Georgian National Energy and Water Supply Regulatory Commission
Resolution N33

December 25, 2014
Tbilisi

On approving Natural Gas TariffSetting Methodology

Based on the Article 5 of the Law of Georgia on Electricity and Natural Gas, Articles 14, 20 and 25 of the Law of Georgia on Normative Acts, Georgian National Energy and Water Supply Regulatory Commission establishes the following:

1. Tariff Setting Methodology for Natural Gas shall be approved (Annex N1).
2. "Regulated Asset Depreciation/amortization Norms for Tariff Regulated Enterprises" shall be approved (Annex N2).
3. Upon entry into force of this Resolution the Resolution N6 of Georgian National Energy and Water Supply Regulatory Commission of September 8, 1999 on "Approving Natural Gas Tariff Setting Methodology" shall be declared invalid.
4. This Resolution shall enter into force on the date of its publication.

Chair of Georgian National Energy and Water Supply Regulatory Commission	Irina Milorava
Commissioner	Gocha Shonia
Commissioner	Sergo Meskhi

Annex 1

Tariff Setting Methodology for Natural Gas

CHAPTER I. GENERAL PROVISIONS

Article 1
Purpose

1. Purpose of the Tariff Setting Methodology for Natural Gas (hereinafter "the Methodology") is to define rules and principles for calculating tariffs for natural gas supply, transportation, distribution, pass through and consumption in accordance with the Law of Georgia on Electricty and Natural Gas.
2. Based on this Methodology the tariff setting is in accordance with the "Cost Plus" regulation principle which stimulates the stable functioning of the utility, recovery of reasonable costs and gain fair profit.

Article 2
Scope of the Methodology

1. The Methodology applies to natural gas supply, transportation, distribution, pass through services and consumption sector while providing natural gas supply, transportation, distribution activities.
2. The Methodology does not apply to the deregulated activity based on the Law of Georgia on Electricty and Natula Gas, exploratory work in a natural gas, extraction, processing and storage, relationship between natural gas producer and supplier, as well as natural gas transit.

Article 3
Definitions

1. The terms used in this Methodlogy have the same meanining as in the Law of Georgia on Electricity and Natural Gas.
2. Other terms used in the Methodology have the following meaning for the tariff regulation purposes:

a) **Intangible assets** – identifiable, non-monetary assets without physical form including patent, trade mark, goodwilll, software, licence and other types of nonmaterialassets;
b) **Assets** – tangible and intangible assets;
c) **Asset replacement costs** - total amount of costs, which is needed to create the similar asset of the evaluated asset.
d) **Asset cost** – the real value of payments in money or money equivalents or other compensation during the creation or the first purchase of an asset;
e) **Historic cost asset valuation method** – Asset cost evaluation using the price of its creation or the first purchase
f) **Net Book Value of the Asset** – Asset cost (including investment) excluded depreciation/amortization;
g) **Natural Gas Distribution Tariff** - price of the distribution service provided by the distribution licensee;
h) **Natural Gas Pass Through Tariff** - price of the pass through service provided by the distribution licensee;
i) **Natural Gas Supply Tariff** - natural gas selling price by supplier to another supplier or consumer;
j) **Natural Gas Consumption Tariff** - price of the consumed natural gas for retail consumer;
k) **Natural Gas Transportation Tariff** - price of the transportation service provided by the transportation licensee;
l) **Natural Gas Over-normative Losses** – positive difference between actual losses and normative losses set by the Commission in the transportation or distribution network;
m) **Natural Gas Normative Losses**–allowed amount of natural gas losses arising in the transportation and distribution network while providing natural gas natural gas transportation, distribution and pass through;
n) **Natural Gas Actual Losses** – difference between the volumes of received and delivered natural gas to the relevant transportation or distribution network which is calculated according to the metering data;
o) **Reasonable costs** – cost incurred on regulated activity in accordance with the minimum cost principle, which is rational and nessesary for the effective and safe functioning of the utility;
p) **Cost audit –** regulatory mechanisms**,** by means of which the commission (or/and neutral third party)verifies the costs incurred by the utility and financial results and definesthe Regulatory Asset Base;
q) **Cost cascading method** –allocation of the part of the costs of the natural gas upper pressure levels of the distribution grid to the costs of the next pressure levels;
r) **Investment –**capital investment which is used for creating, purchasing and rehabilitation of assets;

s) **Weighted Average Cost of Capital (WACC) –** rate of return on Regulatory Asset Base, calculated before taxes, according to the capital structure of the company set by the Commission (own and attracted capital);

t) **Capital Expenditures (CAPEX)** - return on Regulatory Asset Base and depreciation/amortization, for the purpose of this Methodology;

u) **Tangible Assets –** major assets used by the company for the relevant regulated activity, including land, buildings, structures, machinery, equipment and other main assets which useful life is more than one year;

v) **Third party** - any individual or legal person (including a State, customer, etc.), except the shareholder of the enterprise, which provides subsidy to the utility, gives grant, pays fees for the connection to the natural gas transportation and/or distribution network and/or gives tangible and intagible assets to the utility for free;

w) **Regulatory Asset Base (RAB) –** tangible and intangible assets used for the regulated activity, that are directly related to the regulated activity and are used in tariff calculation(except for the assets created by the third party);for the purposes of the tariff calculation for the natural gas supply RAB includes the working capital as well;

x) **Regulatory Cost base (RCB) –** Allowed income for the utility set by the Commission for the Tariff Year, which is necessary for the effective and safe functioning of the utility and includes reasonable costs and fair profit;

y) **Regulated activity** – for the purposes of this Methodology, the activities of the natural gas supply, transportation, distribution and/or path through, regulated by the Commission in accordance with the Law of Georgia on Electricity and Natural Gas;

z) **Working Capital** – amount of costs designated by the Commission for covering operational expenditures of the utility;

aa) **Building block approach** – defining the Regulatory Cost Base by the determination of its components.

bb) **Operational Expenditures**–expenditures related to the maintenance and service of the natural gas transportation and distribution network; for the purposes of this Methodology, other current costs related to the regulated activity; for calculating Natural Gas Supply Tariff - current costs related to the supply activity (including natural gas purchasing cost);

cc) **Tariff application** – application form approved by the Commission, which includes financial and technical data for the Test Year of a company;

dd) **Tariff Year (t+1) -** the calendar year for which the Commission sets tariffs in accordance with this Methodology;

ee) **Test year (t-1)**–the calendar year prior to the tariff calculation year;

ff) **Utility** – natural gas supplier, natural gas transportation or distribution licenseewho are subject to tariff setting according to this Methodology in accordance with the current legislation for their regulated activities;

gg) **Tariff calculation year (t)**-the calendar year prior to the Tariff Year;

hh)**Depreciation/amortization –** gradual allocation ofdepreciable amount of the tangible/intangible asset over its useful life;

Article 4
Main Principles

1. This Methodology and the tariffs set on its bases
   a) protect consumers from the monopolistic prices;
   b) support the stable and realible functioning of the company;
   c) ensure that tariffs are transparent, stable and fair for the companies;
   d) reflect different service costs between the customer categories;
   e) cover costs of the company with funds received from each customer category in proportion to costs incurred for servicing this customer category.
2. For determination of RCB structure the "building blocks" approach is used. RCB defined by this methodology consists with the following components:
   a) Capital Expenditures;
   b) Operational Expenditures.
   c) Cost of Normative Losses
3. Calculation of Capital and Operational Expenditures is carried out by "cost-plus" method, with annual audit of expenditures.
4. In case if result of the cost audit revealed corrective information of the previous years existed before test year, which was not identified in the previous year(s) tariff calculations, Commission has authority to use this information for correcting the results of the audit. Correction shall to be made by using principles outlined in Chapter IV of this methodology.
5. Different tariffs for natural gas transportation, distribution, pass through and consumption may be set according to various consumer categories (groups) the criteria of which could be:
   a) Natural gas pressure;
   b) Volume of natural gas consumption;
   c) Other criteria defined by the legislation;
6. Different tariffs for natural gas supply may be set according to various consumer categories (groups) based on the current legislation.
7. All tariffs set by the Commission are calculated without Value Added Tax (VAT).

Article 5
Tariff Setting Period

The Commission sets tariffs annually for specific utilities on an individual bases and is valid for one year.

CHAPTER II
REGULATORY COST BASE

Article 6
Regulatory Cost Base for the Tariff Year

1. Regulatory Cost Base for the Tariff Year for natural gas transportation, distribution and pass through is calculated according to the following formula:

$$RCB_{(t+1)} = CAPEX_{(t+1)} + OPEX_{(t+1)} + CNL_{(t+1)} + CORR_{(t+1)} \quad (1),$$

Where,

$RCB_{(t+1)}$ - RCB for the Tariff Year(GEL);

$CAPEX_{(t+1)}$-Capital Expenditures for the Tariff Year(GEL);

$OPEX_{(t+1)}$- Operational Expenditures for the Tariff Year(GEL);

$CNL_{(t+1)}$ – Cost of Normative Losses for the Tariff Year(GEL);

CORR(t+1) - Cost correction factor, which provides the reflection of the difference between actual and planned costs in the cost base of the Tariff Year, and also received income from non-operational activity envisaged in the subparagraph "d" of paragraph 1 of Article 20 of this Methodology, based on the principles defined in this Methodology (GEL)

2. For the purpose of calculating the Natural Gas Supply Tariff the RCB is calculated according to the formula under Paragraph 1 of this article which does not include CNL component.

Article 7
Capital Expenditures

For the purposes of calculating tariffs for natural gas supply, transportation, distribution and pass through for the Tariff Year the capital expenditures are calculated according to the following formula:

$$CAPEX_{(t+1)} = RAB_{start(t+1)} * WACC + D_{(t+1)} \quad (2)$$

where,

$CAPEX_{(t+1)}$- Capital Expenditures for the Tariff Year(GEL)

$RAB_{start(t+1)}$-RAB for the beginning of Tariff Year(GEL)

$WACC$ - Rate of return on the RAB for the Tariff Year (%);

$D_{(t+1)}$ - annual depreciation/amortization for the Tariff Year(GEL)

Artilce 8
Regulatory Asset Base

1. The value of asset is defined by the Historic Cost Valuation Method.

2. In case if the assets value can not be determined by the mothod specified in Paragrah 1 of this Article, the Commission has the autority to use replacement cost asset valuation method.

3. In case if the utility sells regulatory assets to other utility, the Commission does not envisage asset re-sale value while calculating relevant tariffs and will consider historic value of the asset.
4. The RAB shall not reflect:
    a) Those investments that were carried out by third party financing; companies should account for such assets separately;
    b) Those investments the Commission does not consider justified and reasonable;
    c) Assets that are not used in regulated activity;
    d) Construction in progress;
    e) Revaluation reserve, except the one which was formed during privatization of the state property.
5. The Commission is authorized not to consider the asset assigned in the capital by the shareholder of the utility and received from the Third Party, if the shareholder of the utility or the Third Party is represented by the State or by the Utility where no less than 50 % of shares are owned by the State.
6. The Commission will consider capitalized cost of the paid loan according to the factual annual interest rate for the long term loan taken to finance the construction during the construction process in the cost of asset defined in subparagraph D of paragraph 4 of this article, but the rate should not exceed the rate of debt (r_d) defined in this methodology.
7. The value of RAB of utility is determined on the basis of the net book value of assets included in this base.
8. For tariff regulation purposes the Commission is authorized to consider asset impairment while defining net book value of the asset. Thereby, the Commission is authorized to reflect asset impairment loss in tariff in some cases. Accounting of impairment loss shall be done separately by the utility.
9. For the purposes of calculating tariffs for natural gas transportation, distribution and pass throughthe RAB value at the beginning of the Tariff Year shall be determined based on the following formula:

$$RAB_{start}(t+1) = RAB_{end}(t-1) + INVt - Dt \qquad (3)$$

where,

$RAB_{start(t+1)}$ - value of RAB at the beginning of the Tariff Year(t+1) (GEL);

$RAB_{end(t-1)}$ - value of RAB at the end of the Test Year (t-1) (GEL);

INV_t- actually made investments approved by the Commissionfor the Tariff Calculation Year(t) (GEL);

D_t -depreciation/amortization for the Tariff Calculation Year (GEL).

10. For the purpose of calculating Natural Gas Supply Tariff the amount of working capital of the utility is consideredin the formula under Paragraph 9 of this Article for calculating the value of RAB for the Tariff Year which is calculated according to the Article 9 of this Methodology.

Artilcle 9
Working Capital

1. The Commission defines the amount of working capital of the utility for the Tariff Year that includes the part of Operational Expenditures and VAT related to regulated activity and is calculated as follows:

$$WC_{(t+1)} = (ARD - APD_{opex}) / 365 \times OPEX_{(t+1)} + (ARD - APD_{vat}) / 365 \times nVAT_{(t+1)} \quad (4)$$

where:

$WC_{(t+1)}$ –the amount of working capital for the tariff year (GEL);

ARD –the payment day for the recievables, but no later than the25th dayof the following month(day);

APD_{opex} – the payment day for payables in relation to the Operational Expenditures but no earlier than 10th day of reporting month (day);

APD_{vat} –the payment day for the payables in relation to the VAT – the 15th day of the following reporting month (day);

$OPEX_{(t+1)}$ –the Operational expenditures for Tariff Year (GEL);

$nVAT_{(t+1)}$–the difference between accrued VAT and offset VAT (GEL);

2. if Working Capital (WC) determined by the Paragraph 1 of this Article is negative number the WC of the Tariff Year of the utility equals to zero.

Article 10
Depreciation and Amortization

1. For the assets which were put in operation after January 1, 2015," Regulated Asset Depreciation/amortization Norms for Tariff Regulated Enterprises" are used which is based on the straight line method for determining the depreciation rates and is approved by the Commission.
2. With regard to assets put in operation before January 1, 2015the Commission envisages the depreciation/amortization rates used in the utility or in case such information does not exist the Commission is authorized to use depreciation/amortization rates defined in the tax code.

Article 11
Weighted Average Cost of Capital

1. Rate of Return on RAB is defined based on Weighted Average Cost of Capital (WACC) method.
2. The pre tax Weighted Avarege Cost of Capital (WACC) for the Tariff Year is calculated as follows:

$$WACC_{pre-tax} = g * r_d + \frac{(1-g)*r_e}{(1-T)} \qquad (5)$$

where,

$WACC_{pre-tax}$ - pre tax Wighted Average Cost of Capital (%)
g- share of borrowed capital (%)
r_d- cost of borrowed capital (%)
r_e- cost of own capital (%)
T- profit tax (%)

3. Cost of borrowed capital and own capital is calculated based on the following formula:

$$r_d = r_{rf} + DP \qquad (6)$$

$$r_e = r_{rf} + \beta \times (r_m - r_{rf}) \qquad (7)$$

where,

r_{rf}- risk free rate (%)
DP- debt premium (%)
r_m- market risk (%)

β- sectorial risk factor.

4. The share of loans (g) of the total capital is defined as 60 percent in the Weighted Average Cost of Capital (WACC) by the Commission.

5. The commission will determine the long-term risk-free interest rate based on the annual income for the long-term international state bonds before the expiration date, and the market risk premium and the debt premium will be determined on the basis of expert opinion and/or benchmarking.

Article 12
Operational Expenditures

1. Test Year data is used for calculation of operational expenditures for the Tariff Year. In the Process of determining forecasted volume, cost and exchange rate of natural gas purchase the Commission is authorized to use actual data of Tariff Calculation Year or forecasted data of Tariff Year.
2. Operational costs for the Test Year which are justified, reasonable and fair are consideredwhile calculating operational costs for the Tariff Year.
3. In case the utility does not have factual data for Test Year, the Commission is authorized to request from the utility technical and economic forecasting data for the Tariff Year defined by the tariff application. The Commission is authorized to consider only the data which is justified, reasonable and fair.
4. Operational expenditures should ensure the recovery of costs associated with the regulated activity, in particular:
    a) service and maintenance expenditures;
    b) administrative and general expenditures;
    c) natural gas purchasing costs while calculating on Natural Gas Supply Tariff;
    d) expenditures related to the asset servicing created under financing of the Third Party, (including, current repair, service and maintenance and other expenditures);
    e) costs for short-term loan interest for the purposes of financing necessary working capital in order to carry out natural gas transportation, distribution and pass through activities , (which should not exceed average annual interest rate on the short term loans issued by commercial banks to legal entities) and commission fee on bank guarantee;
5. While calculation of tariffs for Tariff Year the Commission uses factual financial and technical data of the Test Year, which should be submitted according to the Commission approved forms and verified by the head of the company or duly authorized person.
6. Within its mandate the Commission is authorized to verify the correctness of the submitted documentation and toassess fairness and reasonableness of the costs submitted. For this purpose

the Commission is authorized to assess operational expenditures for the Test Year based on operational expenditures' analysis of the preceding years.

7. If in addition to the regulated activity as defined by this Methodology, the utility carries out other non-regulated activity, costs associated with that activity shall not be reflected in tariff calculation.

Article 13
Natural Gas Normative Loss

1. The Commission sets the amount of normative losses in the natural gas transportation and distribution network which will be envisaged in the tariff.
2. The normative loss of natural gas is defined by the relevant Resolution of the Commission;
3. The amount of normative losses of natural gas set for the utility by the Commission is fixed within the period of the validity of the tariff, except the cases envisaged by the legislation.
4. In case the factual loss of natural gas in transportation and distribution networks exceeds the set normative loss of natural gas for the relevant utility, the cost of over-normative losses will not be considered in tariff calculation and will not be reimbursed to the utility.
5. In case the factual loss of natural gas in transportation and distribution networks is less than the set normative loss of natural gas for the relevant utility, the profit received from the difference will remain in the utility.
6. The purchase cost of the normative loss of the natural gas in transportation and distribution networks is calculated according to the following formula:

$$CNL_{(t+1)}=P_{ave(t+1)}\times G_{loss(t+1)}/\ 100 \quad (8),$$

where:

$CNL_{(t+1)}$ –cost of the normative loss of the natural gas in transportation or distribution network for the Tariff Year (GEL);

$P_{avet+1)}$ –weighted average price of natural gas purchase for the Tariff Year (Tetri/m^3);

$G_{losst+1)}$ –volume of normative losses of natural gas for the Tariff Year (m^3).

7. The weighted average price of natural gas purchase for filling the natural gas normative losses by distribution licensee for Tariff Year includes the costs related to the natural gas purchase (including natural gas transportation costs).
8. The volume of natural gas normative losses for the Tariff Year is defined according to the forecasted volume of transported, distributed and passed through natural gas under Article 14 of this Methodology.

Article 14
The Volume of Natural Gas

While calculating tariffs the Commission uses the factual data of supplied, transported, distributed, and passed through natural gas volume during the Test year by the utility, the forecasted data (considering the consumption trend in the sector) and/or Natural Gas Forecast Balance approved for the Tariff Year in the Tariff Calculation year.

Article 15
Cost Distribution (Allocation)

1. If the utility carries out more than one regulated activity or together with the regulated activity performs non-regulated activity (activities), it is obliged to present to the Commission unbundled data about the expenditures, revenues and asset costs for each regulated activity for the Test Year according to the Commission approved reporting forms.
2. The Commission sets natural gas transportation, distribution and pass through tariffs according to the pressure levels of the transportation and distributionnetwork of the relevant utility.
3. The distribution licensee is obliged to allocate direct cost of the Test Year to the corresponding pressure levels. Non-direct costs should be also allocated to each pressure level and the licensee has to justify the reasonability and fairness of the allocation method.
4. The Commission is authorized to disagree with the non-direct cost allocation method (considering it unjust and unreasonable) and use another method of cost allocation.
5. For calculating the relevant tariff according to pressure levels, the Commission carries out cost allocation between pressure levels based on Cost Cascading Method. (Annex "a").
6. For calculating Natural Gas Supply Tariff according to consumer categories the natural gas supplier is obliged to allocate direct costs of the Test Year to relevant consumer categories and reallocate non-direct costs in proportion with the volume of consumed natural gas by the relevant consumer categories.

Chapter III. Tariff Calculation
Article 16
Natural Gas Supply Tariff

For calculating Natural Gas Supply Tariff for the Tariff Year the RCB of supplier is divided by the supplied volume of natural gas by the supplier and is calculated according to the following formula:

$$T_{supplied\ (t+1)} = \frac{RCB_{(t+1)}}{G_{Supplied\ (t+1)}} X\ 100 \qquad (9)$$

Where,

$T_{supplied\ (t+1)}$ – Natural Gas Supply Tarifffor the Tariff Year (Tetri/m^3);

$RCB_{(t+1)}$ – Regulatory Cost Base for the Tariff Year (t+1) (GEL);

$G_{supplied\ (t+1)}$– Supplied volume of natural gas by the natural gas supplier (m^3).

Article 17
Natural Gas Transportation Tariff

1. Natural gas transportation tariffs are set for natural gas transportation system (>1.2 Mpa).
2. For calculation of Natural Gas Transportation Tarifff or Tariff Year, amount of Regulated Cost Base of the transportation licensee is divided by volume of natural gas delivered by transportation licensee from the supply point (except natural gas supplied for transit purposes) and is calculated according to following formula:

$$T_{\boldsymbol{transportation}(\boldsymbol{t+1})} = \frac{RCB_{(t+1)}}{G_{del(t+1)}} * 100 \qquad (10)$$

Where,

$T_{transportation(t+1)}$ – Natural Gas Transportation Tariff for theTariff Year (tetri/m^3);

$RCB_{(t+1)}$ - RCB of transportation licensee forTariff Year (GEL).

$G_{del(t+1)}$– Volume of natural gas delivered by transportation licensee from transportation system for Tariff Year (m^3).

3. In the process of calculating tariffs pursuant to the paragraph 2 of this Article the Commission is entitled to consider incomes received or to be received by the transportation licensee from transit on the territory of Georgia. In such case Regulated Cost Base of utility is diminished by incomes received or to be received from such transit.

Article 18
Natural Gas Distribution and Pass through Tariffs

1. Natural gas distribution and pass through tariffs are set for natural gas distribution licensees for distribution and pass through services.
2. Natural gas distribution and pass through tariffs are set according to the following pressure levels of distribution network:
a) high pressure (1.2-0.3 Mpa);
b) medium pressure (0.3-0.005 Mpa);
c) low pressure (<0.005 Mpa);
3. Distribution and pass through tariff for Tariff Year is calculated according to the following formula:

$$T_{idistr(t+1)} = \frac{RCB_{i(t+1)}}{G_{idistr(t+1)}} * 100 \qquad (11)$$

Where,

$T_{idistr(t+1)}$ – distribution tariff on *i*-pressure level (Tetri/m^3);

$RCB_{i(t+1)}$ – RCB of distribution licensee on *i*-pressure level for the Tariff Year (GEL);

$G_{idistr(t+1)}$ – total forecasted volume of distributed and passed through natural gas via distribution network on *i*-pressure level for the Tariff Year (m^3).

i – relevant pressurelevel of distribution network.

4. Pass through tariffs are equal to distribution tariffs, except the cases when according to legislation pass through tariffs should be set on the basis of mutual agreement between the parties.

Article 19
Natural Gas Consumption Tariff

1. Natural gas consumption tariffs comprise expenditures related to supply, transportation and distribution (pass through) of natural gas.

2. Natural gas consumption tariff is set according to each pressure level of natural gas distribution network and is calculated on the basis of this methodology and the following formula:

$$T_{i\ consumption(t+1)} = T_{supply(t+1)} + T_{transportation(t+1)} + T_{i\ distribution(t+1)} \quad (12),$$

where:

$T_{iconsumption(t+1)}$– Natural Gas Consumption Tariff on*i*-pressure level of natural gas distribution network forTariff Year (tetri/m^3);

$T_{supplyt+1)}$– Natural gas supply tarifffor relevant consumer categories for Tariff Year (tetri/m^3);

$T_{transportation(t+1)}$– Natural gas transportation tariff for Tariff Year (tetri/m^3);

$T_{idistribution\ (t+1)}$– Natural gas distribution tariff on *i*-pressure level of natural gas distribution network forTariff Year (tetri/m^3);

i – Relevant pressurelevel of natural gas distribution network.

Chapter IV
Tariff Correction
Article 20
Principles and Basic Mechanisms of Tariff Correction

1. This methodology envisages reflection of planned indicators in utility's RCB. Respectively, the Commission is entitled to make corrections for Tariff Year by cost correction indicator, which shall be based on following factors:

a) Operational Expenditures;

b) volumes of natural gas supplied, transported, distributed and passed through;

c) costs of normative losses of natural gas (only in cases of correcting natural gas transportation, distribution and pass through tariffs.);

d) purchase price of Natural Gas and exchange rate (only in case of correcting natural gas supply tariff)

e) income from non-operating activity.

2. Cost correction indicatoris calculated according to the following formula:

$$CORR_{(t+1)} = cOPEX_{(t+1)} - cREV_{(t+1)} + cCNL_{(t+1)} + cGPC_{(t+1)} - nopREV_{(t+1)} \quad (13),$$

where:

$CORR_{(t+1)}$– Cost correction indicator for theTariff Year (GEL);

$cOPEX_{(t+1)}$– difference caused by difference between of actual and planned operational expenditures duringthe Test Year, which are reflected in the Tariff Year (GEL);

$cREV_{(t+1)}$– difference caused by difference between actual and planned volumes of natural gas during the Test Year and which is reflected in the Tariff Year (GEL);

$cCNL_{(t+1)}$– difference caused by difference between actual and planned costs of natural gas normative losses during the Test Year and which is reflected in the Tariff Year (GEL);

$cGPC_{(t+1)}$ – difference caused by difference between actual and planned prices of natural gas purchase and/or exchange rates during Tariff Calculation Year and which is reflected in Tariff Year (GEL);

$nopREV_{(t+1)}$– profit received from exploitation of assets reflected in RAB and other type of activities using human recourses employed in regulated activities and from selling retired assets, positive difference between the income from the connection of new customer to the transportation or distribution network of the utility and the expenditures incurred for the connection, funds received from Third Parties for financing operational expenditures of the utility (GEL) in Test Year.

3. In the process of correcting Natural Gas Supply Tariffs the cost correction component of natural gas normative losses does not take part in the formula defined under paragraph 2 of this Article.
4. In the process of correcting natural gas transportation, distribution and pass through tariffs the cost correction component of natural gas purchase by purchasing price does not take part in the formula defined under paragraph 2 of this article.

Article 21

Correction of Operational Expenditures

If operational expenditures actually incurred by utility in Tariff Year differ from amounts of operational expenditures envisaged during tariff setting process (except changes of expenditures caused by difference between actual and planned volumes of natural gas purchase and supply), the Commission ensures correction of utility's RCB according to following formula:

$$cOPEX_{(t+1)} = (aOPEX_{(t-1)} - pOPEX_{(t-1)}) \times (1 + WACC_{(t-1)}) \times (1 + WACC_t) \quad (14),$$

where,

$cOPEX_{(t+1)}$ –corrected amount of operational expenditures for the Tariff Year (GEL)

$aOPEX_{(t-1)}$– actual amount of operational expenditures for theTest Year (GEL);

$pOPEX_{(t-1)}$ – planned amount of operational expenditures for the Test Year (GEL);

$WACC$ – time value of money, which equals to WACC (%).

Article 22
Income Correction Due to Actual Natural Gas Volumes

1. If natural gas volumes actually supplied by a supplier during the Tariff Year differ from volumes envisaged (planned) during relevant tariff setting process, the Commission ensures correction of utility's RCB according to the following formula.

$$cRev_{(t+1)} = [(aG_{(t-1)} - pG_{(t-1)}) \times (T_{(t-1)} - GP_{(t-1)})] \times (1 + WACC_{(t-1)}) \times (1 + WACC_t) \quad (15),$$

Where,

$cRev_{(t+1)}$ – corrected costs of income for the Tariff Year (GEL);

$aG_{(t-1)}$ – actual amount of supplied natural gas for the Test Year (m^3);

$pG_{(t-1)}$ – planned volume of supplied natural gas for the Test Year (m^3);

$T_{(t-1)}$ – natural gas supply tariffs by test year (tetri/cubic meters);

$GP_{(t-1)}$ – planned price of natural gas purchase for the Test Year (tetri/(m^3);

$WACC$ – time value of money, which equals to WACC (%).

2. If natural gas volumes actually delivered through transportation network or actually distributed and passed through via distribution network by transportation or distribution licensee in Tariff Year differ from respective planned amounts, the Commission ensures correction of utility's RCB according to the following formula:

$$cRev_{(t+1)} = [(aG_{(t-1)} - pG_{(t-1)}) \times T_{(t-1)}] \times (1 + WACC_{(t-1)}) \times (1 + WACC_t) \quad (16),$$

Where,

$cRev_{(t+1)}$ – corrected costs of income for the Tariff Year (GEL);

$aG_{(t-1)}$ – actual volumes of natural gas being transported or distributed and passed through for the Test Year (GEL);

$pG_{(t-1)}$ – planned amounts of natural gas being transported or distributed and passed through for the Test Year (GEL);

$T_{(t-1)}$ – natural gas transportation or distribution tariff for the Test Year (GEL);

$WACC$ – time value of money, which equals to WACC (%).

3. Correction mechanism under paragraph 1 of this Article is not considered by the Commission if reduction of actual natural gas volumes being transported or distributed and passed through in relation to planned is caused by utility's fault.

Article 23
Correction of costs of normative loss

1. If the price of natural gas being purchased by transportation or distribution licensee in Tariff Year with the purpose to fill the normative losses differs from the respective planned price, the Commission ensures the correction of costs of natural gas normative loss according to the following formula:

$$cCNL_{(t+1)} = [(aG_{losses(t-1)} \times aP_{averaget-1)}) - (pG_{losses(t-1)} \times pP_{average(t-1)})] \times (1 + WACC_{(t-1)}) \times (1+WACC_t) \quad (17),$$

where:

$cCNL_{(t+1)}$ – corrected costs of natural gas normative losses for the Tariff Year (GEL);

$aG_{losses(t-1)}$ – corrected volumes of natural gas normative losses for the Test Year (m^3);

$pG_{losses(t-1)}$ – planned volumes of natural gas normative losses for the Test Year (m^3);

$aP_{average(t-1)}$ – actual weighted average price of natural gas purchase for the Test Year (tetri/m^3);

$pP_{average(t-1)}$ – planned weighted average price of natural gas purchase for the Test Year (tetri/m^3);

$WACC$ – time value of money, which equals to WACC (%)

2. Corrected volume of natural gas normative losses for the Test Year is calculated according to the following formula:

$$aG_{losses(t-1)} = aG_{(t-1)}/(1-L) - aG_{(t-1)} \quad (18),$$

where,

$aG_{losses(t-1)}$ – corrected volume of natural gas normative losses for the Test Year (m^3);

$aG_{(t-1)}$ – actual volume of natural gas being transported, distributed and passed through for the Test Year (m^3);

L – amounts of normative losses approved by the Commission (%).

Article 24

Correction of Natural Gas Purchase Expenditures According to Purchase Price and Exchange Rate

If actual natural gas purchase price in the Tariff Calculation Year differs from natural gas purchase price envisaged in tariff of the same year, when one of the causes among them is the difference between planned and actual exchange rates, the Commission ensures correction of RCB according to the following formula:

$$cGPC_{(t+1)} = (aGP_t - pGP_t) \times G_t \times (1 + WACC_t) \qquad (19),$$

Where,

$cGPC_{(t+1)}$ – corrected amount of natural gas purchase expenditures for the Tariff Year (GEL);

aGP_t – actual price of natural gas purchase for the Tariff Calculation Year (tetri/m^3);

pGP_t – planned price of natural gas purchase for the Tariff Calculation Year (tetri/m^3);

G_t – planned amounts of natural gas to be purchased for the Tariff Calculation Year (m^3);

$WACC$ – time value of money, which equals to WACC (%)

Chapter V
Tariff Setting and Application Submission Procedures

Article 25
Accounting and Reporting

1. For regulatory purposes the utility is obliged to carry out its accounting and reporting activities on the basis of Unified System of Accounting (USOA) approved by the Commission according to the current legislation.
2. If the utility simultaneously carries out one or more regulated activities and non-regulated activity, it is obliged to separately keep recording for income, expenses and financial results for each regulated activity.
3. Utility shall submit separately the information on cost of fixed assets created with customer's funds pursuant to the terms laid down in this Methodology.

Article 26

Documentation to be Submitted for Setting Tariff

1. For the tariff setting purposes utility is obliged to submit tariff application by Tariff Calculation Year.
2. Templates of tariff application and other data, also the checklist of documentation to be submitted together with application are established under individual administrative act of the Commission.
3. Together with tariff application utility is obliged to provide the following documentation submited and audited in compliance with International Financial Reporting Standards (IFRS):
a) Accounting Balance;
b) Profit and Loss Statement;
c) Cash Flow Statement.
4. The Commission is entitled to request from the utility the submission of additional information that he finds necessary.
5. The applicant is responsible for the accuracy of tariff application and supplemented documentation.

Article 27
Tariff Setting Terms and Procedures

1. The utility is obliged to submit tariff application no later than 150 days before expiration of existing tariff.
2. The Commission examines completeness of tariff application and its compliance with the application template approved by the Commission within 3 days after submitting the application.
3. If tariff application does not comply with the application template approved by the Commission or it is incomplete, the Commission defines term to the applicant in writing to fill in gaps that should not exceed 45 days. Upon request of applicant such term may be prolonged only once and shall not exceed 15 days.
4. In case if the utility does not submit requested information within timeframe defined according to Paragraph 3 of this Article, the Commission decides to leave application unconsidered. Hereby, if the submission of such tariff application was caused by the requirements of the law, the sanctions envisaged in the legislaton may be imposed upon utility.
5. The Commission is entitled to make a relevant decision and review utility's tariffs on its own initiative. In such case conditions of submitting necessary information and documentation by utility are determined under respective decision of the Commission.
6. Upon acceptance of properly submitted application or in cases envisaged under Paragraph 5 of this Article, the Commission decides to commence public administrative proceedings. The respective information is published on Commission's website.
7. In the tariff application review process the Commission applies Public Administrative Proceeding. Respectively, the tariff application and supplemented documentation (except personal information and

information that is considered to be commercial secret by the Commission) are public and shall be available for any person.

8. Every interested party is authorized to get acquainted with publicly available documentation submitted to the Commission and present relevant comments to the Commission.

9. The comments regarding the tariff application shall be submitted in a written form and shall contain justified reasoning. Moreover, in the process of making comments the person is entitled not to disclose its personality. The copy of the comments shall be sent to the applicant and comments are being discussed during public hearings of tariff application.

10. In the process of discussing tariff application, the Commission is entitled to require additional documentation or various types of conclusions from the utility.

11. During tariff application review process the Commission is entitled to organize meetings and/or public hearings regarding such tariff application.

12. Time and venue of the public hearing should be notified to the applicant prior to 7 business days.

Chapter VI
Transitional Provisions

Article 28
Transitional Provisions

1. Components of the Weighted Average Cost of Capital (WACC) are determined as follows:

a) Risk Free Rate(r_{rf}) – 7.50%;

b) Debt Premium (DP) – 3.50%;

c) Market Risk Premium (r_m- r_{rf}) –7.25%;

d) Sectorial Risk Coefficient (β) –1.00

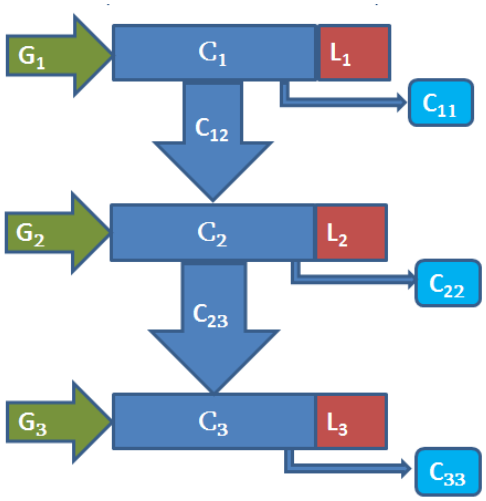
2. The corrections defined in the Chapter IV of this Methodology will be calculated annually and reflected in the tariff of respective year.

3. While determining RAB, the Commission is entitled to take into consideration privatization costs together with relevant privatization conditions of state-owned utility shares carried out before January 1 2015.

Annex "A"

Cost Cascading Method

Cost Cascading (allocation) mechanism of allocating costs of different levels of pressure to the consumers (2nd stage of cost allocation), according to the natural gas consumption by pressure levels:



G_1 –Natural gas volumes received from transportation and/or other distribution licensee's network on the first level ;

G_2 - Natural gas volumes received from transportation and/or other distribution licensee's network on the second level;

G_3 - Natural gas volumes received from transportation and/or other distribution licensee's network on the third level;

L_1 – Total losses on the first level;

L_2 – Total losses on the second level;

L_3 – Total losses on the third level;

C_{11} – Natural gas volumes on the first level delivered to the same level customer (consumption on the first level);

C_{12} – Natural gas volume delivered from the first level to the second one;

$C_1 = C_{11} + C_{12}$, - Total volume of natural gas delivered from the first level ($G_1 - L_1$);

C_{22} – Natural gas volume delivered on the second level to the same level customers (consumption on the second level);

C_{23} – Natural gas volume delivered from the second level to third one;

$C_2 = C_{22} + C_{23}$ - Total volume of natural gas delivered from the second level ($G_2 + C_{12} - L_2$);

C_{33} – Natural gas volume delivered on the third level to the same level customers (consumption on the third level);

$S_{11} = C_{11} / C_1$ - Share of natural gas consumed by the consumers of the first level in total volume of natural gas delivered from this level;

$S_{22} = C_{22} / C_2$ - Share of natural gas consumed by the consumers of the second level in total volume of natural gas delivered from this level;

$S_{33} = C_{33} / C_3$ - Share of natural gas consumed by the consumers of the third level in total volume of natural gas delivered from this level.

Cost cascading (allocation) mechanism is based on natural gas consumption on each pressure level.

$S_1 = S_{11} \times Cost_1$,

For the first level consumers the allocated share of loss value (and other costs) is defined as the first level cost ($Cost_1$) to be allocated to the same level consumers, so S_{11} factor is multiplied by the first level cost.

$S_2 = S_{22} \times Cost_2 + S_{22} \times ((1 - S_{11}) \times Cost_1)$,

For the second level consumers the allocated share of loss value (and other costs) consists of two components:

The first one defines the share of the second level cost ($Cost_2$) to be attributed to the same level consumers, so S_{22} factor is multiplied by the cost allocated to the **second level**.

And the second component determines the **share of the first level cost ($Cost_2$) to be attributed to the second level consumers**. For this purpose, **the residual share of the first level cost** (not attributed to the first level consumers) is taken, from which the part is attributed to the second level that corresponds to the consumed energy share by the second level consumers in the total delivered energy from the same level.

$S_3 = S_{33} \times Cost_3 + S_{33} \times ((1 - S_{22}) \times Cost_2) + S_{33} \times ((1 - S_{22}) \times (1 - S_{11}) \times Cost_1)$,

For the third level consumers the allocated share of loss value (and other costs) consists of three components.

The first one defines the **share of the third level cost (Cost$_3$)** to be attributed to the same level consumers, so S_{33} factor (that equals to 100%) is multiplied by the cost allocated to the **third level**.

The second component determines the **share of the second level cost (Cost$_2$) to be attributed to the third level consumers** and is the residual share of the second level cost (not attributed to the second level consumers), that is totally attributed to the third level **(as S_{33} = 100%).**

And the third component determines the **share of the first level cost (Cost$_1$) to be attributed to the third level consumers.** For this purpose, **the residual share of the first level cost** (not attributed to the first level consumers) is taken, from which the part is attributed to the third level consumer which was not attributed to the second level consumers.

In order to evaluate the total volume of natural gas delivered from each level of pressure (C_1 , C_2 and C_3), one needs to know total losses according to pressure levels (L_1, L_2 და L_3). In case the information about losses contains only total information and allocation of losses according to pressure levels is not available, the Commission ensures allocation of losses according to pressure levels on the basis of available data with the maximum possible approximation.

AnnexN2

Regulated Asset Depreciation/amortization norms for tariff regulated enterprises

1. Following asset depreciation/ amortization norms are used for the regulated utilities' assets being in operation since January 1 2015:

№	Common Assets	Annual norms of depreciation/ amortization (%)	Useful Life (year
1	Transportation facilities	3.33	30
2	Operating buildings	1.82	55
3	Administrative buildings	1.54	65
4	Warehouse Area	5.00	20
5	Furniture and movables	10.00	10
6	Computer and office equipment	20.00	5
7	Instruments/ equipment	10.00	10
8	Light vehicles	12.50	8
9	Heavy vehicles and special equipment	8.33	12
10	Non-tangible assets	20.00	5

	Gas pipelines and related equipment	**Annual norm of depreciation/amortization (%)**	**Useful Life (Year)**
11	Steel gas pipeline (transportation network)	3.33	30
12	Steel gas pipeline (distribution network)	2.86	35
13	Polyethylene gas pipe	2.50	40
14	Gas Flow Metering unit (transportation network)	14.29	7
15	Gas Flow Metering unit (distribution network)	10.00	10
16	Block valves	6.67	15
17	Pressure reduction valves	10.00	10
18	Pressure reduction valves (individual)	14.29	7
19	Metal Box (of metering point or regulating construction)	5.00	20
20	Odorizing Unit	10.00	10
21	Correctors	10.00	10
22	Metering tools and equipment	14.29	7
23	Gas treatment system	10.00	10
24	Cathodic Protection Systems	5.00	20
25	Natural Gas Compressor Station	4.00	25
26	Communication lines and other ancillary equipment	3.33	30