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Indicative Gas Transportation Charges from 1 October 2007 for East of England, London, North West and West Midlands Distribution Networks

1. Introduction

This notice provides indicative levels of the gas transportation charges that will apply from 1 October 2007 for East of England, London, North West and West Midlands distribution networks in line with the GT Licence requirement to provide 150 days' notice of such proposals.

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

2. Indicative Distribution Transportation Charges

The indicative level of distribution transportation charges from 1 October 2007 is shown in Table 1 below.

There is still uncertainty around the level of change that will be necessary at October and the figures provided are the present central estimates.

No change to the structure of the charges is proposed. The percentage change for each network would apply uniformly to the standard LDZ system capacity and commodity charges and customer charges. For other charges, including administration charges and the Optional LDZ charge, which are determined on an individual cost-reflective basis, the present level of the charge is the best indication of the October charge; however we expect to review the level of the administration charges prior to October.

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

Table 1. Indicative Changes in LDZ Transportation Charges from 1 October 2007

Distribution Network:	East of England	London	North West	West Midlands
Indicative Change from October 2007	+2.9%	+64.0%	+22.6%	+21.4%

3. Reasons for the Indicative Level of Change by Network

Table 2 below provides a breakdown of the factors behind the level of change for each network. Each of these factors is explained in the following sections.

Table 2. Breakdown of Indicative Changes to LDZ Transportation Charges for October 2007

	East	London	NW	WM
Price Change at October 2006	*12.3%*	*-12.1%*	*19.7%*	*12.2%*
Annual change required to bring charges into line with underlying price control	-3.2%	27.9%	5.1%	2.3%
Mains Replacement Adjustment and other incentives	-0.3%	7.1%	3.5%	6.2%
Under-recovery from 2006/7	5.2%	6.7%	4.3%	3.7%
Total change required on an annual basis	**1.7%**	**41.7%**	**12.9%**	**12.2%**
Uplift factor for October change	*x 1.75*	*x 1.75*	*x 1.75*	*x 1.75*
Total change required - October change	**2.9%**	**73.0%**	**22.6%**	**21.4%**
Indicative October 2007 change	**2.9%**	**64.0%**	**22.6%**	**21.4%**

3.1. Annual change required to bring charges into line with underlying price control

This represents the level of annual change to bring the charges into line with the underlying price control allowed revenue, including cost pass through items. The main factor behind this change is the one year price control determination for Formula Year (FY) 2007/8 which has increased the allowable revenue in every network. Other than for London network, the increase in charges made at October 2006 has meant that the underlying annual change required for FY 2007/8 is well below the level of increase of the core price control allowed revenue, with an underlying charge reduction for East of England network. The level of increase for London network is discussed in section 3.5 below.

3.2. Mains Replacement Adjustment and other Incentives

The distribution price controls are based upon an assumed level of cost each year for replacing distribution mains in each network. Where the gas transporter carries out a different value of mains replacement activity or where the activity is undertaken either more or less efficiently than assumed within the price control, this gives rise, through sharing factors, to a variation in the allowed revenue. National Grid expects the overall value of mains which will be replaced in FY 2007/8 to exceed that assumed within its price controls in aggregate, leading to a positive adjustment to allowed revenue and charge levels.

It should be noted that the definition of the East of England and London networks for price control purposes does not match that used for operational and HSE purposes. Consequently, variations in the precise location of HSE policy related work can result in a shift of work between networks for price control purposes. This is the case for 2007/8 where there is an increase in the volume of work expected to be undertaken in London (price control) network and a corresponding reduction in East of England compared to the original planning assumptions.

There is a small positive adjustment forecast for other incentives, covering the shrinkage and exit incentives, in each network.

3.3. Under-recovery from 2006/7

The exceptionally warm weather experienced in 2006/7 led to throughput levels being much lower than expected. In addition, the underlying (temperature-corrected) levels of demand in each network were below those experienced in the previous year and below the levels assumed at the time of determining the October 2006 charges. Both these factors have contributed to a large under-recovery of collected revenue against allowed revenue in the past year. The under-recovery increases the allowed revenue for 2007/8.

The warm weather in April has led to throughput and income levels in the past month being well below expectations. This impact has also been included within the factor shown for under-recovery from 2006/7.

National Grid, in conjunction with other DNs, has raised proposals for reducing the throughput exposure of the distribution transportation charges from 2008. If these proposals are implemented this will greatly reduce the potential for under- or over-recovery due to variation in throughput levels in the future and so should lead to more stable charging levels from year to year.

3.4. Uplift Factor for October Change

The effects on charge levels highlighted above have been in terms of annual impacts i.e. the level of change required if implemented at April 2007. Under the terms of its Licence, National Grid, along with other DNs, must endeavour to only change charges at October in each year.

A change to charges at October needs to be much greater than that applied at April in order to have the same impact on revenue within the price control Formula Year which runs from April to the following March. Following the recent full capacitisation of the customer charge there is now a more even pattern of revenue through the year, with typically 57% of the Formula Year revenue collected in the six months from October to March. Accordingly, the change to charges at October needs to be around 1.75 times the level of change at April in order to have the same revenue impact within the Formula Year.

3.5. London Impact

A much larger increase is required in London network than for the other networks to bring the level of charges into line with the underlying price control revenue for 2007/8. This is because charges were reduced last year, following an over-recovery at March 2006, leaving charge levels below the underlying level for 2006/7 and far below the underlying level for 2007/8. In conjunction with the other impacts on allowed revenue levels for 2007/8 and the impact of the October implementation, this necessitates a large increase in charges for London network.

National Grid is aware that such a large increase in charge levels at October could lead to ongoing volatility in charge levels. This would depend upon the Price Control Review outcome for 2008/9 onwards, the level of collected income in 2007/8 and performance against regulatory incentive mechanisms.

In order to reduce the volatility of charges for London network, National Grid intends to increase charges for London network at October by less than the maximum possible. The indicative 64% increase in charges is currently forecast to lead to a £10m under-recovery against allowed revenue for FY 2007/8. National Grid would expect to collect this under-recovery in FY 2008/9. This is intended to smooth price volatility between 2007/8 and 2008/9.

Although the London indicative change is a large percentage increase, it is from a low initial level of charges. Even with such an increase, distribution transportation charges in London would be only 6% higher than for West Midlands network.

The table below shows that even with this increase, distribution transportation charges in London would be below those for West Midlands and East of England networks on average over the three years from 2005/6.

Table 3. Typical annual domestic transportation charge

Network	2005/6 Actual (£)	2006/7 Actual (£)	2007/8 Indicative (£)	Average (£)
West Midlands	86.92	97.31	118.13	100.79
East of England	91.88	103.17	106.16	100.40
London	87.54	76.46	125.39	96.46
North West	75.55	90.22	110.61	92.13

4. Uncertainties around Indicative Transportation Charges

There are a number of factors which could lead the definitive charges implemented at October to vary from the indicative figures shown.

The expected changes to charges depend upon forecasts of gas demand, load factors and customer numbers by sector for FY 2007/8. The main update of these forecasts is in May each year and so can be taken into account in determining the definitive level of charges to apply from October. There is considerable uncertainty around these forecasts given the reductions in underlying demand levels experienced in the past year.

If the level of gas demand is substantially different from that expected over the next three months, this will change the forecast over- or under-recovery position for the price control year.

The definitive mains replacement incentive position for 2006/7 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 workload for 2007/8, will affect the estimated allowed price control revenue for 2007/8 and hence the change to charge levels required for each network.

5. Impact on Gas Supply Prices

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

The potential impact on gas supply prices will vary by size of consumer and network. For a typical domestic consumer, distribution transportation costs currently represent approximately 16% of the gas supply price. For example, a 20% increase in distribution transportation costs is equivalent to a 3.2% increase in the annual gas supply cost for a typical domestic consumer, equivalent to around £18 per annum.