



SOUTHERN GAS NETWORKS plc

Indicative Notice of Proposed Changes to Transportation Charges on 1 October 2008

1. Introduction

The proposed change to gas transportation charges on 1 October 2008 in Southern Gas Networks plc is an increase of 3.5% to apply to the LDZ System Charges and the Customer Charges. The change takes into account the fact that the capacity/commodity split of the LDZ system charges will change from 50:50 to 95:5 with effect from 1 October 2008. The factors contributing to the net change are discussed below.

The change to the capacity/commodity split means significant changes to the levels of the LDZ system charges. To enable Users to compare easily the new indicative charges with the existing charges we are publishing as part of this notice sections **2.2 “LDZ System Charges”** and **2.3 “LDZ Customer Charges”** of the Network Transportation Charges Statement.

2. Change to the LDZ System Charges Capacity/Commodity split

The Capacity/Commodity split of the LDZ system charges for all the DNs is changing from the existing 50:50 to 95:5 with effect from 1 October 2008. The indicative price change is calculated after taking this change into account. The change to 95:5 in itself reduces the amount of revenue which would be collected in the second half of the year compared with the more commodity based 50/50 structure and is therefore in itself equivalent to a price reduction of about 13%.

As part of the change to a 95:5 capacity/commodity split Interruptible supply points will pay 47.4% of the appropriate capacity charge. This is shown in section **2.2 “LDZ System Charges”** of the attachment to this notice.

3. Price Control 2008-2013

The new price control applying to gas distribution networks (GDNs) from 2008/09 to 2012/13 came into effect on 1 April 2008. The predicted total allowed revenue for 2008/09 has increased significantly from the expected allowed revenue for 2007/08.

. The main elements contributing to the price change are:

1. Increase in Core Allowed Revenue due to increases in Operating and Replacement costs taken into account in the Price Control Review.
2. These increases were partially offset by an over-recovery of £5m carried forward from 2007/08 largely due to the fact that transported volumes in 2007/08 were higher than forecast.

4. Forecast Volumes 2008/09

Consistent with the approach adopted last year, for the purposes of setting charges throughput volumes forecast for 2008/09 are reflective of actual volumes in recent years. This more conservative approach produces lower forecast volumes which should reduce the risk of under recovery in any year, although from 1 October 2008 onwards the influence of volumes

on collected revenue will be almost negligible because over 95% of the charges will be capacity based. Volumes already have no effect on the allowed revenue.

5. Uncertainties

At this stage there are still some uncertainties which will probably cause the actual charges which will be notified on 1 August to take effect on 1 October to differ from the indicative charges. The most significant of these are the Mains Replacement Incentive Mechanism for 2007/08, and the shrinkage forecast for 2008/09.

The final mains replacement incentive position for 2007/08 will not be known until July 2008. This, together with the mains and services replacement performance over the next three months and any changes to the forecast performance for the rest of the formula year could affect the Allowed Revenue for 2008/09 and therefore any price change required.

The Allowed Revenue for 2008/09 contains a protection against the price of shrinkage gas. The forecast cost of shrinkage gas is based on prevailing gas prices and as gas prices change the allowance for shrinkage gas will change.

In addition, throughput volumes for 2008/09 are currently forecast for the full 12 months. When the final notice of the charges is given on 1 August four months of actual throughput volumes will be available and this may change the percentage change required if the volumes vary significantly from those forecast.

6. Final Notice of Changes to the Level of Charges

Final notice of the changes to the charges will be given no later than 1 August 2008 in line with the two months' notice of price changes required by the Network Code.