

**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 RIIO-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 2017 and ends on 31 March 2018 ('Formula Year 2017/18').
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, 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 IAECBB, 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 8 November 2016 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.

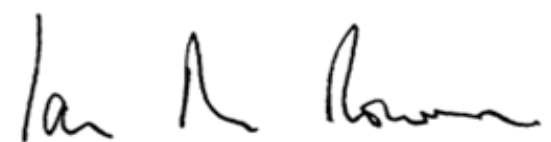
**NOW** the Authority pursuant to the provisions of the Special Conditions referred to in paragraphs 3 and 4, **HEREBY DIRECTS** that:

- 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 2017/18 is to take the value -£11.1m.

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.

**Ian Rowson**



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**Associate Partner, RIIO Finance**

Duly authorised on behalf of the Gas and Electricity Markets Authority  
30 November 2016

**SCHEDULE 1 TO THE AUTHORITY'S DIRECTION - REVISIONS TO VARIABLE VALUES (shown to 1 d.p., except CDE shown to 2 d.p.)**

Northern Gas Networks Ltd				Regulatory Year Ending							
PCFM Variable Value				RIIO-GD1							
	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	CRC 3C	Annual Real %	No Revision	No Revision	No Revision	No Revision	<b>2.22%</b>	<b>2.22%</b>	<b>2.22%</b>	<b>2.22%</b>
ALC	Actual load related capex	CRC 3B	£m 09/10 Prices	No Revision	No Revision	<b>30.3</b>	No Revision	No Revision	No Revision	No Revision	
AOC	Actual other capex	CRC 3B	£m 09/10 Prices	No Revision	No Revision	<b>21.8</b>	No Revision	No Revision	No Revision	No Revision	
ACO	Actual controllable opex	CRC 3B	£m 09/10 Prices	No Revision	No Revision	<b>65.3</b>	No Revision	No Revision	No Revision	No Revision	
ARE	Actual replacement expenditure	CRC 3B	£m 09/10 Prices	No Revision	No Revision	<b>71.6</b>	No Revision	No Revision	No Revision	No Revision	
IAEES	Allowed uncertain costs (Enhanced physical site security)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
IAESW	Allowed uncertain costs (Specified street work costs)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
IAECCB	Allowed uncertain costs (Connection charging boundary change costs)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
IAEFP	Allowed uncertain costs (Fuel poor network extension scheme)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
IAECA	Allowed uncertain costs (Central agent)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	<b>0.1</b>	<b>0.1</b>	<b>-1.7</b>	<b>-2.6</b>	<b>-3.3</b>	
IAESM	Allowed uncertain costs (Smart metering roll out costs)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
RE	Allowed uncertain costs (Mains and services replacement expenditure)	CRC 3E	£m 09/10 Prices	No Revision	No Revision	<b>1.6</b>	No Revision	No Revision	No Revision	No Revision	
IAELLC	Allowed uncertain Costs (Large load connection costs)	CRC 3F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
IRM	Allowed innovation roll-out mechanism	CRC 3D	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
AEx	NTS Exit Capacity costs	CRC 1D	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
ALSC	Shrinkage costs	CRC 1F	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
TGIE	Tax liability allowance adjustments - gearing/interest costs	CRC 3C	£m Nominal	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
TTE	Tax liability allowance adjustments - driven by tax trigger events	CRC 3C	£m 09/10 Prices	No Revision	No Revision	<b>-0.5</b>	No Revision	<b>-1.3</b>	No Revision	No Revision	
APFE	Pension scheme administration and Pension Protection Fund Levy	CRC 3C	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
EDE	Pension scheme deficit revenue allowances	CRC 3C	£m 09/10 Prices	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	
LAR	Legacy price control allowed revenue adjustment	CRC 3A	£m 09/10 Prices	No Revision							
LRAV	Legacy price control RAV additions adjustment	CRC 3A	£m 09/10 Prices	No Revision							

Northern Gas Networks Ltd		Financial Handbook	Price Base	31 March 2014
Incremental Legacy Adjustments used to calculate LAR				
PAR	Pension adjustments	Chapter 10	£m 09/10 Prices	0.1
TAR	Gearing and interest cost adjustments	Chapter 10	£m 09/10 Prices	0.0
CAR	Capex incentive scheme adjustments	Chapter 10	£m 09/10 Prices	16.8
FAR	Non Gas Fuel Poor Network Extension Scheme adjustments	Chapter 10	£m 09/10 Prices	0.5
SAR	Security Logged up costs	Chapter 10	£m 09/10 Prices	0.0
IFIAR	Legacy licence error – IFI	Chapter 10	£m 09/10 Prices	0.0
IAEAR	GDPCR1 Income Adjusting Events	Chapter 10	£m 09/10 Prices	0.0
Incremental Legacy Adjustments used to calculate LRAV				
CRAV	Capex incentive scheme adjustments	Chapter 10	£m 09/10 Prices	-13.8
MRAV	Mains and services replacement expenditure adjustments	Chapter 10	£m 09/10 Prices	0.0
FRAV	Non Gas Fuel Poor Network Extension Scheme adjustments	Chapter 10	£m 09/10 Prices	-0.3
SRAV	Security Logged up costs	Chapter 10	£m 09/10 Prices	0.0

**SCHEDULE 2 TO THE AUTHORITY'S DIRECTION - VARIABLE VALUE TABLE**

Variable Name	Special Condition	Price Base / Units	Term	Regulatory Year Ending							
				31 March 2014	31 March 2015	31 March 2016	31 March 2017	31 March 2018	31 March 2019	31 March 2020	31 March 2021
Allowed percentage cost of debt	CRC 3C	Annual Real %	CDE	2.92%	2.72%	2.55%	2.38%	<b>2.22%</b>	<b>2.22%</b>	<b>2.22%</b>	<b>2.22%</b>
Actual load related capex	CRC 3B	£m 09/10 Prices	ALC	18.0	22.2	<b>30.3</b>	-	-	-	-	-
Actual other capex	CRC 3B	£m 09/10 Prices	AOC	17.1	19.9	<b>21.8</b>	-	-	-	-	-
Actual controllable opex	CRC 3B	£m 09/10 Prices	ACO	68.4	69.6	<b>65.3</b>	-	-	-	-	-
Actual replacement expenditure	CRC 3B	£m 09/10 Prices	ARE	75.7	79.4	<b>71.6</b>	-	-	-	-	-
Allowed uncertain costs (Enhanced physical site security)	CRC 3F	£m 09/10 Prices	IAEEPS	-	-	-	-	-	-	-	-
Allowed uncertain costs (Specified street work costs)	CRC 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)	CRC 3F	£m 09/10 Prices	IAECCB	-	-	-	-	-	-	-	-
Allowed uncertain costs (Fuel poor network extension scheme)	CRC 3F	£m 09/10 Prices	IAEFP	1.6	1.6	1.7	2.2	2.2	2.3	2.3	2.3
Allowed uncertain costs (Central agent)	CRC 3F	£m 09/10 Prices	IAECA	(0.0)	0.0	<b>0.1</b>	<b>0.1</b>	<b>(1.7)</b>	<b>(2.6)</b>	<b>(3.3)</b>	<b>(3.7)</b>
Allowed uncertain costs (Smart metering roll out costs)	CRC 3F	£m 09/10 Prices	IAESM	-	-	-	-	-	-	-	-
Allowed uncertain costs (Mains and services replacement expenditure)	CRC 3E	£m 09/10 Prices	RE	2.8	2.6	<b>1.6</b>	3.0	3.3	3.1	3.0	2.8
Allowed uncertain Costs (Large load connection costs)	CRC 3F	£m 09/10 Prices	IAELLC	-	-	-	-	-	-	-	-
Allowed innovation roll-out mechanism	CRC 3D	£m 09/10 Prices	IRM	-	-	-	-	-	-	-	-
NTS Exit Capacity costs	CRC 1D	£m 09/10 Prices	AEx	8.9	8.9	8.8	8.8	8.8	8.8	8.8	8.8
Shrinkage costs	CRC 1F	£m 09/10 Prices	ALSC	10.0	9.6	9.4	9.0	8.9	8.8	8.6	8.4
Tax liability allowance adjustments - gearing/interest costs	CRC 3C	£m Nominal	TGIE	-	-	-	-	-	-	-	-
Tax liability allowance adjustments - driven by tax trigger events	CRC 3C	£m 09/10 Prices	TTE	-	-	<b>(0.5)</b>	<b>(0.2)</b>	<b>(1.3)</b>	-	-	-
Pension scheme administration and Pension Protection Fund Levy	CRC 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	CRC 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	CRC 3A	£m 09/10 Prices	LAR	17.4							
Legacy price control RAV additions adjustment	CRC 3A	£m 09/10 Prices	LRAV	(14.1)							