Issued 31st October 2008

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

To Apply from 1 April 2009

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 April 2009, 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 distribution transportation charges from 1 April is expected to be published by 31 January, in line with the 60 days' notice requirements within the Uniform Network Code.

2 Indicative LDZ Transportation Charges effective from 1 April 2009

The indicative change in distribution transportation charges from 1 April 2009 is an increase of 4.6%.

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

Ofgem sets allowed revenue from April to March each year. NGN then has to set charges aiming to minimise any potential over or under recovery of revenue within the year. Usually prices can only be changed once a year. As of 2009, the timing of this change has been altered from October to April and so on this occasion the price change occurs after a period of 6 months. However the following price change is expected to be in April 2010.

Consultation Paper DNPC04 (www.gasgovernance.com/industryinfo/TransportationCharges/Consultations/) proposes a rebalancing of the revenue recovery between LDZ System charges and Customer charges on a network specific basis, from April 2009. If this were to be introduced then the overall price change would be the same but the individual unit rates would incur different price changes. The equivalent unit rates that would be charged are shown in the appendix to this notice.

Distribution charges are approximately 15-20% of domestic supply prices. Therefore, a 4.6% increase in distribution transportation charges is equivalent to about a 0.5-1.0% increase on domestic supply cost. The extent to which any transportation charge is passed through to the consumer depends upon the shipper and the gas supplier.

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

3 Reasons for Change in the Indicative Charge

Ofgem allows NGN to earn a specified Allowed Revenue in each year. A new five year price control settlement was agreed with effect from April 2008. This includes an increase in the core Allowed Revenue of 10.3% including inflation, for the year April 2009 - March 2010 relative to the previous year, and so, all other things being equal, April unit prices would need to rise in order to generate this higher level of allowed revenue. However the final level of unit prices must then be adjusted to allow for a number of variables as described below.

3.1 Prior year adjustments

In October 2008, prices were restructured in line with a direction from Ofgem such that the proportion of LDZ Use of System charges allocated between commodity and capacity charges changed to 5% commodity based and 95% capacity based. This was in order to make distribution charges more cost reflective. In addition, interruptible customers began to incur a capacity charge at a rate of 47.4% of the equivalent firm charges. This maintained their discount relative to a similar firm customer of 50% of LDZ Use of System charges, until the new interruption regime begins in 2011.

These restructured charges were then set at a level to generate sufficient revenues to achieve our target of no over or under recovery on Allowed Revenue for 2008/09.

Key drivers of capacity charges are Load Factors and the outcome of the annual AQ review process. AQs are adjusted in October but charges must be set before the impacts of these adjustments are known. The actual impact is less than NGN had forecast, resulting in higher than forecast revenues. However Allowed Revenue is also higher than previously forecast and so there is no significant over or under recovery from 2008/09 to bring forward into 2009/10.

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.

3.5 Mains and Services Replacement Incentive

The distribution price controls are based upon an assumed cost each year for replacing distribution mains and service pipes. If a 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.

3.6 New adjustment items for the current price control

Four new incentives were introduced in the current price control. They are the Environmental Emissions Incentive, the Discretionary Reward Scheme, the Innovation Funding Incentive and the Loss of Meterwork Revenue Driver.

- The Environmental Emissions Incentive promotes reductions in methane emissions.
- The Discretionary Reward Scheme has a two year time lag and so will not come into force until 2010/11. It enables Ofgem to recognise projects relating to reducing environmental impacts, benefiting fuel poor customers or improving gas safety awareness.
- The Innovation Funding Incentive for sustainable development promotes investment in Research and Development.
- The Loss of Meterwork Revenue Driver reflects the impact of stranded costs within emergency service provision from any loss of meterwork contracts.

4 Uncertainties around Indicative Transportation Charges

The indicative price change may change (up or down) when final transportation charges are published at the end of January. The main causes of potential variation between the final price changes and the indicative figures shown are changes in nominated capacities, gas prices, actual mains replacement and other incentives.

- Prices depend on the outcome of the October AQ review process. In January the October 2008 levels will be known but the outcome for the 6 months from October 2009 will have to be estimated.
- The definitive mains replacement incentive position for 2008/09 will not be known until July 2009. This, together with any changes to the forecast mains replacement incentive position for the subsequent price control year, will affect the allowed price control revenue for 2008/09 and hence the under or over recovery and the price change required in 2009/10.
- Changes in gas prices will impact the shrinkage allowance.
- The revenue recovery levels also depend upon several other forecasts such as the number and mix of consumers. These forecasts will be updated before January 31 2009 and will be taken into account in determining the definitive level of charges to apply from April.

APPENDIX

Consultation Paper DNPC04 http://www.gasgovernance.com/industryinfo/TransportationCharges/Consultations/ proposes a rebalancing of the revenue recovery between LDZ System charges and Customer charges on a network specific basis, from April 2009. If this were to be introduced then the overall price change would still be 4.6% but individual consumers may experience charges that are slightly higher or lower. The equivalent unit rates that would be charged are shown below.

Estimated Unit charges if network specific LDZ System charge and Customer charge revenue recovery splits are introduced.

Overall Unit charges are expected to increase by 4.6% from their current levels.

A consultation paper was published in early October, regarding rebalancing the relative levels of Customer and System charges to be more cost reflective. As this rebalancing is primarily from one capacity charge to another, the overall price change would still be 4.6% but this would vary for individual customers depending on the relative value of their Customer and System charges.

If Customer charges were rebalanced to 28.3% of total charges, and overall charges were to increase by 4.6% this would generate the unit rates shown below. Please note that if this rebalancing does not take place then the indicative view of the System and LDZ unit rates would be the current published rates effective 1 October 2008, increased by 4.6%.

Directly connected supply points

	Capacity	**Commodity**
	pence per peak day kWh per day	**pence per kWh**
Up to 73,200 kWh per annum	0.1354	0.0212
73,200 to 732,000 kWh per annum	0.1253	0.0196
732,000 kWh per annum and above	0.5950 x SOQ ^ -0.1806	0.1219 x SOQ ^ -0.2121
Interruptible customers 732,000 kWh per annum and above	0.2819 x SOQ ^ -0.1806	

Connected Systems

	Capacity	**Commodity**
	pence per peak day kWh per day	**pence per kWh**
Up to 73,200 kWh per annum	0.1354	0.0212
73,200 to 732,000 kWh per annum	0.1253	0.0196
732,000 kWh per annum and above	0.6293 x SOQ ^ -0.1939	0.1163 x SOQ ^ -0.2131
Interruptible customers 732,000 kWh per annum and above	0.2981 x SOQ ^ -0.1939	

LDZ Customer Capacity charges

	Capacity
	pence per peak day kWh per day
Up to 73,200 kWh per annum	0.0739
73,200 to 732,000 kWh per annum	0.0026
732,000 kWh per annum and above	0.0564 x SOQ ^ -0.2100

LDZ Customer Fixed charges - 73,200 to 732,000 kWh per annum only

	Fixed
	pence per day
Non-monthly read supply points	23.2671
Monthly read supply points	24.7742