll-out Mechanism) in respect of IRM values;
  - (g) Special Condition 3E (Mains and Services Replacement Expenditure) in respect of RE values; and
  - (h) Special Condition 3F (Arrangements for the recovery of uncertain costs) in respect of IAECB, IAEEPS, IAELLC, IAESW, IAESM, IAECA and IAIEFP values.
5. Each of the Special Conditions referred to in paragraph 4:
  - (a) sets out the basis on which any revisions to relevant PCFM Variable Values are to be determined; and

(b) where applicable, 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. The reason for these directions 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 term MOD, that are used in the formulae set out in Special Condition 1B (Restriction of revenue in respect of the Distribution Network Transportation Activity).
7. In accordance with requirements set out in the Special Conditions referred to in paragraph 4, on 13 November 2014 the Authority gave notice of the revised PCFM Variable Values that it proposed to direct by 30 November 2014 in Formula Year t-1 and specified that any representations concerning the proposed values should be made within fourteen days.
8. The Authority received no representations.

**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 2015/16 is to take the value £-18.4m.

Schedule 2 to these directions shows the complete PCFM Variable Values Table (as that term is defined in Special Condition 1A) including the values revised under these directions (in bold font) and the values that have not been revised under these directions.

This 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 2014**

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

**Schedule 1 to Directions issued by the Gas and Electricity Markets Authority to Southern Gas Networks plc dated 28 November 2014**

Southern Gas Networks plc	<i>Proposed Revised PCFM Variable Values</i>							
<i>PCFM Variable Value names and determination provision</i>	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
AEx Special Condition 1D	<b>45.0</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
ALSC Special Condition 1F	<b>13.3</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
LAR Parts A and B of Special Condition 3A	<b>3.5</b>							
LRAV Parts A and B of Special Condition 3A	<b>-0.1</b>							
ALC Part B of Special Condition 3B	<b>25.7</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
AOC Part B of Special Condition 3B	<b>16.2</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
ACO Part B of Special Condition 3B	<b>93.5</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
ARE Part B of Special Condition 3B	<b>132.4</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
EDE Part A of Special Condition 3C	No revision	No revision	<b>8.9</b>	<b>8.9</b>	<b>8.9</b>	No revision	No revision	No revision
APFE Part A of Special Condition 3C	<b>0.7</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
TTE Part B of Special Condition 3C	No revision	No revision	<b>-0.6</b>	No revision	No revision	No revision	No revision	No revision
TGIE Part B of Special Condition 3C	<b>0.0</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision
CDE Part C of Special Condition 3C	No revision	No revision	<b>2.55%</b>	No revision	No revision	No revision	No revision	No revision
IRM Part F of Special Condition 3D	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
RE Part B of Special Condition 3E	<b>0.0</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision

Southern Gas Networks plc	<i>Proposed Revised PCFM Variable Values</i>							
<i>PCFM Variable Value names and determination provision</i>	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
IAECCB Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAEEPS Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAELLC Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAESW Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAESM Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAECA Part D of Special Condition 3F	No revision	No revision	No revision	No revision	No revision	No revision	No revision	No revision
IAEFP Part D of Special Condition 3F	<b>1.6</b>	No revision	No revision	No revision	No revision	No revision	No revision	No revision

Southern Gas Networks plc

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

PAR	=	0.2
TAR	=	0.0
CAR	=	2.1
FAR	=	0.2
SAR	=	0.0
IFIAR	=	0.8
IAEAR	=	0.3
CRAV	=	0.4
MRV	=	0.0
FRAV	=	-0.5
SRAV	=	0.0

## Schedule 2 to Directions issued by the Gas and Electricity Markets Authority to Southern Gas Networks PLC dated 28 November 2014

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

Input													
Southern													
Parameter	Licence condition	Units	Term	Constant	Annual values								
PCFM year ending				31 Mar 2016	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%	2.72%	<b>2.55%</b>	2.55%	2.55%	2.55%	2.55%	2.55%
	Actual load related capex	3B	£m 09/10 prices	ALC		<b>25.7</b>	-	-	-	-	-	-	-
	Actual other capex	3B	£m 09/10 prices	AOC		<b>16.2</b>	-	-	-	-	-	-	-
	Actual controllable opex	3B	£m 09/10 prices	ACO		<b>93.5</b>	-	-	-	-	-	-	-
	Actual replacement expenditure	3B	£m 09/10 prices	ARE		<b>132.4</b>	-	-	-	-	-	-	-
	Allowed uncertain costs (Enhanced physical site security)	3F	£m 09/10 prices	IAEEPS		-	-	-	-	-	-	-	-
	Allowed uncertain costs (Specified street work costs)	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 boundary change costs)	3F	£m 09/10 prices	IAECCB		-	-	-	-	-	-	-	-
	Allowed uncertain costs (Fuel poor network extension scheme)	3F	£m 09/10 prices	IAEFP		<b>1.6</b>	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 costs)	3F	£m 09/10 prices	IAESM		-	-	-	-	-	-	-	-
	Allowed uncertain costs (Mains and services replacement expenditure)	3E	£m 09/10 prices	RE		<b>0.0</b>	2.1	2.1	2.1	2.1	2.1	2.1	2.1
	Allowed uncertain Costs (Large load connection costs)	3F	£m 09/10 prices	IAELLC		-	-	-	-	-	-	-	-
	Allowed innovation roll-out mechanism	3D	£m 09/10 prices	IRM		-	-	-	-	-	-	-	-
	NTS Exit Capacity costs	1D	£m 09/10 prices	AEx		<b>45.0</b>	46.7	46.7	46.7	46.7	46.7	46.7	46.7
	Shrinkage costs	1F	£m 09/10 prices	ALSC		<b>13.3</b>	13.1	13.0	12.7	12.5	12.3	12.1	11.6
	Tax liability allowance adjustments - gearing/interest costs	3C	£m nominal	TGIE		<b>0.0</b>	-	-	-	-	-	-	-
	Tax liability allowance adjustments - driven by tax trigger events	3C	£m 09/10 prices	TTE		-	-	<b>(0.6)</b>	-	-	-	-	-
	Pension scheme administration and Pension Protection Fund Levy	3C	£m 09/10 prices	APFE		<b>0.7</b>	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	<b>8.9</b>	<b>8.9</b>	<b>8.9</b>	8.9	8.9	8.9
	Legacy price control allowed revenue adjustment	3A	£m 09/10 prices	LAR		<b>3.5</b>							
	Legacy price control RAV additions adjustment	3A	£m 09/10 prices	LRAV		<b>(0.1)</b>							