

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

## To Apply from 1 October 2007

### 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 2007, 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 2 August, in line with the two months' notice requirements within the Uniform Network Code.

### 2 Indicative LDZ Transportation Charges effective from 1 October 2007

The indicative change in distribution transportation charges from 1 October 2007 is an increase of 27%. 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 27% increase in distribution transportation charges is equivalent to about a 4-5% increase on domestic supply cost.

### 3 Reasons for Change in the Indicative Charge

Ofgem allows NGN to earn a specified allowed revenue in each year. A new one year price control settlement has been agreed with effect from April 2007. This has resulted in a real increase in the core Allowed Revenue of 8.7%, and so prices will need to rise in order to generate this higher level of allowed revenue within the six months to April 2008. This allowed revenue is then adjusted to allow for a 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 2006, prices were decreased in order to generate appropriate revenues in the second half of the year to achieve our target of no over or under recovery on allowed revenue for 2006/07.

These lower prices remained in force through the first half of the current year, and so we expect to increase prices in October 2007 to achieve our higher allowed revenue levels for 2007/08.

#### 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 NTS Pensions payments

NTS has pension liabilities which were retained at sale and are now passed down to all the DNs and are allowed by Ofgem as a cost pass-through item within the price control allowed revenue.

#### 3.4 Shrinkage

The price of gas is outside the control of Northern Gas Networks, and so has been separated from the core Allowed Revenue and allowed by Ofgem as an incentive mechanism within the price control allowed revenue. Northern Gas Networks retains the risk of the volume variability of shrinkage gas.

### 3.5 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 or different mix 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.

### 3.6 Breakdown of factors affecting the price change

The table below shows the estimated contribution of each factor to the indicative price change, reflecting the fact that the price change is required to recover the full change in Allowed Revenue within six months. The "base change" figures refer to the change due to the price control, which would have been indicated without the additional rates and incentive impact.

The 27% increase is largely a result of the outcome of the latest price control, including the additional pass through of NTS pension payments.

	2007/08
Change in basic Allowed Revenue due to new Price Control, including new shrinkage incentive arrangements and inflation	21%
NTS Pension payments	2%
Mains Replacement Incentive	2%
Rates increase	2%
Indicative Price Change	27%

## 4 Uncertainties around Indicative Transportation Charges

The introduction of network specific charges in 2005 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, actual mains replacement incentives and gas prices.

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 before August 2007 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 2006/07 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 2006/07 and hence the under or over recovery and the price change required in 2007/08.

## 5 Structure of Distribution Transportation Charges

On 1<sup>st</sup> April 2007, as a result of a direction from Ofgem, the domestic load band Customer Charge was moved from being commodity based to capacity based in order to make it more cost reflective. It is proposed that further changes be made to the structure of charges, effective from April 2008, and a discussion paper has been published to this effect. As it is still under discussion, the form and timing of these proposed changes is not yet known.

## 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 27% increase in distribution transportation costs is equivalent to about a 4-5% increase in the annual gas supply cost for a typical domestic consumer.