

Scotia Gas Networks plc

Scotland Gas Networks plc and Southern Gas Networks plc

Indicative Notice of Proposed Transportation Charge Changes on 1 October 2007

1. Introduction

The proposed change to gas transportation charges on 1 October 2007 in Scotland Gas Networks plc and Southern Gas Networks plc are increases of 23% and 28% respectively to apply to the LDZ System Charges and the Customer Charges. These are significant increases compared to the last 2 years. The reasons for these percentage increases are detailed below.

2. One Year Price Control

The price control that applied to gas distribution networks (GDNs) in 2006/07 expired on 31 March 2007. The gas distribution price control review reset the revenue allowances that apply to the GDNs for one year from 1 April 2007 with an average increase in Allowed Revenue of 11.5%. The revenue increases for Scotland Gas Networks plc and Southern Gas Networks plc published by Ofgem are 12.9% and 13% respectively. These percentage increases are based on constant prices and therefore there is a further increase on the percentages above, due to inflation, forecast at 3%.

3. Under Recovery 2006/07

2006/07 was a very warm year when compared to seasonal normal temperatures. The warm weather resulted in actual throughput volumes being significantly lower than forecast volumes for the formula year.

Under the charging structure in place in 2006/07, typically around 65% of Network billed revenue was sensitive to changes in throughput volume, compared with 35% of Allowed Revenue under the price control formula for 2006/07. Therefore, the lower volumes caused a larger fall in billed revenue than in Allowed Revenue, resulting in a significant under recovery in both Networks.

For 2007/08 changes in the GDNs' charging methodology, introduced on 1 April 2007, mean that only around 35% of the Network billed revenue is now sensitive to changes in throughput. This should help to reduce under/over recovery due to a movement in throughput volumes away from those forecast.

In the Southern Gas Network plc reconciliation invoices, associated with the Farningham offtake metering error, issued in December 2006 resulted in an additional £6.4m in billed revenue, reducing the under recovery for 2006/07. The Mains Replacement Expenditure Adjustment forecast has reduced by £2.5m since setting the October 2006 charges, again reducing the under recovery in that Network.

4. Forecast Volumes 2007/08

The trend over the last few years has been for temperatures to be higher than the 17 year Seasonal Normal Temperature (SNT). So far this formula year, most days have recorded temperatures above SNT and it is looking very likely that it will be the warmest April on record for many places in the UK. Seasonal forecasts from the Met Office indicate that this summer is likely to be warmer than average. Therefore, for the purposes of setting charges, throughput volumes forecast for 2007/08 are more reflective of actual volumes in recent years. The lower forecast volumes for 2007/08 contribute to the rate increase required in October 2007 but reduce the risk of under recovery in the current year.

5. Non Fixed Elements

At this stage there are still uncertainties which may cause the actual price increase to differ from the indicative increases. The most significant of these are the Mains Replacement Incentive Mechanism for 2006/07, and the shrinkage forecast for 2007/08.

The final mains replacement incentive position for 2006/07 will not be known until July 2007. This, together with the mains 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 2007/08 and any price change required.

The Allowed Revenue for 2007/08 contains the pass through element of the cost of shrinkage gas. The forecast cost of shrinkage gas is based on prevailing gas prices and forecast gas volumes. As gas prices and volumes change the cost of shrinkage gas will also change

In addition, throughput volumes for 2007/08 are currently forecast for the full 12 months. At the time of finalising the changes in charges required, four months of actual throughput volumes will be available and will reduce or increase the percentage change required to some degree if the volumes vary from those forecast.

6. Final Notice of Changes to the Level of Charges

Notice of the final changes to the level of charges will be given no later than 1 August 2007 in line with the two months' notice of price changes required by the Network Code.