

**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 RIIO-GD1 Price Control Financial Model**

**WHEREAS**

1. Southern Gas Networks plc ('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 2018 and ends on 31 March 2019 ('Formula Year 2018/19').
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 IAECCB, IAEPS, IAELLC, IAESW, IAESM, IAECA and IAEFP 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 15 November 2017 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.

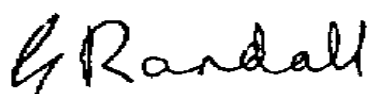
**NOW** the Authority pursuant to the provisions of the Special Conditions referred to in paragraphs 3 and 4, **HEREBY DIRECTS** that:

- 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 2018/19 is to take the value -£25.7m.

Schedule 2 to these directions shows the complete PCFM Variable Value 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.

**Geoffrey Randall**



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**Associate Partner, RIIO Networks**

Duly authorised on behalf of the Gas and Electricity Markets Authority  
30 November 2017

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

Southern Gas Networks plc				Regulatory Year Ending							
				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	No Revision	No Revision	<b>2.03%</b>	<b>2.03%</b>	<b>2.03%</b>
ALC	Actual load related capex	3B	£m 09/10 Prices	<b>26.1</b>	No Revision	<b>36.0</b>	<b>40.8</b>	No Revision	No Revision	No Revision	No Revision
AOC	Actual other capex	3B	£m 09/10 Prices	No Revision	No Revision	No Revision	<b>16.4</b>	No Revision	No Revision	No Revision	No Revision
ACO	Actual controllable opex	3B	£m 09/10 Prices	<b>93.1</b>	<b>91.1</b>	<b>93.7</b>	<b>95.5</b>	No Revision	No Revision	No Revision	No Revision
ARE	Actual replacement expenditure	3B	£m 09/10 Prices	No Revision	No Revision	<b>126.0</b>	<b>140.2</b>	No Revision	No Revision	No Revision	No Revision
IAEEPS	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	No Revision	No Revision	No Revision	No Revision	No Revision
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	No Revision	No Revision	<b>1.7</b>	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	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision	No Revision
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	No Revision	<b>-0.9</b>	No Revision	<b>-3.1</b>	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	<b>9.6</b>	<b>9.6</b>	<b>9.6</b>
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							

Southern Gas Networks plc		Financial Handbook	Price Base	31 March 2014
Incremental Legacy Adjustments used to calculate LAR				
PAR	Pension adjustments	Chapter 10	£m 09/10 Prices	0.2
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	2.1
FAR	Non Gas Fuel Poor Network Extension Scheme adjustments	Chapter 10	£m 09/10 Prices	0.2
SAR	Security Logged up costs	Chapter 10	£m 09/10 Prices	0.0
IFIAR	Legacy licence error – IFI	Chapter 10	£m 09/10 Prices	0.8
IAEAR	GDPCR1 Income Adjusting Events	Chapter 10	£m 09/10 Prices	0.3
Incremental Legacy Adjustments used to calculate LRAV				
CRAV	Capex incentive scheme adjustments	Chapter 10	£m 09/10 Prices	0.4
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	-0.5
SRAV	Security Logged up costs	Chapter 10	£m 09/10 Prices	0.0

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

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