

## Annex 3: PART 4: PRICE CONTROL CONDITIONS

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  - Proposed additions are indicated by red text which is underlined.
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### **PART 4: PRICE CONTROL CONDITIONS**

#### **CONDITION 4.1: GENERAL PROVISIONS, DEFINITIONS AND REPORTING**

##### 4.1.1 General Provisions

(a) This Part 4 shall be subject to the provisions of Part 5, and shall:

- (i) have effect at all times prior to the time and date which is specified in any direction issued by the Authority under Condition 5.1.1;
- (ii) where such a direction is issued, cease to have effect at that time and date and have no effect at any time thereafter (excepting only this paragraph (a) which shall continue in force for the purposes of giving effect to the direction).

~~(a)(b)~~ Without prejudice to any other provisions of the Licence, the Authority shall be entitled on reasonable prior notice to inspect those records of the Licensee reasonably sufficient to enable it to satisfy itself as to the matters which are the subject of this Part 4.

~~(b)(c)~~ The Licensee shall, in submitting or calculating any forecasts or estimates required to be submitted or calculated under or in accordance with this Part 4, use all reasonable endeavours to ensure that it submits or calculates the best forecasts or estimates reasonably achievable, based on the most comprehensive, current information obtainable at the time of submission or calculation.

##### 4.1.2 Definitions

(a) Save where this Part 4 otherwise provides, words and expressions used in this Part 4 which are defined in another Part of the Licence shall have the same meaning as is given to them in that Part.

- (b) In this Part 4, the following words and phrases shall have the meanings given to them below:

<b>Actual Controllable Capital Expenditure</b>	<del>means</del> <u>has</u> the <del>cumulative—actual—Controllable Capital Expenditure,</del> <u>meaning given to that term</u> in <del>accordance with</del> Condition 4.2.1(d)(i).
<b>Actual Controllable Operating Expenditure</b>	has the meaning given to that term in Condition 4.7.3(b).
<b>Actual Uncontrollable Capital Expenditure</b>	<del>means</del> <u>has</u> the <del>cumulative—actual—Uncontrollable Capital Expenditure,</del> <u>meaning given to that term</u> in <del>accordance with</del> Condition 4.2.1(d)(ii).
<b>Actual Capital Expenditure</b>	means the Actual Controllable Capital Expenditure plus the Actual Uncontrollable Capital Expenditure.
<b>Actual Supplemental Income</b>	has the meaning given to that term in Condition 4.7.6(e).
<b>Capital Expenditure</b>	<p>means, in respect of the Network and/or any Postalised Distribution Pipelines:</p> <p>(a) expenditure relating to property, plant or equipment that would be recognised as an asset under:</p> <p style="padding-left: 40px;">(i) International Accounting Standard 16 ‘Property, Plant and Equipment’ (but excluding any attributable interest costs); or</p> <p style="padding-left: 40px;">(ii) such alternative accounting treatment as may be specified by the Authority in a direction issued by it from time to time; and</p> <p>(b) such other expenditure as may be specified for the purposes of this definition in, or approved by the Authority under, any direction issued by the Authority from time to time.</p>

<b>Capitalised Interest Rate</b>	has the meaning given to that term in Condition 4.5.7.
<b><u>Capped Sum</u></b>	<u>has the meaning given to that term in Condition 4.2.2(c).</u>
<b>Compliance Plan</b>	has the meaning given to that term in Condition 4.1.4(c).
<b>Controllable Capital Expenditure</b>	means Capital Expenditure other than Uncontrollable Capital Expenditure.
<b>Controllable Capital Expenditure Estimate</b>	has the meaning given to that term in Condition 4.2.1(a).
<b>Controllable Operating Expenditure</b>	has the meaning given to that term in Condition 4.7.4.
<b>Controllable Operating Expenditure Estimate</b>	has the meaning given to that term in Condition 4.7.2(a).
<b>Designated Pipeline</b>	means any pipeline designated by the Department as forming part of the postalised pipeline network under Article 59 of the Gas Order.
<b>Determined Controllable Operating Expenditure</b>	has the meaning given to that term in Condition 4.7.2(c).
<b>Early Section</b>	means a Section which has been constructed and: <ul style="list-style-type: none"> <li>(a) in relation to which a gas supplier or gas shipper is able to book capacity, pursuant to the provisions of the Network Code, in respect of a date which is prior to the First Operational Commencement Date; or</li> <li>(b) which the Authority has otherwise, in a direction issued for that purpose, deemed to be operational with effect from a date prior to the</li> </ul>

	<p>First Operational Commencement Date,</p> <p>but such that that Section shall be treated as an Early Section for the purposes of this Part 4 only on and from the date applicable in accordance with paragraph (a) or (b) (as the case may be).</p>
<b>Early Sectional Completion</b>	has the meaning given to that term in Condition 4.5.9.
<b>Eligible Pass-Through Costs</b>	has the meaning given to that term in Condition 4.1.3.
<b><u>Fixed Sum</u></b>	<u>has the meaning given to that term in Condition 4.2.2(b).</u>
<b>Joint Holding Company</b>	means, at any point in time, a holding company of the Licensee which owns and/or operates (or any one of the subsidiaries of which, other than the Licensee, owns and/or operates) gas pipelines or gas plant (excluding the Network) and/or electric lines or electrical plant in Northern Ireland.
<b>Joint Support Company</b>	means, at any point in time, a company which is a subsidiary of a Joint Holding Company and which provides or procures the provision of any services (including finance) to the Licensee and to one or more other subsidiaries of the Joint Holding Company of the nature referred to in the definition of Joint Holding Company.
<b>"LIBOR"</b>	means the sterling London Interbank Offered Rate as published in the Financial Times from time to time.
<b>Office and Overhead Costs</b>	means administration, secretarial, employment, secondment, staff training, management, audit and other internal overhead costs, together with accountancy and other advisory fees.

<b>Postalised Distribution Pipeline</b>	means such part of a low pressure gas pipeline as is specified in, or determined by or in accordance with, a direction given to the Licensee by the Authority for the purposes of this definition.
<b>Rate of Return</b>	means the regulatory allowed real weighted average rate of return calculated in accordance with Condition 4.5.3.
<b>Revenue Recovery Period</b>	means, in respect of the Network, the period of {40} years commencing on the First Operational Commencement Date.
<b>Review Date</b>	means:  1 October 2017 and every fifth anniversary thereafter
<b>“Retail Price Index” or “RPI”</b>	means the Index of that name published by the Office of National Statistics each month in respect of all items, or:  (a) if that Index for the specified month in any year shall not have been published on or before the last day of the sixth month after the specified month, such alternative index for such month as the Authority may after consultation with the Licensee determine as appropriate in the circumstances; or  (b) if there is a material change in the basis of the Index, such alternative index as the Authority may after consultation with the Licensee determine as appropriate in the circumstances;
<b>Section</b>	means any part of the Network by which gas can be conveyed (either from that part of the Network or from a low-pressure pipe-line connected, or to be connected, to that part of the Network) to any of the following towns:  (c) Dungannon (including Coalisland);

	<p>(d) Cookstown (including Magherafelt);</p> <p>(e) Enniskillen (including Derrylin);</p> <p>(f) Omagh;</p> <p>(g) Strabane.</p>
<b>Sole Holding Company</b>	means, at any point in time, any holding company of the Licensee which is not, at that time, a Joint Holding Company.
<b>Supplemental Income</b>	means any income that the Licensee receives as a result of owning and operating the Network as determined by the Authority, but shall not include revenue from the Postalised Charges.
<b>Termination Payments</b>	has the meaning given to that term in Condition 4.7.5.
<b>Total Controllable Capital Expenditure</b>	has the meaning given to that term in Condition 4.2.1(d).
<b>Total Uncontrollable Capital Expenditure</b>	has the meaning given to that term in Condition 4.2.1(d).
<b>Uncontrollable Capital Expenditure</b>	has the meaning given to that term in Condition 4.2.24(a).
<b>Uncontrollable Capital Expenditure Estimate</b>	has the meaning given to that term in Condition 4.2.1(a).
<b>Uncontrollable Operating Expenditure</b>	has the meaning given to that term in Condition 4.7.4.
<b>Verified Controllable Capital Forecast</b>	means the Controllable Capital Expenditure Estimate verified (with or without amendment) by the Authority in accordance with Condition 4.2.1(b).

#### 4.1.3 Eligible Operating Pass-Through Costs

**"Eligible Pass-Through Costs"** means, in respect of any Gas Year following the First Operational Commencement Date, the sum of such costs as have been incurred by the Licensee during that Gas Year in relation to:

- (a) the operation, repair, reinstatement, refurbishment and/or maintenance of the Network (or the land or substrata in, on, under, over or through which the Network is laid) or the rectification of any design, engineering, manufacturing, installation, construction or other defect in the Network;
- (b) insurance;
- (c) the discharge of its obligations under:
  - (i) any agreement, code or other document relating to the Network to which it is a party or by which it is bound (including this Licence); and
  - (ii) any indemnity, counter-indemnity or other obligation to pay money arising under any such agreement, code or other document;
- (d) any arrangement for the provision of services in respect of the Network;
- (e) any land or premises occupied or used by the Licensee (or by any Sole Holding Company for the purposes of the Licensee) or on which any part of the Network is built, including in particular costs in respect of:
  - (i) local authority rates;
  - (ii) the discharge of claims for compensation (whether made before or after the Grant of this Licence);
  - (iii) liaison with landowners;
  - (iv) rentals or other amounts payable to any landowner;
  - (v) the repair, maintenance and upkeep of any drainage system associated with the Network,

and an appropriate proportion (in accordance with the provisions of the Compliance Plan) of any equivalent costs incurred by any Joint Holding Company or Joint Support Company;

- (f) (to the extent not separately reimbursed to the Licensee by Gas Suppliers or Gas Shippers) all amounts payable by the Licensee to the owner or operator of any gas plant or gas pipeline system to which the Network is directly or indirectly connected;
- (g) all amounts payable by the Licensee to any PS Gas Supplier or Shipper on account of any withdrawal from service, breakdown, unavailability, or reduction in availability of the Network;
- (h) the purchase of auxiliary electricity supplies for the Network;
- (i) actions required to be taken by the Licensee as a result of changes in legislation;
- (j) Office and Overhead Costs incurred by the Licensee or any Sole Holding Company and an appropriate proportion (in accordance with the provisions of the Compliance Plan) of the Office and Overhead Costs incurred by any Joint Holding Company or Joint Support Company;
- (k) the investigation of payment defaults by PS Gas Suppliers, the exercise of rights against any PS Gas Supplier or other person in respect of any such payment defaults, and the activities of any credit or like committee established pursuant to the Licence (and other Gas Conveyance Licences);
- (l) (to the extent not separately reimbursed to the Licensee by gas suppliers or gas shippers) the purchase of gas for balancing purposes;
- (m) Corporation Tax payable by the Licensee or any Sole Holding Company and an appropriate proportion (in accordance with the provisions of the Compliance Plan) of the amount of Corporation Tax payable by any Joint Holding Company or Joint Support Company;

taken together with:

- (n) any value added tax of equivalent form of tax on any amount falling within paragraphs (a) to (n), to the extent such taxes is not recoverable by the Licensee or (as the case may be) by any Sole Holding Company, Joint Holding Company or Joint Support Company;

but excluding:

- (o) any cost, expense, loss, liability or other amount incurred by the Licensee if and to the extent the same falls under paragraph (a) or (c) of the definition of Postalisation Adjustment in Condition 4.6.1;



- (p) any amount constituting Capital Expenditure.

#### 4.1.4 Reporting

- (a) The Licensee shall ensure that all costs information submitted by it to the Authority under or in accordance with this Part 4 or any other provision of this Licence, and whether in relation to actual or forecast costs, reports fully and accurately all the costs incurred (or forecast to be incurred) in the design, construction operation and maintenance of the Network and any Postalised Distribution Pipeline.
- (b) The Licensee shall ensure that no costs information submitted by it to the Authority under or in accordance with this Part 4 or any other provision of this Licence, whether in relation to actual or forecast costs, relates to costs which are properly to be attributed or apportioned to:
  - (i) the Licensee in undertaking any Separate Business other than the Licensed Business (including in particular when carrying out activities under any other licence granted in accordance with the Order);
  - (ii) any affiliate or related undertaking of the Licensee.
- (c) For the purposes of ensuring its compliance with paragraphs (a) and (b), the Licensee shall submit to the Authority, by no later than three months after the date of the Grant, a draft plan (a "**Compliance Plan**") which:
  - (i) shall set out the arrangements it proposes to establish in order to ensure its compliance with those paragraphs;
  - (ii) makes detailed provision in particular for a method by which:
    - (A) an appropriate apportionment of costs shall take place as between the Licensed Business and any other Separate Business of the Licensee;
    - (B) an appropriate apportionment of Office and Overhead Costs, costs relating to land, Corporation Tax and value added taxes shall take place as between the Licensee and any Joint Holding Company or Joint Support Company for the purposes of Condition 4.1.3;
    - (C) no amount constituting Capital Expenditure shall be treated as an Eligible Pass-Through Cost;
  - (iii) is consistent with the requirements of Conditions 1.2.4 to 1.2.6;

- (iv) shall require to be approved by the Authority and, where the Authority does not approve the initial draft plan, shall be subject to further review and amendment, including any such amendment as the Authority may direct the Licensee to make, until the Authority considers that it is suitable for approval.
- (d) The Licensee shall comply with any Compliance Plan approved by the Authority under paragraph (c), and:
  - (i) shall keep that plan under review and from time to time propose to the Authority any amendments required to ensure that it is accurate and up to date'
  - (ii) amend that plan in any manner directed by the Authority;
  - (iii) not otherwise amend that plan except with the approval of the Authority.

## CONDITION 4.2: CAPITAL EXPENDITURE

### 4.2.1 Allowed Capital Expenditure

- (a) The Licensee may at any time, and shall no later than:
- (i) 18 months after the date of the Grant of the Licence; or
  - (ii) such later date as the Authority may agree (taking account in particular of any exceptional circumstances which could not reasonably have been foreseen by the Licensee),

submit a forecast of the amount and timing of Capital Expenditure, separately identifying the amount of such expenditure that the Licensee believes would be Uncontrollable Capital Expenditure (each an “**Uncontrollable Capital Expenditure Estimate**”) and the amount that the Licensee believes would not (each a “**Controllable Capital Expenditure Estimate**”).

The Licensee shall provide such further information or explanation and documents and records as the Authority reasonably requires for the purpose of verifying each Controllable Capital Expenditure Estimate and Uncontrollable Capital Expenditure Estimate, including all figures, costs, estimates and assumptions comprised in or underlying the same.

- (b) The Authority may, following verification, by notice to the Licensee in respect of each such Controllable Capital Expenditure Estimate:
- (i) approve the Controllable Capital Expenditure Estimate as the “**Verified Controllable Capital Forecast**”; or
  - (ii) determine as the Verified Controllable Capital Forecast such amended figure as it considers appropriate,

provided that before making any amendments to the Controllable Capital Expenditure Estimate for the purpose of determining the Verified Controllable Capital Forecast the Authority shall provide details of the amendments and the reasons for them (such reasons to be based on established high pressure gas pipeline engineering and cost control principles) and give the Licensee an appropriate period (being not less than 28 days) to comment on them.

- (c) The Licensee shall:
- (i) not later than 3 months after the end of each 12 month period from the date of the Grant up to the First Operational Commencement Date; and

(ii) not later than 3 months after the end of each Gas Year,

provide to the Authority:

(A) its current forecasts of the amount and timing of Capital Expenditure, separately identifying the amount of expenditure that the Licensee believes would be Uncontrollable Capital Expenditure; and

(B) details of the amount and timing of Capital Expenditure the Licensee has actually incurred, separately identifying the amount of expenditure that the Licensee believes would be Uncontrollable Capital Expenditure.

(d) As soon as reasonably possible after completion of the Network and any Postalised Distribution Pipelines, the Licensee shall submit details of the amount and timing of cumulative Capital Expenditure actually incurred, separately identifying the amount of such expenditure which it has incurred which it believes to be Uncontrollable Capital Expenditure (the "**Total Uncontrollable Capital Expenditure**"), and the amount that the Licensee believes is not (the "**Total Controllable Capital Expenditure**"), and

(i) that Total Controllable Capital Expenditure shall, subject to paragraphs (e) and (f), be the "**Actual Controllable Capital Expenditure**"; and

(ii) that Total Uncontrollable Capital Expenditure shall, subject to paragraphs (e) and (g), be the "**Actual Uncontrollable Capital Expenditure**".

(e) The Licensee shall provide such further information or explanation and documents and records as the Authority reasonably requires for the purpose of auditing the Total Controllable Capital Expenditure and the Total Uncontrollable Capital Expenditure figures submitted by the Licensee in accordance with paragraph (d), and/or the forecasts and details provided by the Licensee in accordance with paragraph (c).

(f) The Authority may, following audit pursuant to paragraph (e), by notice to the Licensee in respect of the Total Controllable Capital Expenditure figures submitted by the Licensee in accordance with paragraph (d):

(i) approve the Licensee's Total Controllable Capital Expenditure figure as the Actual Controllable Capital Expenditure; or

(ii) determine as the Actual Controllable Capital Expenditure such amended figure as it considers appropriate;

~~(ii)~~(A) if, in its reasonable opinion, the figure proposed by the Licensee does not accurately reflect the Controllable Capital Expenditure incurred by the Licensee; and/or

(B) if the figure proposed by the Licensee requires amendment in order to give effect to any Fixed Sum or Capped Sum that was determined by the Authority in accordance with Condition 4.2.2,

provided that, before making any amendments to the Total Controllable Capital Expenditure figure submitted by the Licensee, the Authority shall provide details of the amendments and the reasons for them (such reasons, except where they related to the application of any Fixed Sum or Capped Sum, to be based on established high pressure gas pipeline engineering and cost control principles) and give the Licensee an appropriate period (being not less than 28 days) to comment on them.

(g) The Authority may, following audit pursuant to paragraph (e), by notice to the Licensee in respect of the Total Uncontrollable Capital Expenditure figures submitted by the Licensee in accordance with paragraph (d):

(i) approve the Licensee's Total Uncontrollable Capital Expenditure figure as the Actual Uncontrollable Capital Expenditure; or

(ii) determine as the Actual Uncontrollable Capital Expenditure such amended figure as it considers appropriate if, in its reasonable opinion, the figure proposed by the Licensee does not accurately reflect Uncontrollable Capital Expenditure incurred by the Licensee (including if, in its reasonable opinion, any part of the expenditure included by the Licensee within the Total Uncontrollable Capital Expenditure figure falls outside the categories of Uncontrollable Capital Expenditure as set out in Condition 4.2.24(a),

provided that, before making any amendments to the Total Uncontrollable Capital Expenditure figure submitted by the Licensee, the Authority shall provide details of the amendments and the reasons for them (such reasons to be based on established high pressure gas pipeline engineering and cost control principles) and give the Licensee an appropriate period (being not less than 28 days) to comment on them.

#### 4.2.2 Fixed and Capped Sums

(a) At the same time as the Authority approves or determines the Verified Controllable Capital Expenditure Forecast in accordance with Condition 4.2.1(b), it may determine that, for the purposes of the approval or determination of the Actual Controllable

Capital Expenditure in accordance with Condition 4.2.1(f), the Controllable Capital Expenditure associated with specified activities or categories of activity is to be:

(i) subject to the application of a Fixed Sum in accordance with paragraph (b);

(ii) subject to the application of a Capped Sum in accordance with paragraph (c),

and where it makes such a determination it shall notify the Licensee of what has been determined.

(b) For the purposes of paragraph (a)(i), a "**Fixed Sum**" means a figure to be included as part of the Actual Controllable Capital Expenditure that is approved or determined in accordance with Condition 4.2.1(f), in respect of the activity or category of activity to which it relates, regardless of the amount of Controllable Capital Expenditure actually incurred by the Licensee in respect of that activity or category of activity.

(c) For the purposes of paragraph (a)(ii), a "**Capped Sum**" means a figure constituting a maximum amount to be included in the Actual Controllable Capital Expenditure that is approved or determined in accordance with Condition 6.2.1(f), in respect of the activity or category of activity to which it relates, so that:

(i) if the amount of the Controllable Capital Expenditure actually incurred by the Licensee in respect of that activity or category of activity is less than the Capped Sum, the figure to be included in the Actual Controllable Capital Expenditure in respect of that activity or category of activity shall be equal to the amount of Controllable Capital Expenditure actually incurred;

(ii) if the amount of the Controllable Capital Expenditure actually incurred by the Licensee in respect of that activity or category of activity is greater than or equal to the Capped Sum, the figure to be included in the Actual Controllable Capital Expenditure in respect of that activity or category of activity shall be equal to the Capped Sum.

(d) Where the Authority makes a determination in accordance with paragraph (a):

(i) it shall specify each activity or category of activity to which that determination relates, and in respect of each such activity or category of activity state the applicable figure and whether it is a Fixed Sum or a Capped Sum; and

(ii) the determination shall have effect for the purposes of the subsequent approval or determination of the Actual Controllable Capital Expenditure in accordance with Condition 4.2.1(f).

#### 4.2.3 Actions Taken Before Part 4 Comes Into Effect

For the purposes of this Part 4, where prior to Condition 4.2.2 coming into effect the Authority has made a determination that it would have been entitled to make under the provisions of Condition 4.2.2(a) after that Condition had come into effect, then:

- (a) that determination shall be treated as having been made in accordance with Condition 4.2.2, and shall have effect for the purposes of this Part 4 on and from the date on which that Condition comes into effect; and
- (b) that determination shall be construed purposively, and the Authority shall be deemed to have determined a Fixed Sum or a Capped Sum where that is the clear purpose and substantive effect of the determination (regardless of the terminology used in it); and
- (c) any amount which is a Fixed Sum or Capped Sum by virtue of that determination shall be treated as such for the purposes of this Part 4 on and from the date on which Condition 4.2.2 comes into effect.

#### 4.2.24.2.4 Uncontrollable Capital Expenditure

- (a) The following categories of Capital Expenditure shall comprise an exhaustive list of all Uncontrollable Capital Expenditure for the purposes of this Part 4:
  - (i) archaeology;
  - (ii) planning conditions;
  - (iii) stock up gas;
  - (iv) such other categories of Capital Expenditure as the Authority may accept as being Uncontrollable Capital Expenditure.
- (b) The Licensee shall at all times use all reasonable endeavours to minimise the amount of Uncontrollable Capital Expenditure so far as is possible without adversely impacting on the safety of the Network.

### **CONDITION 4.3: THE REVENUE RESTRICTION**

#### 4.3.1 Revenue Restriction if no Designation Order

In respect of any period during which a Designation Order is not in force in relation to the Network, the Licensee shall use its reasonable endeavours to ensure that in each Gas Year during that period its total revenue, plus any adjustments approved by the Authority, shall not exceed the Actual Required Revenue for that Gas Year.

#### 4.3.2 Revenue Restriction during the Period of Designation

- (a) In respect of any period during which a Designation Order is in force in relation to all or any part of the Network, the Licensee shall ensure that in respect of each Gas Year during that period:
  - (i) its Forecast Required Revenue to be notified to the Authority and the PSA in accordance with paragraphs (b) and (d) shall be calculated in accordance with Condition 4.4.1; and
  - (ii) its Actual Required Revenue to be notified to the Authority and the PSA in accordance with paragraph (e) shall be calculated in accordance with the formula set out in Condition 4.4.2.
- (b) By no later than the fifteenth Business Day in March in each Gas Year, the Licensee shall provide to the Authority its calculation of Forecast Required Revenue for the next Gas Year and the following four Gas Years together with such explanation and supporting information as the Licensee considers to be reasonably necessary to permit the Authority to be satisfied that the Forecast Required Revenue is a reasonable forecast in accordance with Condition 4.1.1(b).
- (c) If, by not later than the fifth Business Day in April, the Authority, having considered the Licensee's forecast in light of such information as may be submitted by the Licensee, notifies the Licensee, by notice accompanied by an explanation of its conclusions, that it considers that the forecast supplied is not a reasonable forecast of the Licensee's Forecast Required Revenue for the next Gas Year, the Licensee shall review the forecast in the light of the Authority's explanation and submit another forecast to the Authority no later than the fifteenth Business Day ~~of~~in April (which may be the same as the original forecast).
- (d) By no later than the fifteenth Business Day in April in each Gas Year the Licensee shall provide to the PSA its calculation of Forecast Required Revenue, pursuant to paragraph (b), with any variation made thereto pursuant to paragraph (c), in respect of the next Gas Year and the following four Gas Years for the purpose of calculation of the Forecast Postalised Charges in accordance with Part 2A of the Licence.
- (e) By no later than the tenth Business Day in November after the end of each Gas Year the Licensee shall provide to the Authority and to the PSA its calculation of the Actual Required Revenue in that Gas Year and shall, at the same time, provide to the Authority such explanations and supporting information as may be reasonably necessary to permit the Authority to verify that the Actual Required Revenue has been calculated in accordance with the formula set out in Condition 4.4.2.



- (f) By no later than ten Business Days after the end of each Quarter, the Licensee shall provide the Authority, other Designated Pipeline Operators and all PS Gas Suppliers with a report setting out any material change to the Licensee's forecast of the revenue it requires comprised in its Forecast Required Revenue for the Gas Year in which the Quarter falls.

## CONDITION 4.4: FORECAST AND ACTUAL REQUIRED REVENUE

### 4.4.1 Forecast Required Revenue

The Forecast Required Revenue of the Licensee in respect of each Gas Year shall be calculated by the Licensee as its forecast of its Actual Required Revenue for that Gas Year, on the basis of the formula at Condition 4.4.2, but omitting for this purpose the  $Z_t^*(S_t)$  component of that formula.

### 4.4.2 Actual Required Revenue

- (a) The Licensee's Actual Required Revenue ( $ARR_t$ ) for any Gas Year shall be the amount determined in accordance with the formula set out in paragraph (b) for such Gas Year.
- (b) The formula for the calculation of the Licensee's Actual Required Revenue in any Gas Year is as follows:

$$ARR_t = (A_t + B_t + C_t + Z_t^*(S_t)) - (D_t + E_t)$$

### 4.4.3 Definition of Formula Terms

For the purposes of Condition 4.4.2 and this Part 4 generally:

- $t$  denotes a Gas Year;
- $t-1$  denotes the Gas Year which immediately precedes the Gas Year for the purposes of which any forecast or calculation is made in accordance with this Part 4 (and the subscript  $t-2$  shall be construed accordingly);
- $A_t$  in respect of any Gas Year, means the Capital Revenue Requirement for that Gas Year, calculated in accordance with Condition 4.5.1;
- $B_t$  in respect of any Gas Year, means the Eligible Pass-Through Costs relating to the Network for that Gas Year;
- $C_t$  in respect of any Gas Year, means the Postalisation Adjustment for that Gas Year calculated in accordance with Condition 4.6.1;
- $S_t$  in respect of any Gas Year, means the Approved Surplus determined by the Authority in accordance with Condition 4.7.1 and notified by the Authority to the Licensee on or before the eighth Business Day in November following the end of such Gas Year;

- $Z_t$  in respect of any Gas Year, means a factor between 0 and 1, as determined by the Authority for such Gas Year and notified to the Licensee on or before the eighth Business Day in November following the end of such Gas Year;
- $D_t$  means the Termination Payments as calculated in accordance with Condition 4.7.5;
- $E_t$  means the Actual Supplemental Income as calculated in accordance with Condition 4.7.6;

## CONDITION 4.5: THE CAPITAL REVENUE REQUIREMENT

### 4.5.1 The Capital Revenue Requirement

The formula for the calculation of the Licensee's Capital Revenue Requirement in any Gas Year is as follows:

$$A_t = \sum_{m=q}^s A_m$$

Where:

q is the first month in Gas Year t;

s is the twelfth month in Gas Year t;

A<sub>m</sub> is to be calculated in accordance with Condition 4.5.2

### 4.5.2 The Monthly Capital Revenue Requirement

For the purposes of Condition 4.5.1 and this Part 4 generally:

$$A_m = \frac{OAV_m \cdot rr_m}{1 - (1 + rr_m)^{-(N-m+1)}} \cdot (1 + i_m) - k_m$$

Where:

A<sub>m</sub> is the revenue required to recover invested capital at the allowed rate of return in month m calculated to be a constant real amount for  $m = 1 \dots 480$ ;

rr<sub>m</sub> is the regulatory allowed real weighted average rate of return calculated in accordance with Condition 4.5.3;

OAV<sub>m</sub> is the opening asset value in month m calculated in accordance with Condition 4.5.5;

m = 1 is the month in which the First Operational Commencement Date occurs;

$m=N=480$  is the 480<sup>th</sup> month after the month in which the First Operational Commencement Date occurs;

$i_m$  is the rate of inflation in month  $m$ , and:

- (i) for the purposes of forecast figures, shall be  $1.03^{(1/12)} - 1$  during the period until the first Review Date and thereafter shall be the forecast long term RPI rate of inflation as approved by the Authority and
- (ii) for the purposes of actual figures, shall be the RPI rate of inflation calculated as follows:

$$i_m = (1 + i_t)^{1/12} - 1$$

where:

$$i_t = (\text{RPI}^{\text{Oct}_{t+1}} / \text{RPI}^{\text{Oct}_t}) - 1$$

$k_m$  is an error correction mechanism to take account of variances in outturn and forecast variables (including revenue and inflation) calculated in accordance with Condition 4.5.4.

#### 4.5.3 The Rate of Return

- (a) For the purposes of Condition 4.5.2, the Rate of Return ( $rr_m$ ) shall be a number expressed as a percentage representing the real cost of capital and shall be established in accordance with this Condition 4.5.3.
- (b) The Rate of Return from the first Review Date shall be equal to  $(1+1.98\%)^{(1/12)} - 1$  or such other value (expressed as a percentage) as may be determined by the Authority in light of material changes in financial market conditions since April 2014.
- (c) Except where paragraph (e) applies, the Authority shall review the Rate of Return prior to each subsequent Review Date.
- (d) The Rate of Return following each Review Date shall be equal to the Rate of Return prior to that date, unless the Authority specifies a different number in a modification of this Part 4 made by it under Article 14 and Article 14A of the Order in which case the Rate of Return shall be the number so specified.
- (e) Where the Authority has, at the request of the Licensee, determined that the Rate of Return shall be fixed for any period which covers one or more Review Dates, the Authority shall not be required to review the Rate of Return prior to such dates. The

Licensee may use all reasonable endeavours to effect a long term debt financing arrangement approved (including as to tenor, interest rate and amount) by the Authority on or as soon as practicable after the later of (a) the First Operational Commencement Date and (b) the date on which the pipelines comprised in the Network become designated pipe-lines or such earlier date as may be agreed by the Authority.

#### 4.5.4 The Error Correction Mechanism

For the purposes of Condition 4.5.2:

$k_m$  is an error correction mechanism to take account of variances in outturn and forecast variables including revenue, inflation, corporate tax rates and capital ~~allowances~~ allowance and shall be calculated in accordance with the following formula:

$$k_m = \frac{(K_m) \cdot rr_m}{1 - (1 + rr_m)^{-(N-m+1)}} \cdot (1 + i_m)$$

Where:

$$K_{m=j+1} = \left( \sum_{m=1}^j \frac{A_m^a - A_m^{rf}}{\prod_{m=1}^j (1 + rn_m)} \cdot \prod_{m=1}^j (1 + rn_m) \right)$$

And:

$A_m^a$  is the actual revenue in month m, up to j = month before the review month;

$A_m^{rf}$  is the reforecast revenue in month m, up to j = month before the review month;

$rn_m$  is the regulatory allowed nominal weighted average rate of return in month m:

$$rn_m = ((1 + rr_m) \cdot (1 + i_m)) - 1$$

Such that:

$$\sum_{m=j+1}^N \frac{A_m}{\prod_{m=j+1}^N (1+rn_m)} \cdot \prod_{m=1}^j \frac{1}{1+rn_m} + \sum_{m=1}^j \frac{A_m^a}{\prod_{m=1}^j (1+rn_m)} = OAV_{m=1}$$

And:

$$K_m = K_{m-1} - \left( \frac{(K_{m-1}) \cdot (rr_{m-1})}{1 - (1 + rr_{m-1})^{-(N-m+1)}} - (K_{m-1}) \cdot (rn_{m-1}) \right)$$

#### 4.5.5 The Opening Asset Value

For the purposes of Condition 4.5.1:

$$OAV_m = OAV_{m-1} - \left( \frac{(OAV_{m-1}) \cdot (rr_{m-1})}{1 - (1 + rr_{m-1})^{-(N-m+1)}} - (OAV_{m-1}) \cdot (rn_{m-1}) \right)$$

Where:

$$OAV_{m=1} = AC + CI - G + X$$

And:

OAV is the Opening Asset Value;

AC is the Allowed Capital Expenditure calculated in accordance with Condition 4.5.6;

CI is the amount of Capitalised Interest calculated in accordance with Condition 4.5.7;

G is the amount of Grants Received calculated in accordance with Condition 4.5.8;

X is the amount in respect of Early Sectional Completion calculated in accordance with Condition 4.5.9.

#### 4.5.6 The Allowed Capital Expenditure

For the purposes of Condition 4.5.5, the Allowed Capital Expenditure (AC) term is the present value of Capital Expenditure, at the month in which the First Operational Commencement Date occurs, calculated in accordance with the following formula:

$$AC = VFCE + PG + UC$$

Where:

VFCE is the Verified Controllable Capital Forecast;

PG is a positive or negative amount representing the operation of a pain/gain mechanism, and shall be:

- (i) where the Actual Controllable Capital Expenditure is greater than the Verified Controllable Capital Forecast, a positive amount equal to 65% of the difference;
- (ii) where the Actual Controllable Capital Expenditure is less than the Verified Controllable Capital Forecast, a negative amount equal to 65% of the difference;

UC is the Actual Uncontrollable Capital Expenditure.

#### 4.5.7 Capitalised Interest

For the purposes of Condition 4.5.5, the Capitalised Interest (CI) term is the present value of capitalised interest, at the month in which the First Operational Commencement Date occurs, calculated in accordance with the following formula:

~~$$CI = \sum_{m=i}^0 \left( CE_m \cdot \prod_{m=h}^0 (1 + CIR_m) - CE_m \right) + \sum_{m=1}^N \left( CE_m \cdot \prod_{m=1}^N (1 + rn_m)^{-1} - CE_m \right)$$~~

$$CI = \sum_{m=i}^0 \left( CE_m \cdot \prod_{r=i}^m (1 + CIR_r) - CE_m \right) + \sum_{m=1}^N \left( CE_m \cdot \prod_{r=1}^m (1 + rn_r)^{-1} - CE_m \right)$$

Where:

CE<sub>m</sub> is the Actual Capital Expenditure in month m;



$CIR_m$  is the Capitalised Interest Rate for month  $m$ , being  $(1 + LIBOR + 0.5\%)^{(1/12)} - 1$  where LIBOR is the annual LIBOR rate at the first business day of each month;

$m = h_j$  is the month of October 2014, being the first month from which capitalised interest will be charged;

0 is the month in which the First Operational Commencement Date occurs;

$m=1$  is the first month after the month in which the First Operational Commencement Date occurs;

$N$  is a number of months after the month in which the First Operational Commencement Date occurs.

#### 4.5.8 Grants Received

For the purposes of Condition 4.5.5, the Grants Received ( $G$ ) term is the present value at the First Operational Commencement Date of grants received in respect of the Network, calculated in accordance with the following formula:

$$\begin{aligned}
 \cancel{G} &= \cancel{\sum_{m=p}^0 AMGR_m \cdot \prod_{m=p}^0 (1+CIR_m)} + \cancel{\sum_{m=1}^N AMGR_m \cdot \prod_{m=1}^N (1+rn_m)^{-1}} \\
 G &= \sum_{m=p}^0 \left( AMGR_m \prod_{r=p}^m (1+CIR_m) \right) + \sum_{m=1}^N \left( AMGR_m \cdot \prod_{r=1}^m (1+rn_m)^{-1} \right)
 \end{aligned}$$

Where:

$AMGR_m$  is the actual monthly grant receipt amount audited and approved by the Authority as being equal to the amount of capital grant actually received by the Licensee in each calendar month ending prior to and after the First Operational Commencement Date in respect of the design, development and construction of the Network;

$m = p$  is the first month that the capital grant is received by the Licensee, where that month is before the month in which the First Operational Commencement Date occurs;

0 is the month in which the First Operational Commencement Date occurs;

m=1 is the first month after the month in which the First Operational Commencement Date occurs;

N is a number of months after the month in which the First Operational Commencement Date occurs.

#### 4.5.9 Early Sectional Completion

For the purposes of Condition 4.5.5, the Early Sectional Completion (X) term is an amount which has been calculated so as to comprise:

- (a) any operating costs in relation to Early Sections which have been approved by the Authority; plus
- (b) any additional interest in relation to Early Sections calculated by the Authority to reflect the application of the Rate of Return (rather than the Capitalised Interest Rate) between the date when each Early Section is operational and the First Operational Commencement Date; minus
- (c) any revenues determined by the Authority as having been received in respect of Early Sections prior to the First Operational Commencement Date.

## CONDITION 4.6: THE POSTALISATION ADJUSTMENT

### 4.6.1 The Postalisation Adjustment

The Postalisation Adjustment (which may be a negative or positive amount) shall be calculated as the sum of the amounts identified in paragraphs (a) to (c):

- (a) the costs, expenses, losses and/or liabilities incurred (or to be incurred) by the Licensee which related to the PSA or the Trustee under the agreements under which they were appointed;
- (b) the amounts due in respect of Commodity Reconciliation Payments for Gas Year t-2, calculated in accordance with the following formula:

$$\text{UNRPT}_{t-2} \times (1+\text{RE})^{1.5} \times \frac{\text{CPI}_t}{\text{CPI}_{t-2}} \times \frac{\text{ARR}_{L,t-2}}{\text{PS ARR}_{t-2}}$$

Where:

$\text{UNRPT}_{t-2}$  are the unrecovered Postalisation Payments in respect of Gas Year t-2, as calculated by the PSA;

$\text{CPI}_t$  is the forecast of the absolute value of the General Index of Consumer Prices – All items (1996 =100) as published by the Office of National Statistics (Series Identifier CHVJ) for Gas Year t, as published in the preceding year's May edition of the Bank of England Inflation Report or if such index is no longer published, such alternative index as the Authority shall, after consultation with the Licensee, determine most closely reflects the Consumer Prices Index;

$\text{CPI}_{t-2}$  is the absolute value of the General Index of Consumer Prices – All items (1996 =100) as published by the Office of National Statistics (Series Identifier CHVJ) - for Gas Year t-2, or if such index is no longer published, such alternative index as the Authority shall, after consultation with the Licensee, determine most closely reflects the General Index of Consumer Prices – All items (1996 =100);

$\text{ARR}_{t-2}$  is the Actual Required Revenue in respect of Gas Year t-2;

PS ARR<sub>t-2</sub> is the sum of the Actual Required Revenues (as defined in each Licensee's respective licence) of all Designated Pipeline Operators in respect of Gas Year t-2;

RE is the applicable real interest rate, which is calculated as the one-year LIBOR rate, as published on the 10<sup>th</sup> business day of June in Gas Year t-1, plus 2% minus CPI factor, calculated as:

$$\text{LIBOR rate \%} + 2\% - \left( \left[ \frac{\text{CPI}_t}{\text{CPI}_{t-1}} - 1 \right] \times 100 \right)$$

CPI<sub>t-1</sub> is the absolute value of the General Index of Consumer Prices – All items (1996 =100) as published by the Office of National Statistics (Series Identifier CHVJ) – for Gas Year t-1, or if such index is available the latest CPI figure published in Gas Year t-1;

- (c) such amount as the Authority may, after consultation with the Department, deem appropriate in respect of costs incurred by the Licensee in connection with approved activities in relation to the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland.

## CONDITION 4.7: THE APPROVED SURPLUS AND OTHER ARR COMPONENTS

### 4.7.1 The Approved Surplus

The formula for the calculation of the Approved Surplus ( $S_t$ ) in any Gas Year is as follows:

$$S_t = (DCO_t - ACO_t) + ARF_t$$

but such that, where in accordance with this formula  $S_t$  is a negative number, it shall be deemed to be zero.

Where:

$DCO_t$  is the Determined Controllable Operating Expenditure in Gas Year  $t$ ;

$ACO_t$  is the Actual Controllable Operating Expenditure in Gas Year  $t$ ;

$ARF_t$  is to be determined in accordance with the following formula:

$$ARF_t = \sum_{i=3}^1 [(DCO_{t-i} - ACO_{t-i}) - (Z_{t-i} * S_{t-i})]$$

where  $i$  is each Gas Year in the period of the three Gas Years prior to Gas Year  $t$ .

### 4.7.2 Determination of DCO

(a) The Licensee may at any time, and shall no later than:

- (i) the first Business Day of July 2016 (or such alternative date as may be determined by the Authority and notified to the Licensee in writing); and
- (ii) no later than 15 months prior to each subsequent Review Date (or such alternative date as may be determined by the Authority and notified to the Licensee in writing),

submit to the Authority, an estimate of its Controllable Operational Expenditure (a "**Controllable Operating Expenditure Estimate**") and an estimate of its Uncontrollable ~~Operational~~ Operational Expenditure (a "**Uncontrollable Operating Expenditure Estimate**") for each of the next five Gas Years. The format of the submission will be set out in the Regulatory Instructions and Guidance ("**RIGs**") published by the Authority pursuant to Condition 1.21.

The Licensee must also submit such explanation and supporting information as the Licensee considers to be reasonably necessary to permit the Authority to verify that such estimates are reasonable estimates in accordance with Condition 4.1.1(b).

- (b) The Licensee shall provide such further information or explanation and access to documents and records as the Authority reasonably requires for the purpose of verifying each Controllable Operating Expenditure Estimate and each Uncontrollable Operating Expenditure Estimate (including all figures, costs, estimates and assumptions comprised in or underlying those estimates) in accordance with paragraph (a).
- (c) The Authority shall, following its verification of a Controllable Operating Expenditure Estimate, notify to the Licensee the amount of the "**Determined Controllable Operating Expenditure**" (DCO) (being the sum of the amount of each item of Controllable Operating Expenditure determined to be reasonable by the Authority) that it considers appropriate for each of the next five Gas Years.

The Authority shall provide to the Licensee details of any changes that it has made to the Licensee's Controllable Operational Expenditure Estimate and Uncontrollable Operating Expenditure Estimate and the reasons for them and give the Licensee an appropriate period (being not less than 28 days) to comment on them.

- (d) After consideration of any comments received from the Licensee, the Authority shall notify the Licensee in writing of its determination of the amount of the Determined Controllable Operating Expenditure for each of the next five Gas Years (which may be the same as the amount that the Authority notified to the Licensee in accordance with paragraph (c)).
- (e) The Authority may, following a written request from the Licensee to review the DCO for any Gas Year to take into consideration any fact or matter that has arisen following the Authority's determination pursuant to paragraph (d) – provided that, if such a request is made in respect of the current Gas Year, such request is submitted before 31st of August in that Gas Year – conduct a review of DCO for that Gas Year.

The Licensee shall provide such information and explanation and access to documents and records as the Authority reasonably requires for the purpose of conducting its review. Before making any changes to its determination of the Determined Controllable Operating Expenditure, the Authority shall provide details of the changes and the reasons for them and give the Licensee an appropriate period (not being less than 28 days ) to comment on them.

After consideration of the Licensee's comments, the Authority shall notify the Licensee in writing of its new determination of the Determined Controllable Operating Expenditure for the relevant Gas Year (which may be the same as the amount that the Authority notified to the Licensee in accordance with paragraph (d)).

#### 4.7.3 Determination of ACO

- (a) The Licensee shall, by no later than the first Business Day of November following the end of each Gas Year, submit to the Authority, a statement detailing the amounts of Controllable Operating Expenditure and Uncontrollable Operating Expenditure actually incurred by the Licensee in that Gas Year. The format of the submission will be set out in the Regulatory Instructions and Guidance ("**RIGs**") published by the Authority pursuant to Condition 1.21.
- (b) The Licensee's "**Actual Controllable Operating Expenditure**" for each Gas Year shall be the aggregate of the actual amounts of Controllable Operating Expenditure referred to in the statement submitted in accordance with paragraph (a).

#### 4.7.4 Definition of Controllable Operating Expenditure and Uncontrollable Operating Expenditure

For the purposes of this Part 4, "**Controllable Operating Expenditure**" shall comprise those categories of expenditure that are properly within the control of the management of the Licensee, such categories to be those agreed in writing between the Licensee and the Authority no later than the first Business Day of June 2015 subject to any amendments by the agreement of the Authority and the Licensee from time to time. In the absence of agreement between the Licensee and the Authority, the Authority shall determine the categories of expenditure that comprise Controllable Operational Expenditure and notify the Licensee of its decision in writing.

For the purposes of this ~~part~~Part 4, "**Uncontrollable Operating Expenditure**" means Operating Expenditure which is outside the reasonable control of the Licensee and which has been included in the list of the "Uncontrollable Operating Expenditure" determined as such by the Authority for the purposes of this Condition, as such list may be amended, supplemented or varied by the Authority from time to time.

#### 4.7.5 The Termination Payments

The Termination Payments (D<sub>t</sub>) in any Gas Year shall be calculated as the aggregate of any sums received by the Licensee during that year after falling due under the Network Code upon the termination of any Gas Supplier's Accession Agreement in respect of future years following the Gas Year in which the termination occurred.

#### 4.7.6 The Supplemental Income

- (a) The Licensee shall, on a good faith basis use its reasonable endeavours to maximise the Supplemental Income provided that it is acknowledged that the primary purpose of the Network is to transport gas for the purposes of its supply to customers in Northern Ireland.
- (b) The Licensee shall report to the Authority not later than six months before the end of each Gas Year:
  - (i) with the Licensee's calculation of all Supplemental Income reasonably anticipated by it to become due to, or receivable by, it in the forthcoming Gas Year; and
  - (ii) details of what the Licensee considers to be the Supplemental Income recovered in the preceding Gas Year.
- (c) The Licensee shall promptly provide to the Authority such information, explanations, documents and records as the Authority may reasonably require in connection with or relating to Supplemental Income and the report provided in accordance with paragraph (b).
- (d) The Authority may, following verification, by notice to the Licensee in respect of the figures submitted in the Licensee's report in accordance with paragraph (b)(i):
  - (i) approve the figures in the report as the Supplemental Income for the relevant Gas Year; or
  - (ii) determine as the Supplemental Income for the relevant Gas Year such amended figure as it considers appropriate,

provided that before making any amendments to the figures in the report submitted by the Licensee in accordance with paragraph (b)(i) the Authority shall provide details of the amendments and the reasons for them and give the Licensee an appropriate period (being not less than 28 days) to comment on them.
- (e) The Authority may, following verification, by notice to the Licensee in respect of the figures submitted in the Licensee's report in accordance with paragraph (b)(ii):
  - (i) approve the figures in the report as the "**Actual Supplemental Income**" ( $E_t$ ) for the relevant Gas Year; or
  - (ii) determine as the Actual Supplemental Income for the relevant Gas Year such amended figure as it considers appropriate.



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## **CONDITION 4.8: ALLOWED REVENUE AFTER THE FINAL REPAYMENT DATE**

### 4.8.1 Allowed Revenue after the Final Repayment Date

- (a) Not less than twelve (12) months prior to the expiry of the Revenue Recovery Period the Licensee shall submit to the Authority:
- (i) a proposal as to the formula to be used for calculation of conveyance charges following the end of the Revenue Recovery Period; and
  - (ii) a forecast of the amount of such charges for the five years following expiry of the Revenue Recovery Period,
- which comply with the basis of calculation set out in paragraph (d).
- (b) The Licensee shall provide such further information or explanation and documents and records as the Authority reasonably requires for the purpose of verifying that the formula and forecasts submitted to it by the Licensee in accordance with paragraph (a) comply with the principles set out in paragraph (d).
- (c) The Authority may, following review of the submissions provided in accordance with paragraph (a), by notice to the Licensee:
- (i) approve the formula and forecasts; or
  - (ii) make such amendments to the formula and forecasts as it deems necessary or appropriate to ensure compliance with the basis of calculation set out in paragraph (d) provided that before making any modifications to the Licensee's formula and forecast, the Authority shall provide details of the proposed modifications and the reasons for them and give the Licensee an appropriate period (being not less than 28 days) to comment on them.
- (d) The Licensee shall in setting its charges for the conveyance of gas in the Network for each Gas Year commencing after the expiry of the Revenue Recovery Period do so in accordance with such arrangements as shall have been approved by the Authority having regard to the principle that the Licensee shall be entitled to receive by way of conveyance charges:
- (i) the costs incurred by the Licensee deemed necessary or appropriate by the Authority in administering, maintaining and operating the Network for each conveyance service; and
  - (ii) the costs incurred by the Licensee deemed necessary or appropriate by the Authority from time to time to expand, reinforce and renew the Network

together with an appropriate return on those costs as agreed between the Authority and the Licensee;

(iii) minus any Supplemental Income.