

## Condition 35. Definitions for the Price Control Conditions

### Introduction

- 35.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 35.2 In this Licence, a Price Control Condition is any condition the purpose of which, whether on its own or in combination with any other Price Control Condition, is to limit or control the charges of, or the revenue of, the Licensee.

### Part A: Defined terms used in the Price Control Conditions

- 35.3 Part B below sets out most of the defined words and expressions (all of which begin with capital letters) that are used in the Price Control Conditions of this Licence, and gives their definitions next to them (“the Chapter 9 Particular Definitions”).
- 35.4 But words and expressions used in the Price Control Conditions that are defined for any of the purposes of this Licence in Condition 1 (Definitions for the Conditions of this Licence) have in this Chapter 9 the meaning given to them in that condition.

### Part B: The Chapter 9 Particular Definitions

- 35.5 In the Price Control Conditions, unless the context otherwise requires:

<b>Allowed Revenue</b>	means the total amount of revenue determined on an accruals basis in relation to each Regulatory Year in accordance with the Principal Formula set out at Part C of Condition 36 (Determination of the Licensee’s Allowed Revenue) after the deduction of value added tax (if any) and any other taxes based directly on the amount concerned.
<b>Average Specified Rate</b>	means the rate that is equivalent to the average value of the Official Bank Rate of the Bank of England during the period in respect of which the calculation falls to be made.
<b>Baseline Margin</b>	means in relation to each Regulatory Year an amount of additional revenue, over and above the sum of the Licensee’s Internal Costs and External Costs, that the Secretary of State has agreed shall be included (subject to the operation of the Baseline Margin Performance Adjustment) in the Licensee’s Allowed Revenue, and is determined in accordance with the provisions of Part C of Condition 36.
<b>Baseline Margin Implementation Performance Adjustment</b>	means the amount (if any) of reduction in the Baseline Margin determined in accordance with the provisions of Part B of Condition 38 so as to secure, with respect to the applicable period, the effect set out in Part A of that condition.

<b>Baseline Margin Implementation Total</b>	means the Licensee's Baseline Margin, in total, for the period running from 23 September 2013 until the end of the Regulatory Year 2015/16 (and, arising from the Licence Application Process, is calculated for the purposes of Schedule 3 to this Licence to have the value of £7.687 million, subject to adjustments for inflation as set out in paragraph 35.6).
<b>Baseline Margin Performance (BMP) Adjustment</b>	means the component of the Licensee's Allowed Revenue that is determined in accordance with Part <del>E</del> <u>E</u> of Condition 36 and subject to the operation of the provisions of Condition 38 (Determination of the BMP Adjustment).
<b>Baseline Margin Operational Performance Adjustment</b>	means the amount (if any) of reduction in the Baseline Margin determined in accordance with the provisions of Part C of Condition 38 so as to secure, with respect to the applicable period, the effect set out in Part A of that condition.
<b>Centralised Registration Service Cost Adjustment</b>	means in relation to each Regulatory Year a cost adjustment to Centralised Registration Service Revenue that may be directed by the Authority. In the absence of a direction, this shall take the value of zero.
<b>Centralised Registration Service External Cost</b>	means in relation to each Regulatory Year the actual amount of the cost that were economically and efficiently incurred by the Licensee in procuring Fundamental Registration Service Capability during that period.
<b>Centralised Registration Service Internal Cost</b>	means in relation to each Regulatory Year the sum of the costs (excluding Internal Costs, External Costs, Pass-through Costs, Centralised Registration Service External Costs and Centralised Registration Service Pre-Agreed Costs) that were economically and efficiently incurred by the Licensee for the purposes of the provision of Mandatory Business Services
<b>Centralised Registration Service Performance Adjustment</b>	means in relation each Regulatory Year a Performance Adjustment to Centralised Registration Service Revenue that may be directed by the Authority. In the absence of a direction, this shall take the value of zero.
<b>Centralised Registration Service Pre-Agreed Cost</b>	means in relation each Regulatory Year cost that will be directed by the Authority. In the absence of a direction, this shall take the value of zero.
<b>Centralised Registration Service Revenue</b>	means in relation to each Regulatory Year, revenue for Centralised Registration Services calculated in accordance with Part D of Condition 36.
<b>External Contract</b>	means the component of the Allowed Revenue of the

**Gain Share** Licensee that is determined in accordance with the provisions of Condition 39 (Determination of External Contract Gain Share) so as to secure the effect set out in Part A of that condition.

**External Costs** means in relation to each Regulatory Year the actual amount of the costs that were economically and efficiently incurred by the Licensee in procuring Fundamental Service Capability during that period.

**Internal Costs** means in relation to each Regulatory Year the sum of the costs (excluding Centralised Registration Service External Costs, Centralised Registration Internal Costs, Centralised Registration Service Pre-agreed Costs, External Costs and Pass-Through Costs) that were economically and efficiently incurred by the Licensee for the purposes of the provision of Mandatory Business Services under or pursuant to the SEC (and may include costs incurred in respect of the governance and administration of the SEC that are not included in Pass-Through Costs).

**Pass-Through Costs** means in relation to each Regulatory Year the sum of the amounts that are specified as Pass-Through Costs in paragraph 8 of Condition 36.

**Project** means an activity, or group of related activities, that is:

- (a) being undertaken, or planned to be undertaken, by the Licensee;
- (b) intended to support a change to the nature or scope of the Services; and
- (c) identified as being a 'Project', for the purposes of the Price Control Conditions, in a direction given by the Secretary of State to the Licensee, and:
  - (i) constitutes an activity, or group of related activities, specified in that direction;
  - (ii) takes place during such period of time as is specified in that direction; and
  - (iii) is undertaken for any such purpose as may be specified in that direction,

and any individual project shall be represented by the subscript n.

**Regulatory Year t** means the particular Regulatory Year for the purposes of which any calculation is required to be made under

the Price Control Conditions.

**Regulatory Year t-1** means the Regulatory Year immediately preceding the Regulatory Year t (and any similar expressions are to be read accordingly).

**Regulated Revenue** means in relation to each Regulatory Year the actual revenue, measured on an accruals basis:

- (a) received by the Licensee through Service Charges that are levied in accordance with the provisions of Condition 18 (Charging Methodology for Services) and Condition 19 (Charging Statement for Services); or
- (b) otherwise received by the Licensee in relation to the carrying on of the Mandatory Business,

after the deduction of value added tax (if any) and any other taxes based directly on the amount concerned. Paragraph (a) above shall be deemed to include any and all amounts paid by SEC Parties under the SEC to persons (other than the External Service Provider) engaged (indirectly pursuant to an External Service Provider Contract) in the business of financing Communications Hubs.

**Value Added Service (VAS) Contribution** means the component of the Allowed Revenue of the Licensee that is determined in accordance with the provisions of Condition 40 (Determination of the VAS Contribution) so as to secure the effect set out in Part A of that condition.

35.6 The value of the Baseline Margin Implementation Total shall be the sum of:

- (a) £1.769 million;
- (b) £3.194 million multiplied by the value of PIBM in Regulatory Year 2014/15; and
- (c) £2.724 million multiplied by the value of PIBM in Regulatory Year 2015/16,

where PIBM is the price index adjuster applied to the Baseline Margin in each Regulatory Year and calculated in accordance with Part C of Condition 36 (Determination of the Licensee's Allowed Revenue).

### **Part C: Matters agreed by the Secretary of State**

35.7 A reference in this condition or in any of the other Price Control Conditions to a value or amount agreed by the Secretary of State is a reference to that value or amount as agreed by the Secretary of State during or as a consequence of the Licence Application Process.

### **Part D: Guide to abbreviated price control terms**

35.8 Most of the defined terms in the Chapter 9 Particular Definitions set out above appear in formulas embedded in the Price Control Conditions in the following abbreviated forms:

Allowed Revenue	AR
Average Specified Rate	ASR
Baseline Margin	BM
Baseline Margin Implementation Performance Adjustment	BMIPA
Baseline Margin Implementation Total	BMIT
Baseline Margin Operational Performance Adjustment	BMOPA
Baseline Margin Performance Adjustment	BMPA
<u>Baseline Margin Project Performance Adjustment</u>	<u>BMPPA</u>
Centralised Registration Service Cost Adjustment	CRSCA
Centralised Registration Service External Cost	CRSEC
Centralised Registration Service Internal Cost	CRSIC
Centralised Registration Service Performance Adjustment	CRSPA
Centralised Registration Service Pre-Agreed Cost	CRSPC
Centralised Registration Service Revenue	CRSR
External Contract Gain Share	ECGS
External Costs	EC
Internal Costs	IC
Pass-Through Costs	PTC
<u>Project Activity Amount</u>	<u>PAA</u>
<u>Project Activity Performance Factor</u>	<u>PF</u>
<u>Project Activity Weighting Factor</u>	<u>WF</u>
<u>Project Baseline Margin</u>	<u>PBM</u>
<u>Project Performance Adjustment</u>	<u>PPA</u>
Regulated Revenue	RR
Value Added Service Contribution	VASC

## **Condition 36. Determination of the Licensee's Allowed Revenue**

### **Introduction**

- 36.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 36.2 The purpose of this condition is to establish the mechanism for determining the amount of Allowed Revenue that may be recovered by the Licensee through Service Charges levied in respect of its provision of Mandatory Business Services.

### **Part A: Conditions supplementary to this condition**

- 36.3 This condition is supplemented by:
- (a) Condition 37 (Assessment of Mandatory Business costs), which provides for the Authority to determine the treatment of any costs associated with the provision of Mandatory Business Services that the Authority considers were not economically and efficiently incurred;
  - (b) Condition 38 (Determination of the BMP Adjustment), which provides for the Allowed Revenue to be adjusted upwards or downwards to reflect the Licensee's performance against certain specified incentives; and
  - (c) Condition 39 (Determination of External Gain Share) and Condition 40 (Determination of the VAS Contribution), which provide for the Allowed Revenue to be varied to reflect benefits arising from, respectively, the Licensee's management of External Service Provider Contracts and its provision of Value Added Services.

### **Part B: Duty of the Licensee with respect to Regulated Revenue**

- 36.4 The Licensee, in setting Service Charges for its Mandatory Business Services, must take all reasonable steps to secure that, in Regulatory Year t, its Regulated Revenue does not exceed a prudent estimate of its Allowed Revenue for that Regulatory Year.
- 36.5 For the purposes of paragraph 36.4, and subject to paragraph 36.6, a prudent estimate of Allowed Revenue is the Licensee's best estimate of Allowed Revenue as adjusted to ensure that (disregarding any within-year adjustments that may be permitted in circumstances prescribed by the Charging Methodology of the Licensee) the Service Charges as they apply for Regulatory Year t will not need to be amended in the course of that year except in response to a reasonably unlikely contingency.
- 36.6 The adjustment to which paragraph 36.5 refers must not be such as to result in an expectation that Regulated Revenue will significantly diverge from the Allowed Revenue in Regulatory Year t.

### **Part C: Determination of the Allowed Revenue (AR) term**

- 36.7 The amount of the Licensee's Allowed Revenue in relation to Regulatory Year t is to be determined in accordance with the following formula (in this condition, the Principal Formula):

$$AR_t = -EC_t + IC_t + CRSR_t + PTC_t + BM_t + BMPA_t + ECGS_t - VASC_t + K_t$$

36.8 In the Principal Formula above:

- $AR_t$  means the amount of the Allowed Revenue in Regulatory Year  $t$ .
- $EC_t$  means the actual amount of the Licensee's External Costs, as calculated for Regulatory Year  $t$  by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.
- $IC_t$  means the actual amount of the Licensee's Internal Costs, as calculated for Regulatory Year  $t$  by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.
- $CRSR_t$  means the amount of the Licensee's Centralised Registration Services Revenue, as calculated for Regulatory Year  $t$  in accordance with Part D below.
- $PTC_t$  means the total amount of Pass-Through Costs incurred by the Licensee in Regulatory Year  $t$ , and is the sum of:
- (i) the amount that is equal to the total annual fee paid by the Licensee to the Authority during Regulatory Year  $t$  as determined in accordance with Part A of Condition 4 (Licensee's payments to the Authority);
  - (ii) the amount that is equal to the payments made by the Licensee during Regulatory Year  $t$  to SECCo Ltd for purposes associated with the governance and administration of the SEC; and
  - (iii) the amount that is equal to the payments made by the Licensee during Regulatory Year  $t$  to AltHANCo Ltd for purposes associated with the Alt HAN Arrangements.
- $BM_t$  means the amount of the Licensee's Baseline Margin that is specified for the Regulatory Year  $t$  in Appendix 1 (which has effect as part of this condition) (or such other amount as may have been determined for that Regulatory Year pursuant to the provisions of Part ~~D~~E below), as multiplied by the price index adjuster (PIBM) for that year, which in the Regulatory Year 2013/14 shall have the value of 1 and in each subsequent Regulatory Year is derived from the following formula:

$$PIBM_t = \left[ 1 + \frac{RPI_t}{100} \right] \times PIBM_{t-1}$$

where  $RPI_t$  means the percentage change (whether it is positive or negative) between (i) the arithmetic average of the Retail Prices Index numbers published or determined with respect to each of the six months from July to December (inclusive) in Regulatory Year  $t-2$  and (ii) the arithmetic average of the Retail Prices Index numbers published or determined with respect to the same months in Regulatory Year  $t-1$  (and "Retail Prices Index" has the meaning given to that term in Part ~~G~~H below).

BMPA<sub>t</sub> means the Baseline Margin Performance Adjustment, as calculated for the Regulatory Year t in accordance with Part ~~E-F~~ below.

ECGS<sub>t</sub> means the amount of revenue adjustment in respect of External Contract Gain Share, as calculated for Regulatory Year t in accordance with Condition 39 (Determination of External Contract Gain Share).

VASC<sub>t</sub> means the amount of the Value Added Services Contribution, as calculated for Regulatory Year t in accordance with Condition 40 (Determination of the VAS Contribution).

K<sub>t</sub> means the correction factor, whether positive or negative, as calculated for Regulatory Year t in accordance with the formula set out in Part ~~F-G~~ below.

#### **Part D: Centralised Registration Service Revenue term**

36.9 For the purposes of the Principal Formula, the total amount of the Centralised Registration Service Revenue (CRSR) will be calculated for Regulatory Year t in accordance with the following Formula:

$$CRSR_t = CRSEC_t + CRSIC_t + CRSPC_t + CRSCA_t + CRSPA_t$$

36.10 In the formula above:

CRSEC<sub>t</sub> means the actual amount of the Licensee's Centralised Registration Service External Costs, as calculated for Regulatory Year t by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.

CRSIC<sub>t</sub> means the actual amount of the Licensee's Centralised Registration Service Internal Costs, as calculated for Regulatory Year t by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.

CRSPC<sub>t</sub> (a) \_means in relation to each Regulatory Year Centralised Registration Service Pre-Agreed Cost

(b) \_the value of the CRSPC<sub>t</sub> term will be zero unless otherwise directed by the Authority, following consultation with the Licensee, the SEC Panel, and SEC Parties.

CRSCA<sub>t</sub> (a) \_means in relation to each Regulatory Year a cost adjustment to the pre-agreed cost.

(b) \_the value of the term CRSCA<sub>t</sub> will be zero unless directed by the Authority, as set out in (c).

(c) \_CRSCA<sub>t</sub> will be determined in accordance with provisions developed and populated by the Authority in a direction to be given to the Licensee following consultation with the Licensee, the SEC Panel, and SEC Parties.

CRSPA<sub>t</sub> (a) \_means in relation to each Regulatory Year a performance adjustment.



(b) the value of the term  $CRSPA_t$  will be zero unless directed by the Authority, as set out in (c).

(c)  $CRSPA_t$  will be determined in accordance with provisions developed and populated by the Authority in a direction to be given to the Licensee following consultation with the Licensee, the SEC Panel, and SEC Parties.

### **Part E: Adjustment mechanism for the Baseline Margin term**

36.11 The amount of the Baseline Margin term as specified in Appendix 1 for any one or more of the Regulatory Years to which that Appendix applies may be varied in such manner and to such extent as may be directed by the Authority in accordance with and subject to the provisions of Appendix 2 (Adjustment mechanism for the BM term), which has effect as part of this condition.

### **Part F: Calculation of the BMP Adjustment (BMPA) term**

36.12 For the purposes of the Principal Formula, the total amount of the Baseline Margin Performance Adjustment term (BMPA) will be calculated for Regulatory Year  $t$  in accordance with the following formula:

$$BMPA_t = BMIPA_t + BMOPA_t + \underline{BMPPA_t}$$

36.13 For the purposes of paragraph 36.12, the value of the term  $BMIPA_t$ :

- (a) shall be determined in accordance with the provisions of Part B of Condition 38 (Determination of the BMP Adjustment) until the end of the Regulatory Year in which Completion of Implementation (within the meaning given to that term in Condition 5 (General Objectives of the Licensee)) is achieved (or such earlier date as the Authority may specify in a direction given to the Licensee under paragraph 36.15); and
- (b) thereafter shall be zero.

36.14 For the purposes of paragraph 36.12, the value of the term  $BMOPA_t$ :

- (a) shall be zero until the end of the Regulatory Year 2015/16 (or such later date as the Authority may specify in a direction given to the Licensee under paragraph 36.15); and
- (b) thereafter shall be determined in accordance with the provisions of Part C of Condition 38 (Determination of the BMP Adjustment).

36.15 A direction that is given for the purposes of paragraph 36.13 or 36.14 will be of no effect unless, before issuing it, the Authority has first:

- (a) by Notice given to the Licensee and published on the Authority's website, set out the revised date that it proposes to specify in the direction;
- (b) set out in that Notice a statement of the reasons why the Authority proposes to specify that date;
- (c) specified in the Notice the period (which may not be less than 28 days from the date of the Notice) within which representations may be made to the Authority

about its proposals; and

(d) considered any representations duly received in response to the Notice.

36.16 The Authority must have regard to any representations duly received in response to its Notice under paragraph 36.15 and must give reasons for its decisions in relation to them when giving the relevant direction.

36.17 For the purposes of paragraph 36.12, the value of  $BMPPA_t$  shall be determined in accordance with the provisions of Part D of Condition 38 (Determination of the BMP Adjustment).

### **Part G: Calculation of the correction factor (K)**

~~36.16~~36.18 For the purposes of the Principal Formula, the correction factor (K) shall in the Regulatory Year 2013/14 have the value of 0, and in each subsequent Regulatory Year shall be calculated in accordance with the following formula:

$$K_t = (AR_{t-1} - RR_{t-1} - BDC_{t-1}) \times \left[ 1 + \frac{(ASR_t)}{100} \right]$$

~~36.17~~36.19 In the formula for the K term above:

$AR_{t-1}$  means the amount of Allowed Revenue in Regulatory Year t-1.

$BDC_{t-1}$  means the contribution to bad debt within the Licensee's Internal Costs and Centralised Registration Service Internal Costs in Regulatory Year t-1, and will be zero except where the Licensee has failed to comply fully with its obligations under or pursuant to the SEC in relation to the management of SEC Parties' credit cover and the recovery of bad debt, in which event it will have such value as may be determined by the Authority.

$RR_{t-1}$  means the Regulated Revenue in Regulatory Year t-1.

$ASR_t$  means the Average Specified Rate, as defined in Condition 35 (Definitions for the Price Control Conditions), in Regulatory Year t.

### **Part H: Interpretation**

~~36.18~~36.20 For the purposes of this condition, **Retail Prices Index** means:

- (a) the general index of retail prices that is published by the Office for National Statistics each month in respect of all items; or
- (b) if that index in respect of any month that is relevant for the purposes of this condition has not been published on or before the last day of February, such price index as the Authority, after consultation with the Licensee, may determine to be appropriate; or
- (c) if there is a material change in the basis of that index, such other index as the Authority, after consultation with the Licensee, may determine to be appropriate.

~~36.19~~36.21 Appendices 1 ~~and to 23~~ follow immediately below.

**Appendix 1: Values for the BM term (£ million and before adjustment for RPI) for each Regulatory Year**  
**(see Part C-E of this condition)**

2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>1.769</b>	<b>3.194</b>	<b>2.724</b>	<b>2.041</b>	<b>2.008</b>	<b>2.059</b>	<b>2.443</b>
2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
<b>1.959</b>	<b>1.869</b>	<b>1.875</b>	<b>2.035</b>	<b>1.840</b>	<b>0.762</b>	<b>n/a</b>

## Appendix 2: Adjustment mechanism for the BM term

### Introduction

- A1. In accordance with Part ~~D~~-E above, and recognising the uncertainty attaching to the BM values as specified in Appendix 1 (above) at the Licence Commencement Date, this Appendix 2 enables adjustments to be proposed to those amounts and provides for the Authority to assess and determine any such proposals.

### Part A: Requirements for the proposal of Relevant Adjustments

- A2. Subject to the following provisions of this Part A, the Licensee may, by Notice given to the Authority, and the Authority may, by Notice given to the Licensee, propose a Relevant Adjustment to any one or more of the BM values specified in Appendix 1 for any one or more of the Regulatory Years to which that Appendix applies.
- A3. A Relevant Adjustment proposed (whether by the Licensee or the Authority) under paragraph A2 must relate to any variation (whether occurring as an aggregation of incremental but non-material changes or as a discrete but material change) that has taken place, or is likely to take place, in any one or more of the following aspects of the Mandatory Business of the Licensee:
- (a) the total volume of the activities comprising that business;
  - (b) the characteristics of the activities comprising that business;
  - (c) the mixture (whether by category or volume) of the activities comprising that business;
  - (d) the risks (whether financial or operational) to which the Licensee is exposed in the carrying on of that business; and
  - (e) the timescales or deadlines that the Licensee is required to meet (whether under this Licence or otherwise) in the carrying on of that business.
- A4. Notice given under paragraph A2 of a proposed Relevant Adjustment must:
- (a) refer to relevant information about actual or forecast levels of expenditure, use of resources, or performance of activities in the carrying on of the Mandatory Business of the Licensee that could not have been available when the values of the BM term in Appendix 1 were first agreed;
  - (b) demonstrate why, to what extent, and in which respects the variation to which the proposed Relevant Adjustment relates is a material change within the overall context of the Mandatory Business of the Licensee;
  - (c) separately identify the value of any element of the proposed Relevant Adjustment that relates to a Project n (the **Project Baseline Margin**), so that it is clearly distinguishable both from:
    - (i) the value of any element of the proposed Relevant Adjustment that relates to any other Project n; and

~~(b)~~(ii) the value of the elements of the proposed Relevant Adjustment that do not relate to a Project; and

~~(e)~~(d) take account of any Relevant Adjustments previously determined under this Appendix 2.

- A5. Notice given under paragraph A2 of a proposed Relevant Adjustment must also:
- (a) detail the change (or changes) to the BM value (or values) that are proposed and the Regulatory Year (or Years) to which the change (or changes) would relate, in each case identifying separately the change (or changes) relating to the Project Baseline Margin for any Project n;
  - (b) set out the basis of the calculation of those proposed changes; and
  - (c) explain why, in the opinion of the person making the proposal, the Relevant Adjustment is justified in all the circumstances of the case.
- A6. Notice given under paragraph A2 of a proposed Relevant Adjustment:
- (a) may be served at any time during the month of July (“the Application Window”) in any Regulatory Year (excluding the Regulatory Year 2013/14) provided that it complies in all respects with the provisions of this Part A;
  - (b) must be served within the first Application Window after the date on which the grounds for proposing the Relevant Adjustment first arose; and
  - (c) must contain an Adjustment Date (being the date on which it is proposed that the Relevant Adjustment should take effect), which may not be earlier than April of the Regulatory Year immediately following the Regulatory Year in which the Notice has been served.

## **Part B: Authority’s power to determine Relevant Adjustments**

- A7. Where a proposal for a Relevant Adjustment has been duly made under paragraph A2, the Authority will, by direction given to the Licensee at any time before the end of the Determination Period, and subject to paragraphs A8 and A9, determine any adjustment that is to be made to any BM value specified in Appendix 1 for the Regulatory Year to which that BM value relates (excluding the BM value for the Regulatory Year 2013/14).
- A8. The Authority may, at any time within the Determination Period, by Counter-Notice given to the Licensee direct that the Determination Period is to be extended with effect from the date of its expiry by such a further period (which may not be longer than three months) as is specified in the Counter-Notice.
- A9. The Authority may, at any time within the Determination Period, direct the Licensee to supply any further information that the Authority considers is necessary to enable it to determine the proposed Relevant Adjustment.
- A10. In determining any adjustment under paragraph A7, the Authority will:
- (a) consult with the Licensee and with SEC Parties;

- (b) have particular regard to the purposes the BM term is intended to serve within the Price Control Conditions and to the basis on which the values attributed to that term were agreed during the Licence Application Process with respect to the Licensee's expected rate of return on its activities over time; and
- (c) take no account of the general financial performance of the Licensee under the provisions, taken as a whole, of the Price Control Conditions.

A11. A determination under paragraph A7 may:

- (a) confirm, reject, or amend the proposed Relevant Adjustment; ~~and~~
- (b) include such additional or consequential adjustments (if any) as the Authority thinks appropriate to the BM value (or values) for any Regulatory Year (or Years) other than the Regulatory Year (or Years) set out in the proposed Relevant Adjustment;
- (c) separately identify the value of any Project Baseline Margin that relates to a Project n, so that it is clearly distinguishable both from:
  - (i) the value of any element of the Relevant Adjustment that relates to any other Project n; and
  - ~~(b)(ii)~~ (ii) the value of the elements of the Relevant Adjustment that do not relate to a Project.

**Part C: Licensee's right to make a Relevant Adjustment**

A12. If the Authority has not determined a Relevant Adjustment proposed by the Licensee under paragraph A2 by the end of the Determination Period, and the proposal has not been withdrawn, the Relevant Adjustment will be deemed to have been made and Appendix 1 will have effect for all relevant purposes as if it had been amended accordingly with effect from the Adjustment Date.

**Part D: Guidance for the purposes of this Appendix**

A13. The Authority may issue, and from time to time revise, guidance on the procedure that it will follow and the matters that it will take into account in determining a proposed Relevant Adjustment under paragraph A7.

A14. Guidance under paragraph A13 may, in particular, set out the principles, methods of assessment, and types of criteria that are likely to be applied by the Authority in determining any proposed Relevant Adjustment.

A14. —

**Part E: Relationship to Baseline Margin Project Performance Adjustment Scheme**

A15. For the purposes of:

- (a) any proposal for a Relevant Adjustment under paragraph A2;
- (b) any determination of a Relevant Adjustment under paragraph A7,

no account shall be taken of a Baseline Margin Project Performance Adjustment Scheme that has been, or may be, made by the Secretary of State under Appendix 1 of Condition 38.

## **Interpretation**

~~A15-A16.~~ For the purposes of this Appendix:

**Adjustment Date** has the meaning that is given to that term in paragraph A6(c).

**Application Window** has the meaning that is given to that term in paragraph A6(a).

**Counter-Notice** has the meaning that is given to that term in paragraph A8.

**Determination Period** means the period running from the close of the Application Window at the end of July until the end of the first month of November after that closure, or such later date as may be directed by the Authority in a Counter-Notice served under paragraph A8.

**Project Baseline Margin** has the meaning given to that term in paragraph A4(c).

**Relevant Adjustment** means an adjustment that is proposed in accordance with the requirements of Part A of this Appendix.

## **Condition 37. Assessment of Mandatory Business costs**

### **Introduction**

- 37.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 37.2 The purpose of this condition is to enable the Authority to monitor and assess certain costs associated with the provision of Mandatory Business Services in order to determine whether they were economically and efficiently incurred or, where that is not the case, whether such costs may be liable:
- (a) to be excluded from the mechanism for determining the Licensee's Allowed Revenue under Condition 36; or
  - (b) to be the subject of an undertaking given by the Licensee with respect to their future management.

### **Part A: Submission of annual report on cost performance**

- 37.3 The Licensee, in submitting Price Control Information to the Authority for the period of any Regulatory Year of this Licence ("the Relevant Regulatory Year") by 31 July in the next Regulatory Year, as required by Condition 32 (Reporting of Price Control Information), must at the same time submit to the Authority a report drawing upon the Price Control Information that includes the following two comparisons.
- 37.4 Comparison 1 is between:
- (a) the amount of the External Costs and Centralised Registration Service External Cost that were actually incurred for the Relevant Regulatory Year; and
  - (b) the amount of the External Costs and Centralised Registration Service External Cost that the Licensee estimated would be likely to be incurred for the Relevant Regulatory Year in its Licence Application Business Plan (and in all updated forecasts of expenditure submitted under Condition 32 by the Licensee).
- 37.5 Comparison 2 is between:
- (a) the amount of the Internal Costs and Centralised Registration Service Internal Cost that were actually incurred by the Licensee for the Relevant Regulatory Year; and
  - (b) the amount of the Internal Costs and Centralised Registration Service Internal Cost that the Licensee estimated it would be likely to incur for the Relevant Regulatory Year in its Licence Application Business Plan (and in all updated forecasts of expenditure submitted under Condition 32 by the Licensee).
- 37.6 The report submitted under paragraph 37.3 must also contain:
- (a) an explanation of any material divergence that is revealed by any of the two comparisons to which paragraphs 37.4 and 37.5 refer between the amount of the category of costs mentioned in sub-paragraph (a) of the comparison and the amount of the category of costs mentioned in sub-paragraph (b) of that comparison; and



- (b) a statement of any material revision arising from any such divergence that the Licensee thinks it is appropriate or necessary to make to any financial or operational matter included in its Licence Application Business Plan for the purposes of any of the remaining years of that plan.

37.7 Without prejudice to the requirements of paragraphs 37.4 and 37.5 with respect to the presentation of costs within the required report, all of the categories of cost mentioned in those paragraphs must be set out in that report in such manner and at such levels of detail as may be required by any Regulatory Instructions and Guidance issued by the Authority under Condition 33 that apply to the Price Control Information provided by the Licensee to the Authority under Condition 32.

### **Part B: Authority's powers with respect to certain costs**

37.8 Subject to paragraph 37.9, and after considering the report that has been submitted to it under paragraph 37.3, the Authority may:

- (a) direct that any External Costs and Centralised Registration Service External Cost or Internal Costs and Centralised Registration Service Internal Costs that it considers were not economically and efficiently incurred in the Relevant Regulatory Year ("the Unacceptable Costs") are to be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36; or
- (b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:
  - (i) the Licensee's future management of those costs, and
  - (ii) the Licensee's future procurement of Relevant Service Capability.

37.9 In deciding whether to make a direction or to accept an undertaking under paragraph 37.8, the Authority must:

- (a) consult with the Licensee;
- (b) consider the extent to which the Licensee was able, or should have been able, to control or otherwise influence the occurrence of the Unacceptable Costs, taking due account of the Licensee's role in procuring any Relevant Service Capability giving rise to those costs;
- (c) consider the likelihood that the Licensee will be able to recover any of the Unacceptable Costs through its future procurement of Relevant Service Capability; and
- (d) consider the likelihood that through appropriate future management actions the Licensee will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar costs.

37.10 Paragraphs 37.8 and 37.9 are without prejudice to the power of the Authority to take account of any other matters that are revealed by or are capable of being derived from the Licensee's Price Control Information under Condition 32 and that the Authority considers would be relevant to its functions under this Condition 37 of monitoring and assessing certain costs associated with the provision of Mandatory Business Services

during any Regulatory Year.

**Part C: Guidance for the purposes of this condition**

- 37.11 The Authority may issue, and from time to time revise, guidance about the procedure it will follow and the matters it will take into account in considering whether and to what extent to exercise its power to give a direction or accept an undertaking under paragraph 37.8.
- 37.12 Guidance under paragraph 37.11 may, in particular, set out the principles, methods of assessment, and types of criteria that are likely to be applied by the Authority in determining whether costs have been economically and efficiently incurred.

**Part D: Interpretation**

37.14 For the purposes of this condition:

**Licence Application Business Plan** means the plan of that name that:

- (a) was submitted by the Licensee in the course or as a consequence of the Licence Application Process;
- (b) contains the Licensee's estimates (which may be estimates that have been modified by the Licensee as a consequence of the Licence Application Process) of its revenues, costs, capital investments, and cashflows for each Regulatory Year of the Licence Term;
- (c) was taken into account by the Secretary of State in determining the grant of this Licence to the Licensee,

and to which the Licensee committed itself as a condition of that grant.

**Relevant Regulatory Year** has the meaning given to that term in paragraph 37.3.

**Unacceptable Costs** has the meaning given to that term in paragraph 37.8(a).

## Condition 38. Determination of the BMP Adjustment

### Introduction

- 38.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 38.2 The purpose of this condition is to establish the mechanism for determining the amounts of the Baseline Margin Implementation Performance Adjustment term (BMIPA), ~~and the Baseline Margin Operational Performance Adjustment term (BMOPA), and Baseline Margin Project Performance Adjustment term (BMPPA)~~ that have effect in Part ~~E-F~~ of Condition 36 (Determination of Licensee's Allowed Revenue).

### Part A: Intended effect of applying the BMIPA and BMOPA terms

- 38.3 The effect of the application of the BMIPA, ~~term and the BMOPA~~ ~~and BMPPA~~ terms in Part ~~E-F~~ of Condition 36 is to provide for an adjustment to the Allowed Revenue of the Licensee, where appropriate, to reflect the Licensee's performance against certain Implementation Milestones and, subsequently, against other measures.

### Part B: Calculation of the value of the BMIPA term

- 38.4 For the purposes of sub-paragraph ~~H13~~(a) of Condition 36, the value of BMIPA in Regulatory Year t is calculated in accordance with the following formula:

$$\text{BMIPA}_t = \text{IM1}_{t-1} + \text{IM2}_{t-1} + \text{IM3}_{t-1} + \text{IM4}_{t-1} + \text{IM5}_{t-1} + \text{IM6}_{t-1} + \text{IM7}_{t-1} \\ + \text{IM8}_{t-1} + \text{IM9}_{t-1} + \text{IM10}_{t-1} + \text{IM11}_{t-1} + \text{IM12}_{t-1} + \text{IM13}_{t-1} + \text{IM14}_{t-1}$$

where the amount of each of those terms will be zero unless determined otherwise in accordance with such calculations as may apply to the term under the Implementation Performance Regime that is set out at Schedule 3 to this Licence.

- 38.5 To facilitate the determination of the value of any term falling within the formula set out at paragraph 38.4, the Licensee may enter into a contract of appointment with an appropriate Performance Auditor requiring him to review, verify, and confirm in Writing to the Authority that the Implementation Due Date that is applicable to that term by virtue of Schedule 3 was in fact reached.
- 38.6 The Licensee must provide a person appointed as a Performance Auditor with such assistance for the purposes of his appointment as would be required to be given to a Reviewer appointed by the Authority under Part C of Condition 31 (Reporting of Quality of Service Information) for the purposes of that condition.
- 38.7 The Secretary of State may require, in accordance with and subject to the provisions of Part F of Schedule 3:
- (a) that any Implementation Due Date that is specified in that Schedule is to be changed to such other date as he may direct; or
  - (b) that such Implementation Milestone Criteria as are identified in the Schedule as subject to further definition and development are to be further defined and developed in such manner and to such extent as he may direct.

### Part C: Calculation of the value of the BMOPA term

38.8 For the purposes of sub-paragraph ~~42~~14(b) of Condition 36, the value of the BMOPA term in Regulatory Year t is to be calculated in accordance with the following formula:

$$BMOPA_t = [SUM 1-4] + [SDM 1-4] + [DIM 1-4] + [VMM 1-4]$$

where the amount of each of those terms will be zero unless determined otherwise in accordance with such calculations as may apply to the term under the Operational Performance Regime (being the regime that is set out at Schedule 4 to this Licence and that has effect in relation to this condition for illustrative purposes only, until it is modified by the Authority pursuant to paragraph 38.9).

38.9 The provisions of Schedule 4 will be developed and populated (subject to paragraph 38.10) by the Authority in a direction to be given to the Licensee for the purposes of paragraph 38.8 no earlier than 31 March 2016, but no later than 31 October 2018, following consultation with the Licensee, the SEC Panel, and SEC Parties.

38.10 Without limiting the general effect of paragraph 38.9, the Operational Performance Regime established by Schedule 4:

(a) must not relate to any Project Baseline Margin;

(a)(b) must not allow the amount of the Licensee's revenues that are at risk under that regime in Regulatory Year t to be less, in total, than 100% of the value of  $BM_t$  excluding any Project Baseline Margin; and

(c) must not, in terms of its structure and contents, differ substantially from the illustrative provisions of Parts A to D of Schedule 4.

### Part D: Calculation of the value of the BMPPA term

38.11 For the purposes of paragraph 17 of Condition 36, the value of the BMPPA term in Regulatory Year t is to be expressed as an amount in £ million to three decimal places, and calculated in accordance with the following formula:

$$BMPPA_t = \left( \sum_{All\ n} PPA_{n,t} \right) \times -1$$

38.12 For the purposes of paragraph 38.11:

$PPA_{n,t}$  means a **Project Performance Adjustment**, being the amount of an adjustment that is determined in respect of Project n in Regulatory Year t in accordance with the terms of a BMPPA Scheme made by the Secretary of State under Appendix 1 (Baseline Margin Project Performance Adjustment Schemes) which has effect as part of this condition.

38.13 Where in respect of any Regulatory Year t the Secretary of State has not made any BMPPA Scheme that results in the determination of a Project Performance Adjustment in that Regulatory Year, the value of BMPPA shall be zero.

(b) —

**Part DE: Interpretation**

~~38.11~~38.14 For the purposes of this condition:

**Implementation Due Date, Implementation Milestone, and Implementation Milestone Criteria** have the meaning that is given to those terms respectively in Schedule 3 (The Implementation Performance Regime) to this Licence.

**Performance Auditor** means a person who is appointed by the Licensee for the purposes set out in paragraph 38.5.

Project Baseline Margin has the meaning given to that term in Appendix 2 to Condition 36 (Adjustment Mechanism for the BM term).

# Appendix 1: Baseline Margin Project Performance Adjustment Scheme

## Introduction

A1. For the purposes of Part D above, this Appendix 1 provides for the Secretary of State to make a Baseline Margin Project Performance Adjustment Scheme, and to determine the nature and terms of operation of that scheme, in order to calculate the value of BMPPA in any Regulatory Year.

## Part A: Baseline Margin Project Performance Adjustment Scheme

A2. The Secretary of State may at any time, by notice in writing given to the Licensee, make a scheme for the purposes of this Appendix, which shall be known as a **Baseline Margin Project Performance Adjustment Scheme** (or **BMPPA Scheme**).

A3. A BMPPA Scheme made under paragraph A2 may relate to one or more Projects in respect of which a Project Baseline Margin has been (or is deemed to have been) determined, or may subsequently be (or be deemed to be) determined.

A4. A BMPPA Scheme made under paragraph A2 must include, in respect of each Project to which the scheme relates:

(a) a description of one or more activities which are being carried out, or are to be carried out, by the Licensee for the purposes of undertaking that Project (each a **Project Activity**);

(b) a weighting factor in relation to each such Project Activity, corresponding to the proportion of that Project which the Project Activity is deemed to represent for the purposes of the scheme (a **Project Activity Weighting Factor**), where:

(i) that factor is a number between 0 (zero) and 1 (one);

(ii) the total of all such factors in relation to all Project Activities described in the scheme shall not exceed 1 (one);

(c) a description of a performance target relating to each Project Activity (a **Project Activity Milestone**); and

(d) a performance factor in relation to each Project Activity Milestone, representing a measure of the Licensee's performance of the Project Activity relative to the target (a **Project Activity Performance Factor**), where:

(i) that factor is a number falling within in a range of numbers equal to or less than 1 (one), which may in particular include negative numbers;

(ii) that number may vary within that range in accordance with such aspects of the performance of the Licensee, measured by reference to the Project Activity Milestone, as may be described in the scheme.

A5. For the purposes of sub-paragraph A4(c), a Project Activity Milestone may be related to such factors concerning the performance by the Licensee of a Project Activity as the

Secretary of State considers appropriate, which may include in particular any one or more (or any combination) of the following:

- (a) the date on which the Project Activity takes place;
- (b) the number of steps, events, actions or outputs that constitute (or are generated by) the Project Activity;
- (c) any measure of quality associated with the steps, events, actions or outputs that constitute (or are generated by) the Project Activity;
- (d) the results of an audit or assessment carried out by any person in respect of any matter relating to the performance by the Licensee of the Project Activity; and
- (e) a determination made by the Secretary of State or the Authority in respect of any matter relating to the performance by the Licensee of the Project Activity.

A6. For the purposes of sub-paragraph A4(d)(ii), a Project Activity Performance Factor may vary by reference to such aspects of the performance by the Licensee of a Project Activity as the Secretary of State considers appropriate, which may include in particular any one or more (or any combination) of the factors specified at sub-paragraphs A5(a) to (e).

A7. In paragraphs A5 and A6, any reference to a Project Activity shall be read as including a reference to any part of that Project Activity.

A8. A BMPPA Scheme made under paragraph A2 may also include such provision as the Secretary of State considers appropriate for the purpose of interpreting and giving effect to the scheme (the **BMPPA Scheme Principles**).

A9. For the purposes of paragraph A8, BMPPA Scheme Principles may include in particular provisions for the purpose of any one or more (or any combination) of the following:

- (a) interpreting the provisions of the scheme in relation to any Project Activity Milestone or Project Activity Performance Factor;
- (b) identifying whether the Licensee has reached any Project Activity Milestone;
- (c) identifying whether any Project Activity has been completed;
- (d) calculating any Project Activity Performance Factor;
- (e) requiring an audit or assessment to be carried out by any person in respect of any matter relating to the performance by the Licensee of the Project Activity; and
- (f) the determination by the Secretary of State or the Authority in respect of any matter relating to the performance by the Licensee of the Project Activity.

A10. Where a BMPPA Scheme includes any BMPPA Scheme Principles:

- (a) the scheme shall be interpreted and applied in accordance with those principles; and

(b) any question as to the calculation of a Project Performance Adjustment under the scheme shall be determined, and the amount of that adjustment calculated, in accordance with those principles.

A11. The Secretary of State may amend an existing BMPPA Scheme at any time by notice in writing given to the Licensee.

### **Part B: Consultation**

A12. Before making or amending a BMPPA Scheme, the Secretary of State must first:

(a) consult with the Authority, the Licensee and the SEC Parties on a draft of the proposed scheme (or of the amendments to it); and

(b) take into account any responses received to the consultation before finalising and making the scheme (or the amendments to it).

### **Part C: Calculation of PPA**

A13. For the purposes of Part D above, the Project Performance Adjustment in respect of any Project n in Regulatory Year t shall be calculated in accordance with the following formula:

$$PPA_{n,t} = \sum_{All\ PA} PAA_{PA,t}$$

A14. In paragraph A13:

PPA<sub>n,t</sub> has the meaning given to it in paragraph 38.12;

PAA<sub>PA,t</sub> means a **Project Activity Amount**, being the amount determined in relation to each Project Activity PA in respect of Project n in Regulatory Year t, and calculated in accordance with the provisions of paragraphs A15 to A18.

Regulatory Years before completion of the Project Activity

A15. In each Regulatory Year t prior to that in which the circumstances described in paragraph A16 occur, the value of the PAA term in respect of a Project Activity PA shall be 0 (zero).

Regulatory Year in which the Project Activity is completed

A16. In any Regulatory Year t in which:

(a) the Project Activity PA is first completed; or

(b) if that Project Activity PA had been completed, the Project Activity Performance Factor would be 1 (one).

the value of the PAA term shall be calculated in accordance with paragraph A17.

A17. Where this paragraph applies, the value of the PAA term shall be calculated in accordance with the following formula:



$$PAA_{PA,t} = WF_{PA} \cdot PF_{PA} \left( PBM_{n,t} + \sum_{All_I} PBM_{n,I} \right)$$

Where:

WF<sub>PA</sub> means the Project Activity Weighting Factor of that Project Activity PA, in accordance with the BMPPA scheme.

PF<sub>PA</sub> means the Project Activity Performance Factor of that Project Activity PA, calculated in accordance with the provisions of the BMPPA Scheme (and in the circumstances described in paragraph A.16(b), its value shall be 1 (one)).

PBM<sub>n,t</sub> means the amount of the Project Baseline Margin in respect of Project n in Regulatory Year t which has been (or is deemed to have been) determined for that Regulatory Year, multiplied by the price index adjuster (PIBM) for that Regulatory Year and divided by PIBM for the Regulatory Year in which that Project Baseline Margin was (or is deemed to have been) determined,

and for these purposes PIBM in the Regulatory Year 2013/14 shall have the value of 1 and in each subsequent Regulatory Year shall be derived from the following formula:

$$PIBM_t = \left[ 1 + \frac{RPI_t}{100} \right] \times PIBM_{t-1}$$

where RPI<sub>t</sub> means the percentage change (whether it is positive or negative) between (i) the arithmetic average of the Retail Prices Index numbers published or determined with respect to each of the six months from July to December (inclusive) in Regulatory Year t-2 and (ii) the arithmetic average of the Retail Prices Index numbers published or determined with respect to the same months in Regulatory Year t-1 (and “Retail Prices Index” has the meaning given to that term in Part H of Condition 36 (Determination of the Licensee’s Allowed Revenue)).

PBM<sub>n,I</sub> means the value of PBM<sub>n</sub> in any preceding Regulatory Year, indexed up to Regulatory Year t by reference to the Average Specified Rate, so that:

(a) in relation to PBM<sub>n</sub> for Regulatory Year t-1:

$$PBM_{n,I} = PBM_{n,t-1} \left[ 1 + \frac{(ASR_t)}{100} \right]$$

(b) in relation to PBM<sub>n</sub> for Regulatory Year t-2:

$$PBM_{n,I} = PBM_{n,t-2} \left[ \left( 1 + \frac{(ASR_t)}{100} \right) \cdot \left( 1 + \frac{(ASR_{t-1})}{100} \right) \right]$$

(c) in Regulatory Year t-3 and any preceding Regulatory Year,  $PBM_{n,t}$  shall be calculated using the same method as in sub-paragraphs (a) and (b).

Regulatory Years after the Project Activity is completed

A18. In each Regulatory Year t after that in which the circumstances described in paragraph A16 have occurred, the value of the PAA term shall be calculated in accordance with the following formula:

$$PAA_{PA,t} = WF_{PA} \cdot PF_{PA} \cdot PBM_{n,t}$$

For the purposes of paragraph A18, the meaning of each formula term shall be the same as in paragraph A17.

#### **Part D: Interpretation**

A19. For the purposes of this Appendix:

Baseline Margin Project Performance Scheme (or BMPPA Scheme) has the meaning given to that term in paragraph A2.

BMPPA Scheme Principles has the meaning given to that term in paragraph A8.

Project Activity has the meaning given to that term in paragraph A4(a).

Project Activity Amount has the meaning given to that term in paragraph A14.

Project Activity Milestone has the meaning given to that term in paragraph A4(c).

Project Activity Performance Factor has the meaning given to that term in paragraph A4(d).

Project Activity Weighting Factor has the meaning given to that term in paragraph A4(b).

Project Baseline Margin has the meaning given to that term in Appendix 2 to Condition 36 (Adjustment Mechanism for the BM term).