

## **To the Company Secretary:**

Northern Gas Networks Ltd  
Company number 05167070

### **Directions issued by the Gas and Electricity Markets Authority to Northern Gas Networks Ltd 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. Northern 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 to it in Special Condition 1A (Restriction of revenue in respect of the Distribution Network Transportation Activity: definitions) of the licence 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 2016 and ends on 31 March 2017 ('Formula Year 2016/17').
3. Special Condition 2B (Annual Iteration Process for the GD1 Price Control Financial Model) requires the Gas and Electricity Markets Authority ('the 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, for the purposes of the formula specified in Special Condition 1B (Restriction of revenue in respect of the Distribution Network Transportation Activity);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 2B (Annual Iteration Process for the GD1 Price Control Financial Model) 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, MRV and SRV);
  - (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 IAEPF values.

5. Each of the Special Conditions referred to in paragraph 4:

- (a) sets out the basis on which any revisions to the 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 the value of the term MOD, for the purposes of the formula specified 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 9 November 2015 the Authority gave notice of the revised PCFM Variable Values that it proposed to direct by 30 November in Formula Year t-1 and specified that any representations concerning the proposed values should be made within 14 days of receiving the notice.

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 these directions; and
- the term MOD for the licensee for Formula Year 2016/17 is to take the value £-6.2m.

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

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

**30 November 2015**

**Schedule 1 to Directions issued by the Gas and Electricity Markets Authority to Northern Gas Networks Ltd dated 30 November 2015 (figures shown to 1 d.p., except CDE shown to 2 d.p.)**

Northern Gas Networks Ltd				RIIO-GD1							
PCFM Variable Value		Special Condition	Price Base / Units	31 March 2014	31 March 2015	31 March 2016	31 March 2017	31 March 2018	31 March 2019	31 March 2020	31 March 2021
CDE	Allowed percentage cost of debt	3C	Annual Real %	No Revision	No Revision	No Revision	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>
ALC	Actual load related capex	3B	£m 09/10 Prices	No Revision	<b>22.2</b>	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
AOC	Actual other capex	3B	£m 09/10 Prices	No Revision	<b>19.9</b>	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
ACO	Actual controllable opex	3B	£m 09/10 Prices	No Revision	<b>69.6</b>	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
ARE	Actual replacement expenditure	3B	£m 09/10 Prices	No Revision	<b>79.4</b>	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAEPS	Allowed uncertain costs (Enhanced physical site security)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAESW	Allowed uncertain costs (Specified street work costs)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAECCB	Allowed uncertain costs (Connection charging boundary change costs)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAEFP	Allowed uncertain costs (Fuel poor network extension scheme)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	<b>2.2</b>	<b>2.2</b>	<b>2.3</b>	<b>2.3</b>	<b>2.3</b>
IAECA	Allowed uncertain costs (Central agent)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAESM	Allowed uncertain costs (Smart metering roll out costs)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
RE	Allowed uncertain costs (Mains and services replacement expenditure)	3E	£m 09/10 Prices	No Revision	<b>2.6</b>	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IAELLC	Allowed uncertain Costs (Large load connection costs)	3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
IRM	Allowed innovation roll-out mechanism	3D	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
AEx	NTS Exit Capacity costs	1D	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
ALSC	Shrinkage costs	1F	£m 09/10 Prices	No Revision	<b>9.6</b>	<b>9.4</b>	<b>9.0</b>	<b>8.9</b>	<b>8.8</b>	<b>8.6</b>	<b>8.4</b>
TGIE	Tax liability allowance adjustments - gearing/interest costs	3C	£m Nominal	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
TTE	Tax liability allowance adjustments - driven by tax trigger events	3C	£m 09/10 Prices	No Revision	No Revision	<b>-0.3</b>	<b>-0.2</b>	No Revision	No Revision	No Revision	No Revision
APFE	Pension scheme administration and Pension Protection Fund Levy	3C	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
EDE	Pension scheme deficit revenue allowances	3C	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
LAR	Legacy price control allowed revenue adjustment	3A	£m 09/10 Prices	No Revision							
LRAV	Legacy price control RAV additions adjustment	3A	£m 09/10 Prices	No Revision							

**Schedule 2 to Directions issued by the Gas and Electricity Markets Authority to Northern Gas Networks Ltd dated 30 November 2015**

Northern												
Parameter	Licence condition	Units	Term	Constant	Annual values							
PCFM year ending				31 Mar 2017	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021
<b>PCFM Variable Values Table</b>												
Allowed percentage cost of debt	3C	annual real %	CDE		2.92%	2.72%	2.55%	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>	<b>2.38%</b>
Actual load related capex	3B	£m 09/10 prices	ALC		18.0	<b>22.2</b>	-	-	-	-	-	-
Actual other capex	3B	£m 09/10 prices	AOC		17.1	<b>19.9</b>	-	-	-	-	-	-
Actual controllable opex	3B	£m 09/10 prices	ACO		68.4	<b>69.6</b>	-	-	-	-	-	-
Actual replacement expenditure	3B	£m 09/10 prices	ARE		75.7	<b>79.4</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		0.7	0.6	0.6	0.5	0.5	0.4	0.4	0.4
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		1.6	1.6	1.7	<b>2.2</b>	<b>2.2</b>	<b>2.3</b>	<b>2.3</b>	<b>2.3</b>
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		2.8	<b>2.6</b>	2.9	3.0	3.3	3.1	3.0	2.8
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		8.9	8.9	8.8	8.8	8.8	8.8	8.8	8.8
Shrinkage costs	1F	£m 09/10 prices	ALSC		10.0	<b>9.6</b>	<b>9.4</b>	<b>9.0</b>	<b>8.9</b>	<b>8.8</b>	<b>8.6</b>	<b>8.4</b>
Tax liability allowance adjustments - gearing/interest costs	3C	£m nominal	TGIE		-	-	-	-	-	-	-	-
Tax liability allowance adjustments - driven by tax trigger events	3C	£m 09/10 prices	TTE		-	-	<b>-0.3</b>	<b>-0.2</b>	-	-	-	-
Pension scheme administration and Pension Protection Fund Levy	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		6.7	6.7	7.0	7.0	7.0	7.0	7.0	7.0
Legacy price control allowed revenue adjustment	3A	£m 09/10 prices	LAR		17.4							
Legacy price control RAV additions adjustment	3A	£m 09/10 prices	LRAV		-14.1							