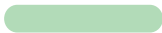


R110-GD1

Business Plan Summary





Contents

NGN is the UK's frontier gas distribution network and has a significant contribution to make to the UK's energy future.

NGN continues to listen to its stakeholders to deliver value for money from a safe, reliable, customer and environmentally focused network.

This business plan delivers the most all-round efficient financial package and represents the most appropriate balance of short and long term impacts on customers' bills, investors and providers of finance.

NGN's innovation strategy, based on its industry-leading Total Cost of Ownership approach to replacement, capital and operating expenditure, is driving further improvements in safety, efficiency and meeting environmental challenges.

NGN continues to work with stakeholders to build on its frontier position to ensure that customers continue to get more value: safely, efficiently and sustainably.



Northern Gas Networks is the licensed gas transporter for the North of England

NGN is responsible for the safe and efficient delivery of gas to homes and businesses in West, East and North Yorkshire, the North East and northern Cumbria

NGN's network:

- Consists of 37,000km of pipeline
- Covers 25,000km²
- Serves 2.6m customers

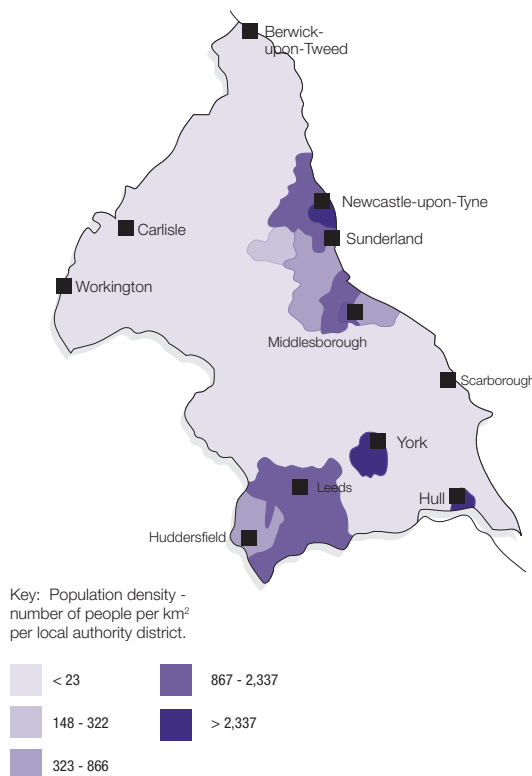
50% of NGN's customers are located in two large conurbations.

The remainder live in sparsely populated rural areas taking in four national parks.

The network transports approximately 82,000 GWh of energy annually.

NGN is a significant regional employer with a highly skilled workforce of more than 1,200 staff and 800 contractors.

Invests over £120m annually in the infrastructure of the region.



A corporate vision was introduced in 2005, reflecting the primary objectives of the business: safely, efficiently and sustainably delivering a secure supply of gas to NGN's customers.

To be benchmarked by Ofgem and the HSE consistently in the top two comparable utilities for safety, efficiency and customer service.

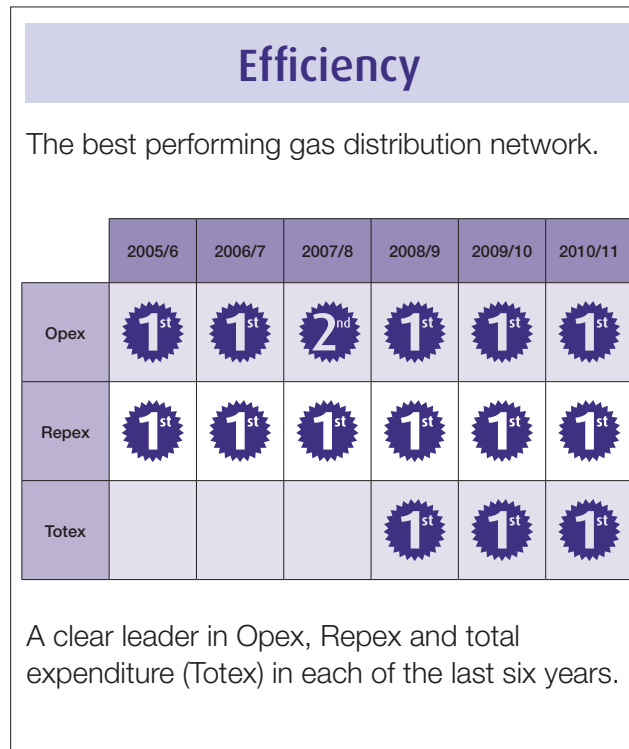
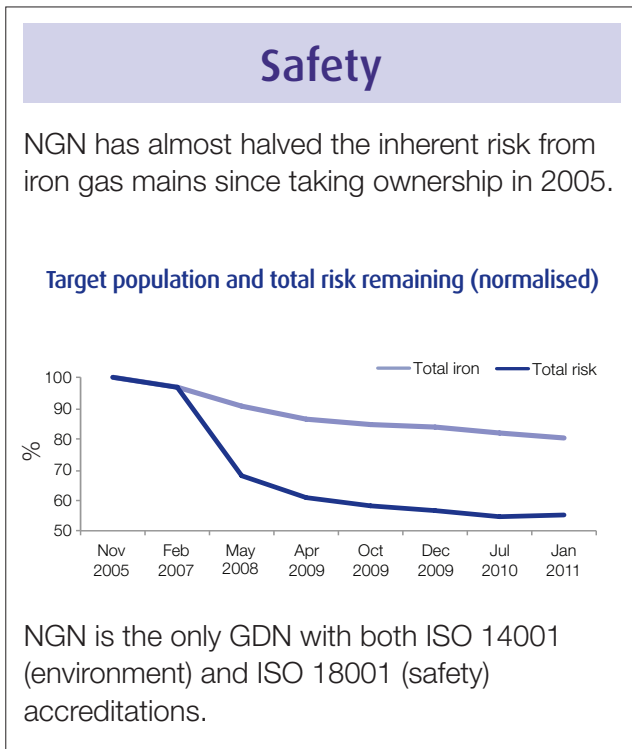
NGN's corporate vision is supported directly by its business values which reflect the way its employees deliver their roles and activities. The consistent demonstration of these values in day to day business activities has helped build a culture that drives sustainable business performance.

The vision is based firmly within the scope of NGN's role as a monopoly utility service provider, and has provided a robust basis against which NGN has successfully addressed the challenges faced since June 2005.

The vision remains appropriate as NGN adapts to the additional challenges that a changing energy market will present as the UK moves towards a low carbon economy

NGN is the UK's frontier gas distribution network

Since 2005, NGN's vision has been to be benchmarked consistently by Ofgem and the HSE, in the top two comparable utilities in safety, efficiency and customer service. This vision is being achieved.



This unrivalled performance is underpinned by excellent levels of network asset reliability



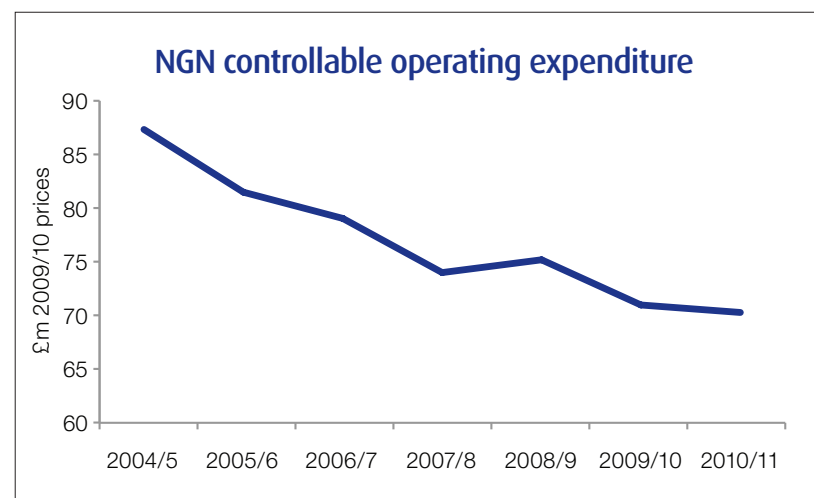
NGN has already delivered its 'demerger dividend' commitment to customers

It was predicted that the sale of the gas networks by National Grid in 2005 would result in significant reductions in controllable operating expenditure over two regulatory periods through new ownership and comparative competition, referred to as the 'demerger dividend'.

NGN has delivered this benefit in just one regulatory period, through driving consistent year on year efficiencies whilst improving customer service and safety.

This represents early delivery of the full 'demerger dividend' as the benefit to customers of network sale.

Customers benefit from lower transportation charges from the beginning of RII0-GD1 rather than waiting until RII0-GD2 for the full benefit of demerger.



Industry-leading 18% real reduction in controllable operating expenditure since 2005

Benefit has been delivered 10 years early, creating significant long term value for customers



NGN has maintained its frontier position despite significant cost pressures

Loss of the National Grid Metering contracts

- NGN lost the majority of its metering work having been unsuccessful in the 2008 tenders.
- This resulted in a stranded resource cost in the regulated business of c.£10m annually.
- NGN took the decision it was better for its customers to reduce the stranded costs and, wherever possible, to address this issue immediately.
- NGN has managed this stranded cost down as much as possible, however still faces c.£4m of recurring annual costs.
- No other GDN has faced this cost pressure in GDPCR1 and this should be reflected in Ofgem's benchmarking and setting of allowances going forward.

There are several regional factors which NGN faces while maintaining its frontier position

- Work on mains and services in the West Yorkshire conurbation is impacted by a unique combination of physical factors impacting c.£3m p.a. These are:
 - Underlying limestone bedrock, a feature of the Pennines, making excavation significantly more difficult than in other areas of the country.
 - Many services are on a “double rail design” peculiar to the West Yorkshire districts.
- NGN is also impacted by an unique combination of sparsity and urbanity.
 - The NGN region has two of the UK's top six conurbations yet 97% of NGN's region has the lowest population density outside Scotland and contains four national parks.
 - Requires maintaining higher resource levels and number of depots to service these areas - equivalent to a further c.£4m p.a. operating cost impact.

These regional and stranded costs must be reflected in benchmarking and cost allowances



NGN recognises that it has a significant contribution to make to the UK's long term energy future

Gas will continue to play a long term role in the UK's energy mix

- The Energy Networks Association Gas Futures Group undertook a long-range scenario-based modelling study of the future utilisation of gas to 2050 which considered four key scenarios - all of which achieved the UK Government's 2050 environmental commitments.
- Gas and the associated distribution and transmission networks have a significant role to play in three of the four scenarios both in transition to and as a key component of the future low carbon energy mix.
- The study illustrated that gas will remain a cost-effective solution for a low-carbon transition, and could represent a total cost saving of more than £700bn compared to alternative scenarios.

This business plan maintains network capability to meet future challenges

- The pathway to 2050 and the policy options required to deliver these commitments are uncertain at this stage. However, it is clear that gas and the distribution networks will have a significant role to play in that journey.
- This business plan ensures that the capability of NGN's network is maintained during RII0-GD1 and begins to adapt to the future challenges that a low carbon economy will bring.
- NGN's plan is predicated on this and delivers:
 - £1.2bn investment in the network;
 - maintains NGN's skilled workforce;
 - support and investment in innovation; and
 - maintains network reliability.

It is in the UK's interest to maintain strong and efficient gas distribution networks



NGN continues to listen to its stakeholders to deliver value for money from a safe, reliable, customer and environmentally focused network.



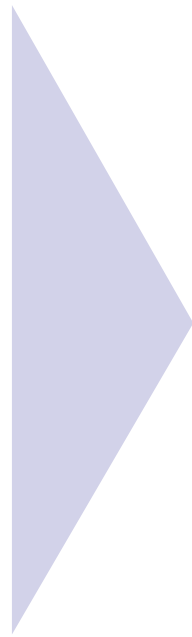
NGN listens to its stakeholders and its engagement strategy is highly effective

NGN has engaged with 1,700 individual stakeholders and groups to ask them what they need, value and want. NGN will continue this critical engagement as part of our on-going business operations.

Stakeholder Engagement Approach

- Customers
- Members of the public
- Highway authorities
- Local authorities
- Pressure groups
- Business groups
- Charities and support groups
- Gas shippers
- Consumer groups
- MPs

NGN has listened to its stakeholders in meetings (focus groups, one to one and customer panels) as well as through specific phone calls and on-line technology.



Stakeholders have given us clear messages

Stakeholders want NGN to deliver a safe, reliable and environmentally focused gas distribution network which delivers value for money.

These requirements have directly impacted NGN's business plan for RIIO-GD1 including reducing the overall cost.

We will continue to listen to the views of stakeholders and adapt as a business to meet their requirements.

Customers want NGN to run a safe, reliable and environmentally-focused network which continues to deliver value for money



NGN will meet its output commitments and prioritise spend to deliver what stakeholders want

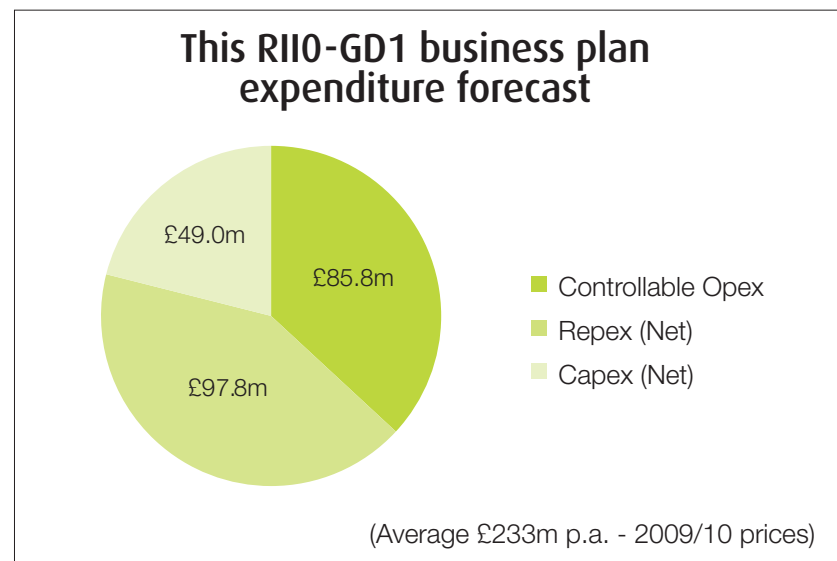
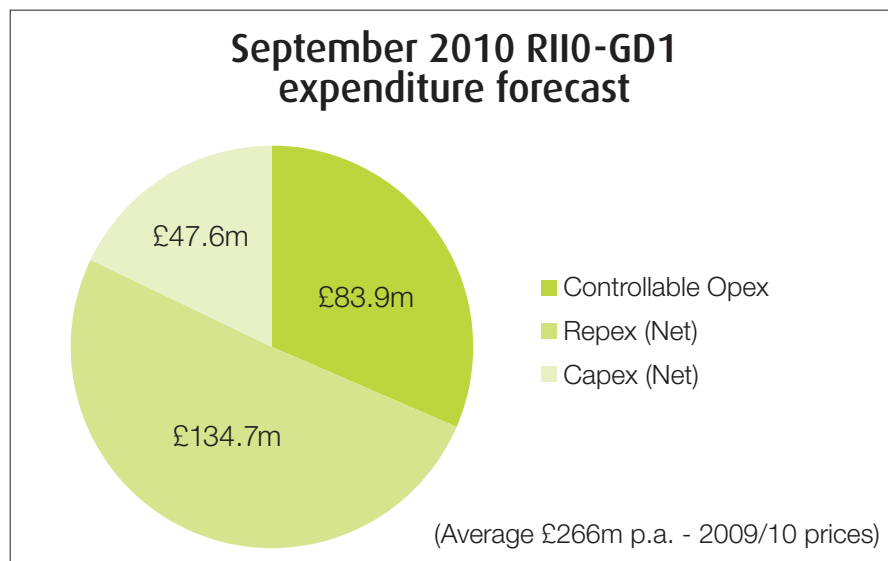
- NGN's business plan commits to improve current performance in 35 key output measures and maintain high levels of performance in a further 21 targeted areas.
- NGN is committed to six additional voluntary output measures identified as important by NGN's extensive stakeholder engagement.

Output area						
Category	Customer Service	Environment	Social Obligations	Safety	Reliability	Connections
Ofgem measures (no.)	8	7	3	16	11	11
What stakeholders want more of	▲	▲	▲	↔	↔	↔
NGN's focus in RIIO-GD1	<ul style="list-style-type: none"> • Maintain commitment to a top two position in GPCR1 and across RIIO-GD1. • Reduce complaints by c.40% and improve customer satisfaction scores annually. 	<ul style="list-style-type: none"> • Reduce carbon footprint by 500,000 tonnes. • Facilitate bio-methane connections. • Maintain use of recycled aggregate at 80%. 	<ul style="list-style-type: none"> • Connect 6,500 more fuel poor customers. • Enhanced carbon monoxide awareness and testing. 	<ul style="list-style-type: none"> • Maintain a leading position. • Reduce risk by iron mains replacement. • Adopt a zero tolerance to employee and public safety incidents. 	<ul style="list-style-type: none"> • Minimise customer interruptions. • Target and measure asset health improvements. • Invest efficiently. 	<ul style="list-style-type: none"> • Maintain a reliable customer connections service. • Connect low carbon gas.

NGN is committed to delivering and maintaining high levels of performance



In response to stakeholder feedback NGN has reduced its forecast expenditure in RII0-GD1



- Current plans represent a reduction of c.£33m p.a. on a like for like basis (c.£264m in total over RII0-GD1) when compared to the previously submitted September 2010 forecasts (on a consistent basis) whilst still delivering improvements in safety, efficiency, customer service and environmental performance.
- This has been achieved by assessing NGN's expenditure using a more holistic risk-based approach and identifying the key trade-offs between expenditure categories and the delivery of outputs largely enabled by the changes to the Repex proposals.

NGN has responded to stakeholders' demand for value for money by providing significantly more value for a penny a day increase in gas bills on a like for like basis



This business plan delivers the most all-round efficient financial package and represents the most appropriate balance of short and long term impacts on customers' bills, investors and providers of finance.



NGN's required financial package balances critical financeability factors and the impact on customers' bills

The proposed financial package represents an appropriate balance between the short and long term impact upon customers and the providers of finance. The package is effectively measured against four key assessment criteria

Evaluation criteria		NGN's response
1	Impact on customers' bills	Transitional arrangements over 12 years insulates customers' exposure to significant future volatility in bills driven by growth in the RAV as a result of the capitalisation of Repex.
2	Long term market confidence to attract investment	A package of transitional arrangements and cost of equity that continues to support the stable regulatory framework essential to attract the significant investment required in UK energy networks over the longer term.
3	Ability to finance RIIO-GD1 investment	A financial package that delivers equity and credit metrics that are commensurate with NGN maintaining its strong investment grade ratings.
4	Appropriate balance of risk and reward between customers and shareholders	Shareholders continue to share the burden of risk with customers over the RIIO-GD1 period. This is being delivered with an overall lower cost of capital.

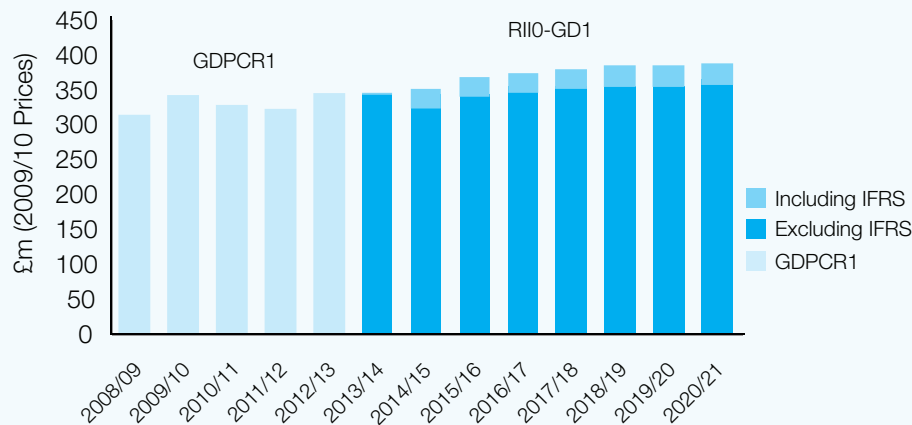
This package delivers an acceptable balance of risk/reward between customers and investors



NGN's allowed revenue requirement for RII0-GD1 is £2.7bn excluding IFRS

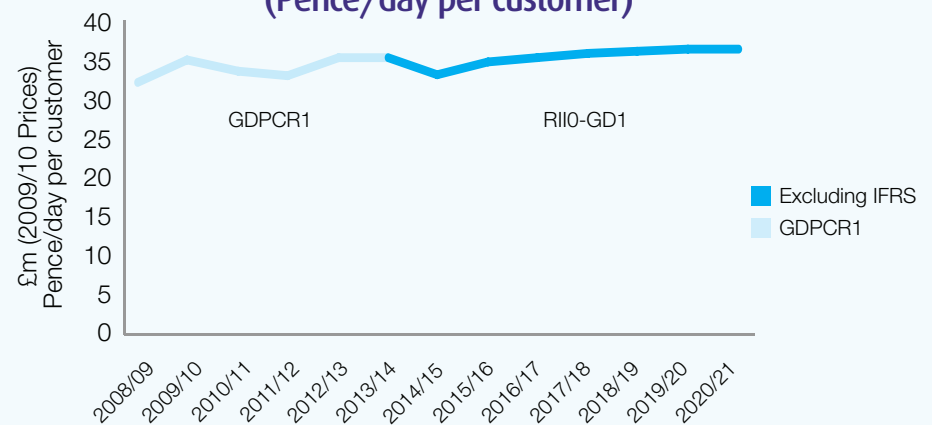
Average revenue of £342m p.a.
– broadly in line with GDPCR1

NGN's annual allowed revenue



...or an increased cost to customers
of a penny a day on a like for like basis

NGN annual allowed revenue - Excluding IFRS
(Pence/day per customer)

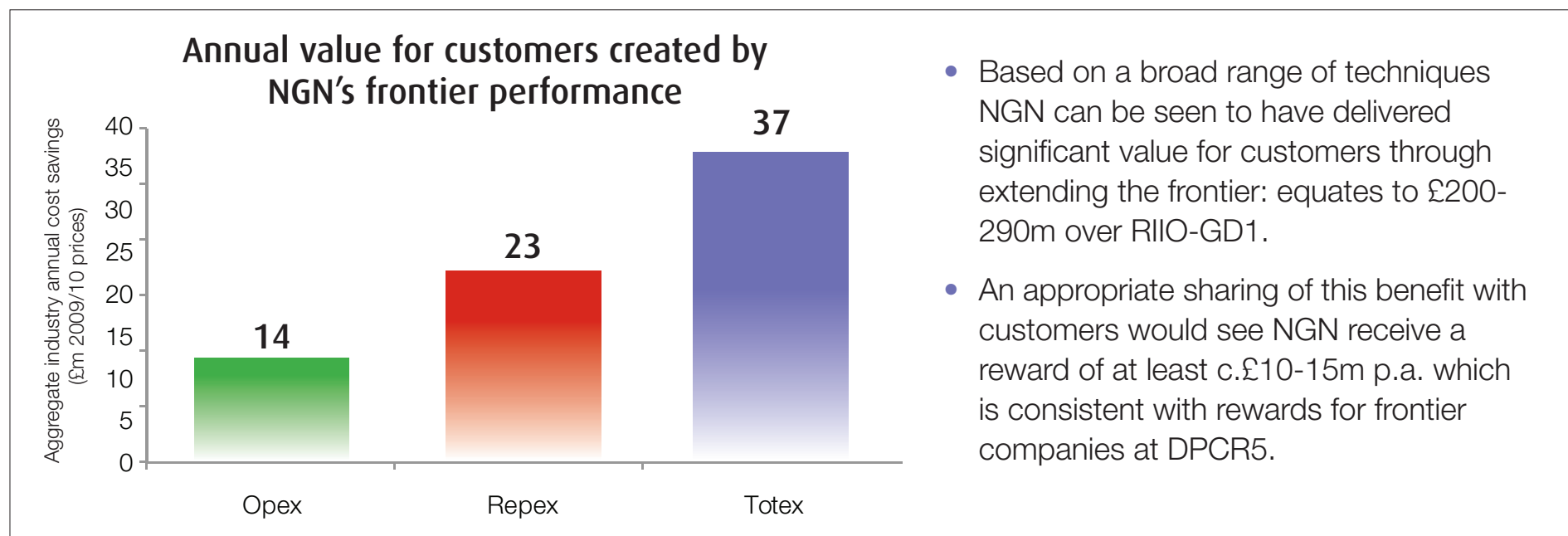


On a like for like basis customers will get significantly more value for a penny a day increase in gas bills



NGN's frontier levels of efficiency have created significant value for customers nationally

- Rewards for frontier performance maintain the correct incentive framework both within and across regulatory periods.
- NGN's performance has pushed less efficient companies towards the efficiency frontier and created enormous value for UK gas customers.



NGN should be rewarded for delivering significant value for customers



This plan delivers the most all round efficient financial package

NGN's financial package contains a balanced set of parameters.

Parameter	Base line assumption
Notional gearing	62.5%
Cost of equity	7.2%
Cost of debt (average)	2.8%
Vanilla WACC (average over RIIO-GD1)	4.46%
Asset lives	45 years
Depreciation profile	Sum of digits
Notional equity return	5% on equity RAV
Transition arrangements	Average c7.5% p.a. adjustment to Fast:Slow money split

NGN's business plan is compliant with the RIIO-GD1 financial principles.

The proposed transitional arrangements for Repex are spread over 12 years to minimise the impact on customers and the cost of finance.

The transitional arrangement will allow NGN to:

- maintain its investment grade credit ratings;
- raise the necessary additional finance to deliver planned investment during RIIO-GD1;
- reduce the volatility in customers' bills between regulatory periods; and
- deliver this within an overall lower cost of capital.

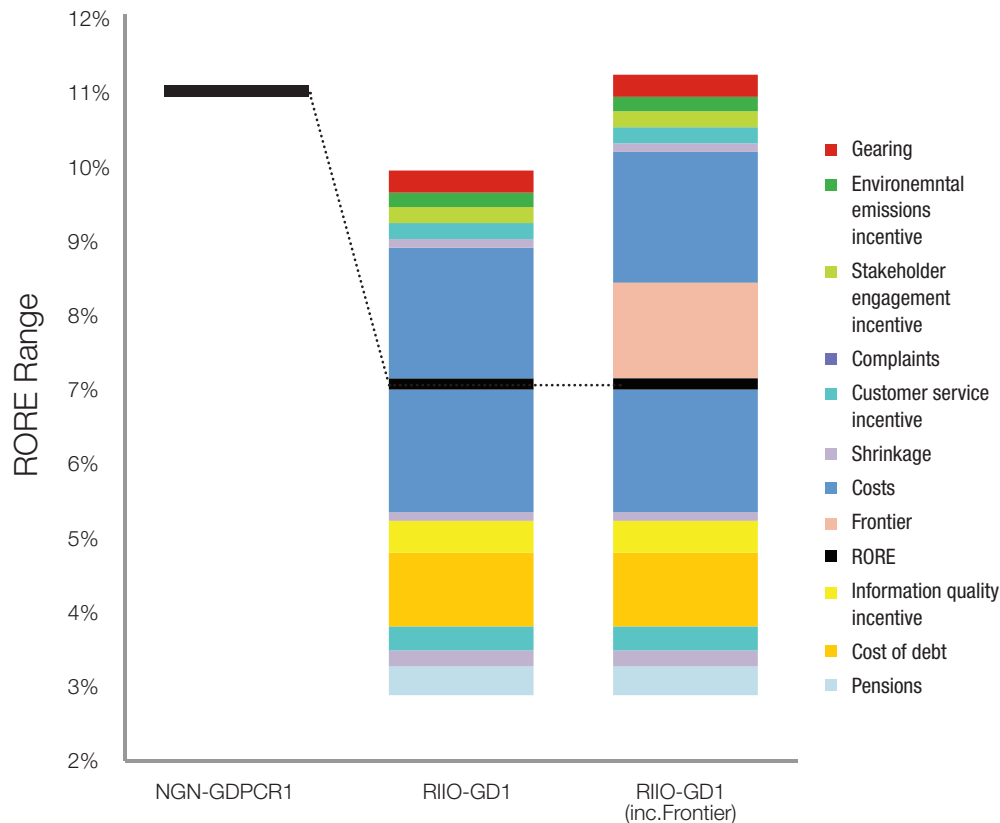
Without the transitional arrangements there are several significant implications:

- deferring revenue which is effectively 'mortgaging' future customers bills;
- deterioration of credit ratings, reducing NGN's ability to raise finance;
- investors in UK energy networks will look for greater returns to compensate for the additional risk of delayed cash flows; and
- sends an adverse message to investors that Ofgem are unwilling to reward frontier companies.

This plan delivers an equitable balance of risk and reward



NGN, as a frontier company, should have the opportunity to earn higher returns



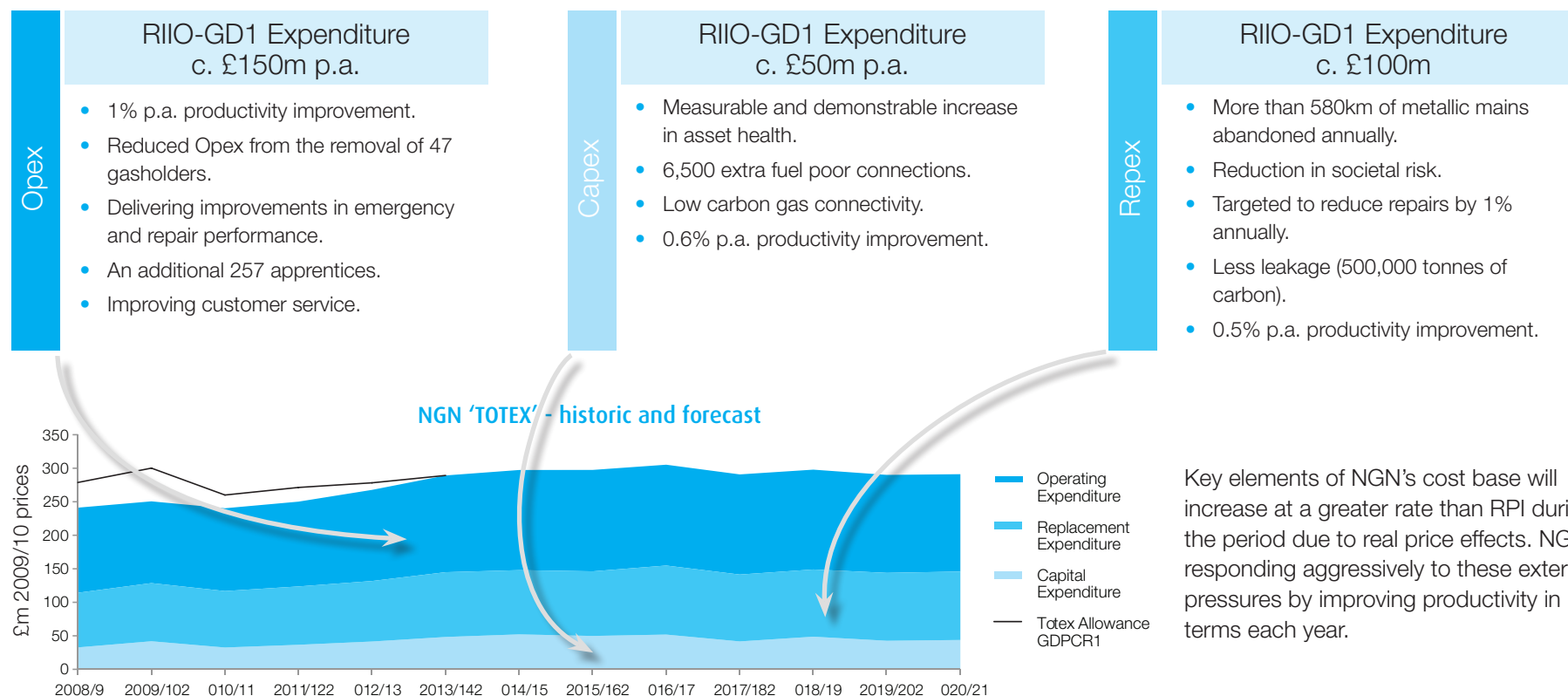
- NGN's proposed financial package with transitional arrangements represents an appropriate balance between:
 - the level of notional gearing;
 - the level of cash flow risk; and
 - the ability of NGN as a frontier company to earn strong returns.
- With a cost of equity of 7.2% and notional gearing of 62.5% this represents a RORE range of 3.1-10%. At the maximum this is well below NGN's GDPCR1 level, even if NGN assume exceptional performance and additional gearing.
- A frontier reward consistent with the DPCR5 approach of at least £10m p.a. is included in NGN's plan and drives it to maintain the strong incentive for efficiency within the RIIO framework.
- Combined this represents a RORE range from 3.1-11.3%, a level NGN feels is an appropriate risk-reward framework associated with being a frontier company.
- This approach is wholly consistent with regulatory precedent and the core incentive principles of RIIO and should be reflected in NGN's final allowances.

NGN's plan represents an appropriate level of return for being the most efficient operator and balances upside potential with downside risks



The overall levels of required Totex are consistent with allowances received in GDPCR1

NGN will spend a total of £2.4bn in RIIO-GD1, investing £1.2bn in the network and a further £1.2bn in continuing to operate an efficient, safe and reliable network. All underpinned by extensive investment in new apprentices to ensure NGN maintains the necessary skills.



Key elements of NGN's cost base will increase at a greater rate than RPI during the period due to real price effects. NGN is responding aggressively to these external pressures by improving productivity in real terms each year.

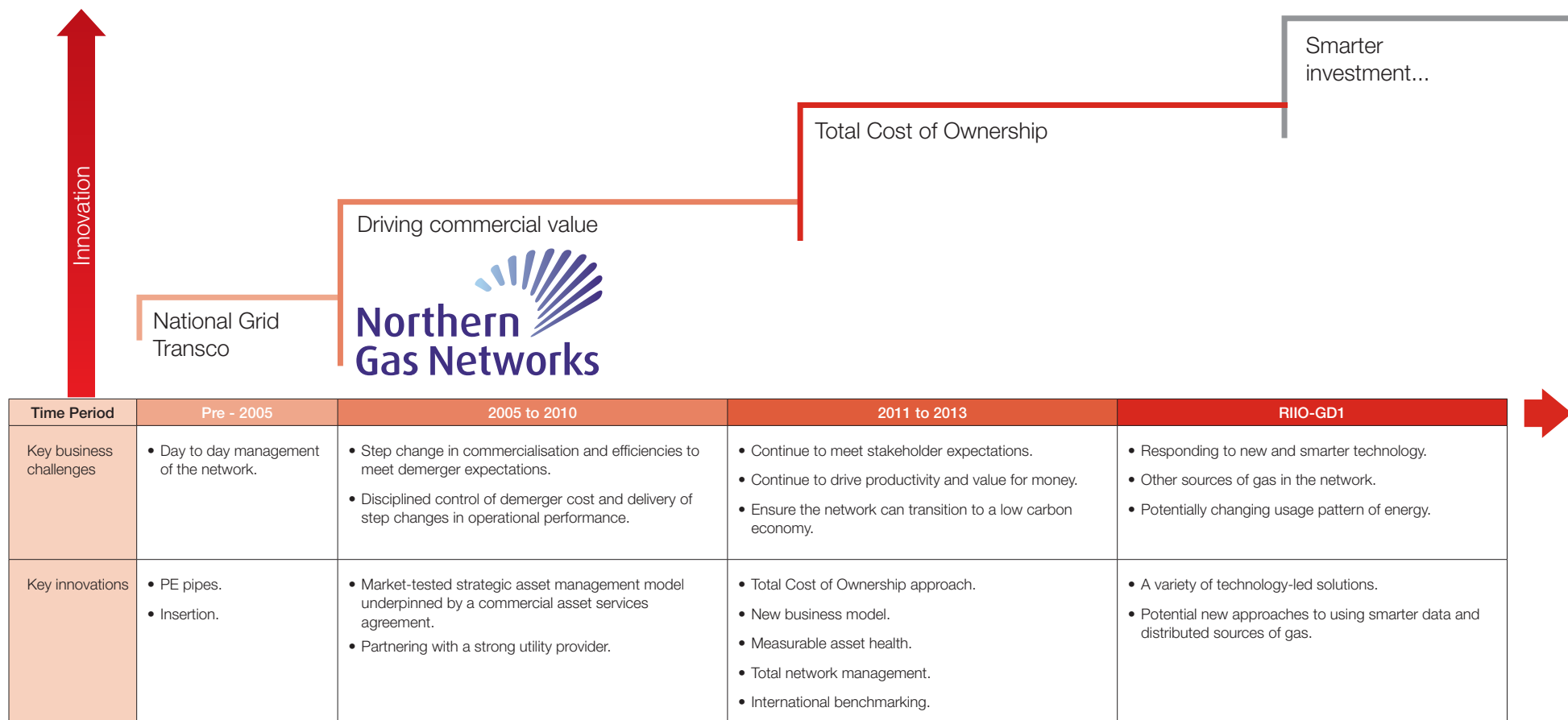
Delivering £1.2bn of investment and importantly investing in the economy of the North of England



NGN's innovation strategy, based on its industry-leading Total Cost of Ownership approach to replacement, capital and operating expenditure, is driving further improvements in safety, efficiency and meeting environmental challenges.



NGN has a significant track record of innovation, particularly in developing its business model



NGN will continue to innovate to deliver customer benefit



NGN's expenditure programme is driven by stakeholder and safety needs and requires a new approach: Total Cost of Ownership (TCO)

The challenges of the future require a new approach to management and operation of network assets.

- This innovative approach drives informed decisions in the most efficient way to deliver the required outputs for customers and other stakeholders.
- Detailed geographic and asset performance data coupled with greater flexibility on mains Repex enables investment to be targeted at the worst performing assets.

The TCO approach is at the heart of our innovation strategy and has four main building blocks.

NGN's innovation strategy = TCO		NGN's approach
Integrated business model	Fully integrated business model that allows functions to work together.	TCO delivers an holistic approach to asset stewardship which is required to meet increasingly complex challenges and cost - pressures over the next decade. In particular the business has to deliver: <ul style="list-style-type: none"> • a reduction in safety risks; • fewer gas leaks and supply interruptions; • better customer service; • less impact on the environment; • improved sustainability; • improved asset health; • further operating cost efficiencies; and • investment in processes, skills and workforce renewal.
Total Network Management	A deeper approach to asset management using health indices.	
Innovation investment programme	Detailed innovation plans including new ways of working, new technologies and new processes.	
Benchmarking	An understanding of best practice internationally and in other industries.	

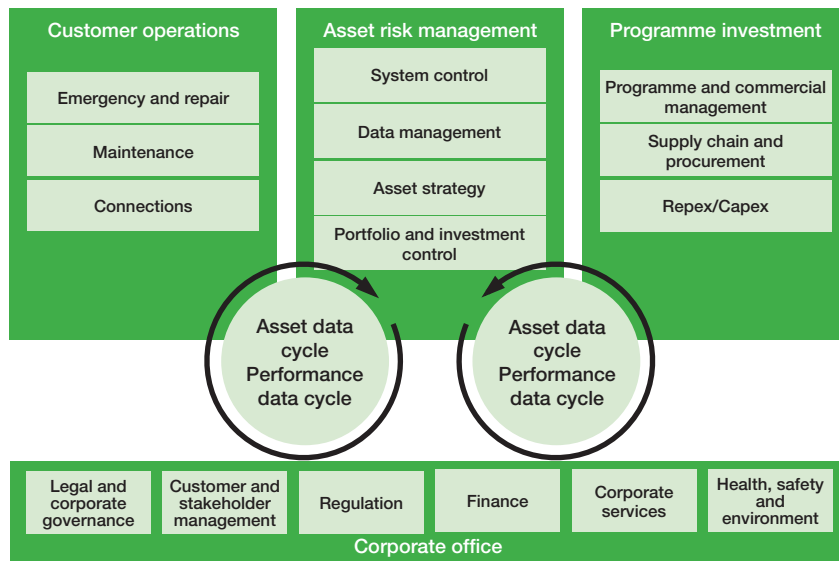
NGN's innovative TCO approach prioritises network expenditure to effectively manage risk and deliver key outputs



NGN's new integrated business model has been designed to enable TCO

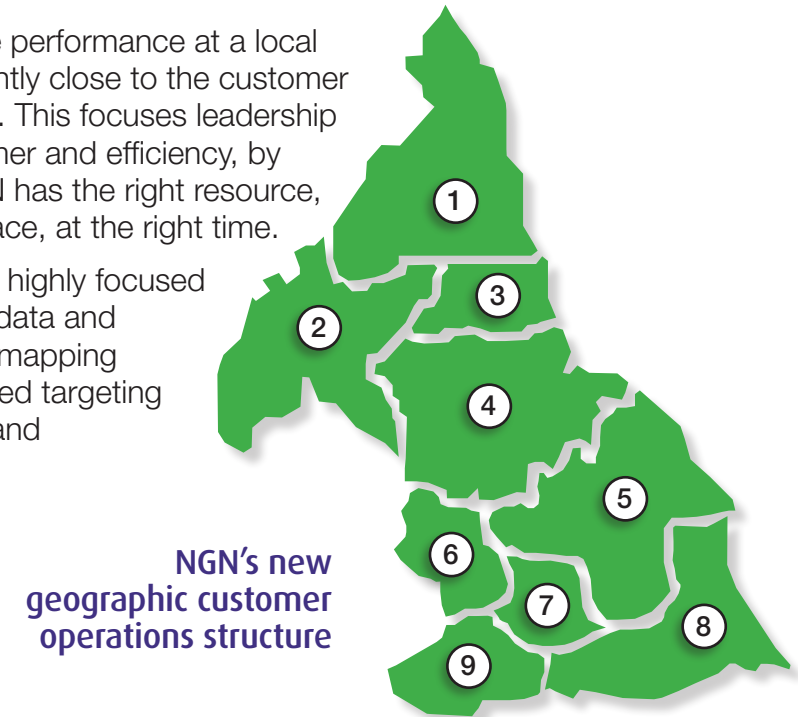
A fully integrated customer-focused business model

- Links asset integrity management with customer operations and in turn programme investment; and
- Puts asset management strategies and asset health at the heart of the business, underpinning all investment and expenditure decisions.



A geographic focus supported by central planning and scheduling

- Ability to drive performance at a local level, importantly close to the customer and the asset. This focuses leadership on the customer and efficiency, by ensuring NGN has the right resource, in the right place, at the right time.
- Supported by highly focused performance data and geographical mapping allows improved targeting of resources and investment.



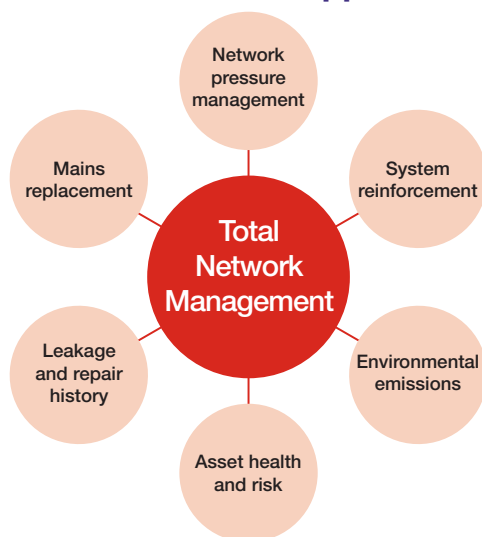
The flow of asset and performance data through the integrated business facilitates holistic and economic decision making about the network



The new Total Network Management (TNM) processes are central to supporting NGN's TCO approach

TNM considers a wide range of factors to focus expenditure on delivering improvements across multiple output measures. The approach allows clear trade-offs to be made between alternative solutions and type of expenditure to deliver the best value for money.

The overall TNM approach



Asset health indices

- An holistic, joined up approach to the management of our network assets.
- Links accurate data about the condition and health of the asset to the risk and consequence of failure.
- Drives timely and efficient investment decisions and creates the ability to assess all alternative approaches to managing identified risks.
- First full network analysis of asset health has been completed and built into our investment plans.

Asset health process

- NGN has undertaken a comprehensive exercise to create a base set of asset health indices.
- This exercise has been completed for all 22 asset categories on the NGN network.
- NGN has developed asset health indicators in line with best practice. NGN consider this to be an ongoing and evolving process which will be further refined during RIIO-GD1.

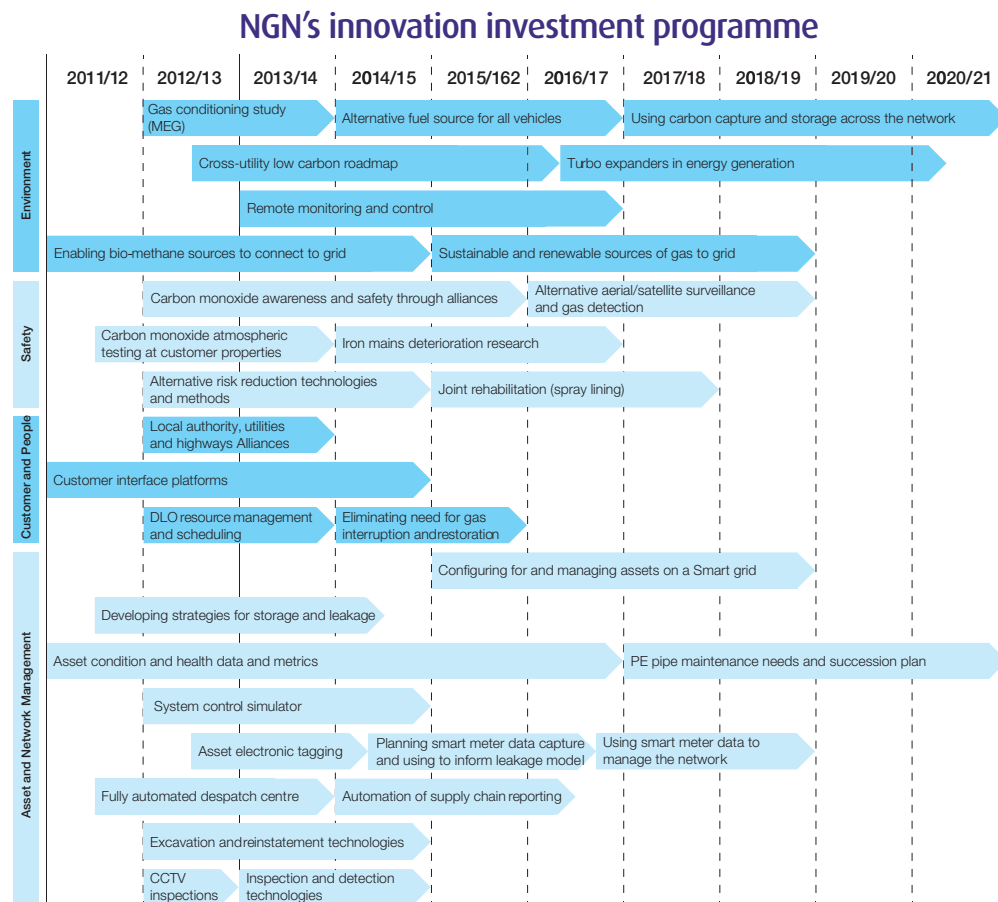
The NGN asset health model has been used to inform the prioritisation of investment to reduce Totex costs



NGN already has detailed innovation plans that will flow into RII0-GD1

NGN has earmarked investment on innovation of £25m for RII0-GD1

- NGN will develop many of these innovations in partnership with external organisations.
- NGN will also continue to generate ideas and carry out research and development in partnership with other GDNs and third parties.
- The investment model is designed to meet a changing energy market.
- The focus will be to explore new ways of working, new technologies and new processes to enable continuous improvement in:
 - customer service;
 - environmental impact;
 - safety;
 - asset performance and
 - efficiency.



The innovation strategy will continue to be at the heart of NGN's business, delivering a safe, reliable and operationally excellent network



NGN continues to work with stakeholders to build on its frontier position to ensure that customers continue to get more value: safely, efficiently and sustainably.



This business plan delivers...

- A network driven by customer and stakeholder requirements.
- Expenditure plans derived from industry-leading levels of efficiency and a commitment to ongoing real improvements in productivity.
- Firm commitment to deliver more for less, with increased outputs at a like for like increase per customer of a penny a day.
- A financial package underpinned by appropriate incentives that balances short and long term requirements of customers and shareholders and provides an appropriate risk-reward balance.
- Significant improvements in the health, integrity, reliability and safety of the network which can play its full part in the transition to a low carbon economy.
- A strategy for investment in young people and the regional economy of the North of England.

A unique approach with the development of innovative processes, business model and technologies that will allow NGN and the wider industry to meet the significant challenges of the future.

...exceptional value for money



NGN will continue to innovate and build on its frontier position, working with stakeholders, to ensure that customers continue to get more value for money safely, efficiently and sustainably

That is our pledge.





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