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

To Apply from 1 April 2011

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 2011, 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 2011 is expected to be published by 31 January 2011, in line with the 60 days' notice requirements within the Uniform Network Code.

2 Indicative LDZ Transportation Charges effective from 1 April 2011

The indicative change in distribution transportation charges from 1 April 2011 is an increase of approximately 5.5%. In addition, the CSEP administration charge will be reset to 0.1020 pence per supply point per day.

There is still uncertainty around the level of change that will be necessary in April 2011 and the figures provided are the current projections. This could move up or down before final changes in charges are published in January 2011.

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. The next price change after 1 April 2011 is expected to be in April 2012.

Distribution charges are approximately 15-20% of domestic supply prices. Therefore, a 5% increase in distribution transportation charges is equivalent to around a 1% 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 7% including inflation, for the year April 2011 – March 2012 relative to the previous year, and so, all other things being equal, April 2011 unit prices would be expected to increase by this amount in order to generate this higher level of allowed revenue. However, after adjustments, the increase in Final Allowed Revenue is approximately 4%.

Collected Revenue for the year April 2010 – March 2011 is also around 2% higher than Allowed Revenue for the period, so all other things being equal, around a 2% price increase would be required, as an additional 2% revenue must be generated this year.

However, the October 2010 AQ review has reduced SOQs and resulting monthly revenues by 5.5%, and it is forecast that SOQs will further reduce by around 3% in October 2011.

Therefore an increase in unit prices of approximately 5.5% is required to generate revenues of the level required to achieve the 2011/12 Final Allowed Revenue.

The final level of unit prices must also be adjusted to allow for a number of variables as described below.

3.1 Prior year adjustments

In the current formula year no changes to the charging methodology have been implemented, and there was no additional price change in October 2010.

3.2 Change in Business Rates

This cost is outside the control of NGN, 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 through 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 wholesale gas is outside the control of NGN, 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 pipe decommissioned for eight specific mains pipeline diameter bands and the associated services.

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 did 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. In 2009/10, NGN was awarded £200,000 under the networks extensions and gas safety categories, and this has been included in the 2011/12 Allowed Revenue calculations.
- 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 2011. 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 2010 AQ Review process. In January 2011 the October 2010 levels will be known but the outcome for the 6 months from October 2011 will have to be estimated.
- The definitive mains replacement incentive position for 2010/11 will not be known until July 2011. 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 2010/11 and hence the under or over recovery and the price change required in 2011/12.
- Changes in wholesale 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 31 January 2011 and will be taken into account in determining the definitive level of charges to apply from 1 April 2011.