

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):

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

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.

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);

and

(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 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 below).

$BMPA_t$ means the Baseline Margin Performance Adjustment, as calculated for the Regulatory Year t in accordance with Part E below.

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- $ECGS_t$ 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).
- $VASC_t$ 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_t means the correction factor, whether positive or negative, as calculated for Regulatory Year t in accordance with the formula set out in Part F below.

Part D: Adjustment mechanism for the Baseline Margin term

- 36.9 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 E: Calculation of the BMP Adjustment (BMPA) term

- 36.10 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:

$$BMPA_t = BMIPA_t + BMOPA_t$$

- 36.11 For the purposes of paragraph 36.10, 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 36.13); and
 - (b) thereafter shall be zero.
- 36.12 For the purposes of paragraph 36.10, 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 36.13); and
 - (b) thereafter shall be determined in accordance with the provisions of Part C of Condition 38 (Determination of the BMP Adjustment).
- 36.13 A direction that is given for the purposes of paragraph 36.11 or 36.12 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;

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- (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.
- 36.14 The Authority must have regard to any representations duly received in response to its Notice under paragraph 36.13 and must give reasons for its decisions in relation to them when giving the relevant direction.

Part F: Calculation of the correction factor (K)

- 36.15 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:

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

- 36.16 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 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 G: Interpretation

- 36.17 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.

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36.18 Appendices 1 and 2 follow immediately below.