

Indicative Notice of LDZ Transportation Charges for North of England Distribution Network

To Apply from 1 October 2006

1. Introduction

This notice provides indicative levels of the LDZ transportation charges that will apply for the use of the Northern Gas Networks Limited (NGN) network from 1 October 2006, in accordance with the GT Licence requirements in Standard Special Condition A4, to provide 150 days' notice of such proposals.

The definitive notice of new distributions transportation charges from 1 October is expected to be published by 1 August, in line with the two months' notice requirements within the Uniform Network Code.

2. Indicative LDZ Transportation Charges effective from 1 October 2006

The indicative change in distribution transportation charges from 1 October 2006 is a **reduction of 6%**.

There is still uncertainty around the level of change that will be necessary at October and the figures provided are the present estimates. This could move up or down before final changes in charges are published in August.

The reasons for the level of change and the uncertainties surrounding the potential changes are explained in the following sections.

Distribution charges are approximately 15-20% of supply price. Therefore, a 6% decrease in distribution transportation charges is equivalent to about 1% reduction on domestic supply cost.

3. Reasons for Change in the Indicative Charge

Ofgem allows NGN to earn a specified allowed revenue in each year. This can then be adjusted to allow for a small number of variables as described below.

3.1 Prior year adjustments

Ofgem sets allowed revenue from April to March each year. NGN then has to adopt a pricing strategy aiming to minimise any potential over or under recovery of revenue within the year. However prices can only be changed once a year, in October.

In October 2005, prices had to be increased in order to generate sufficient revenues in the second half of the year to achieve our target of no over or under recovery on allowed revenue for 2005/6.

These higher prices remain in force through the first half of the current year, and so we expect to be able to reduce prices in October 2006 to achieve our allowed revenue levels for 2006/07.

3.2 Change in Business Rates

This cost is outside the control of Northern Gas Networks, and so is allowed by Ofgem as a cost pass-through item within the price control allowed revenue.

3.3 Mains Replacement Incentive

The distribution price controls are based upon an assumed level of cost each year for replacing distribution mains. If a different level of mains replacement activity is carried out, or if the activity is carried out more or less efficiently than assumed in the price control, this gives rise to a variation in the allowed revenue. The net position is difficult to forecast accurately as it depends on the length of mains decommissioned for six pipeline diameter bands, and is no longer smoothed across all the networks.

3.4 Breakdown of factors affecting the price change

The table below shows the estimated contribution of each factor to the indicative price change. The “base change” figures refer to the change that would have been indicated without the additional rates and incentive impacts.

The 6% reduction is largely a reversal of the 8.5% price increase last year, which was made to target no over or under recovery on allowed revenue for 2005/6.

	Base Change	Rates increase	Mains Repl. Incentive	Indicative price change
2006/7	(7.7%)	2.5%	(0.8%)	(6.0%)

4. Uncertainties around Indicative Transportation Charges

The introduction of network specific charges last year increased the level of uncertainty around the indicative charges, by removing the smoothing that a national charge provided. The indicative price change may change (up or down) when final transportation charges are published in August. The main causes of potential variation between the final price changes and the indicative figures shown are changes in demand forecasts, actual demand in the current year, and actual mains replacement incentives:

- The price changes depend upon forecasts of the throughput volumes, load factors and customer numbers by sector for the control year. These forecasts will be updated in May 2006 and will be taken into account in determining the definitive level of charges to apply from October.
- If the level of gas demand over the next three months is substantially different from that expected, this will change the forecast position for the price control year.
- The definitive mains replacement incentive position for 2005/6 will not be known until July. This, together with the mains replacement performance over the next three months and any changes to the forecast mains replacement incentive position for the price control year, will affect the allowed price control revenue for 2005/6 and hence the under or over recovery and the price change required in 2006/07.

5. Structure of Distribution Transportation Charges

No change to the structure is proposed this year. However, the result of a recent consultation is that some aspects of the methodology behind the charges will be adjusted in time for the October 2007 price change, in order to improve the future cost reflectivity of charges across customer types.

6. Impact on Gas Supply Prices

The extent to which any transportation charge is passed through to the consumer depends upon the shipper and the gas supplier.

The potential impact on gas supply prices will vary by size of consumer and network. For a typical consumer, distribution transportation costs represent approximately 15-20% of the gas supply price. For example, a 6% decrease in distribution transportation costs is equivalent to about a 1% decrease in the annual gas supply cost for a typical domestic consumer.