

EMBARGOED UNTIL 07.00 HOURS ON MONDAY 4 DECEMBER 2006

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FINAL PROPOSALS FOR GAS DISTRIBUTION ONE YEAR PRICE CONTROL

- **Companies' capital expenditure allowances will increase so they can upgrade networks for customers**
- **Domestic customers' gas bills will increase by around £10 for 2007-2008 as gas distribution companies face rising costs for the mains replacement programme, pensions, business rates and replacing the small amounts of gas lost as it is transported**

The final proposals for the gas distribution one-year price control have been published today (Monday) by energy regulator Ofgem, giving a significant boost to investment in local gas networks.

The companies which run Britain's gas distribution networks (GDNs) will be able to invest £946 million* in 2007-2008 to upgrade their networks to benefit customers. This is 11 per cent higher than the network owners have forecast they will spend in 2006-2007.

To enable the companies to meet rising costs, Ofgem is proposing to allow an increase in the revenue which GDNs can recover from customers by, on average, 11.5 per cent. This partly reflects the additional investment, but the majority of the increase reflects rising costs over the past five years which are outside the companies' control.

These include business rates, pensions and costs relating to the small amounts of gas lost as it is transported through the networks. At the same time Ofgem has reduced the amount the companies will receive for the other day to day running costs of their business by 2.5 per cent so that customers will benefit from efficiency savings that this brings.

For domestic customers the effect of our proposals will be an increase of around £10 in their gas bill in 2007-2008.

Ofgem Chief Executive, Alistair Buchanan, said: "The gas distribution networks require increases in their investment allowances to pay for projects which will bring benefits to customers. Ofgem has also recognised that the companies are facing rising costs which are outside their control and we have allowed these costs to be passed on to customers.

"We are currently reviewing the five-year price control for the gas distribution networks which will apply from 2008. The 2008-2013 price controls will be our first opportunity to compare the performance of companies which are owned and operated by different management teams – each trying to improve the way they operate in terms of cost and quality. We will collect and use this information to set tougher price controls in future than we would have been able to do without these comparators. "

* in 2005-2006 prices.

Notes to Editors:

1. The existing gas distribution price controls come to an end on March 31, 2007 but they are being extended for one year until April 2008 and then reset for the following five years until 2013. The proposals published today relate only to the one year control. Work on the subsequent five-year control will continue throughout 2007.

2. The GDNs spent £864 million (in 2005-2006 prices) more in their networks over the current five-year price control period than anticipated at the last review. Where Ofgem considers that this investment is inefficient, GDNs will not be able to recover any of the additional costs from customers. If the additional investment is efficient and brings benefits to customers, GDNs will be allowed to recover some but not all of the additional money. Overall shareholders will fund 37 per cent of the additional investment.

3. A programme to replace ageing gas mains on local distribution networks was introduced in 2002. It means that the companies must replace all iron mains within 30 metres of premises over the course of 30 years.

3. Timeline for the Gas Distribution Price Control Review:

One year extension:

- September 2006 - initial proposals
- December 2006 – final proposals

Main review:

- November 2006 – third consultation document
- September 2007 – updated proposals
- March 2007 – fourth consultation document
- May 2007 – initial proposals
- December 2007 – final proposals

4. Copies of the document “Gas Distribution Price Control Review One Year Control Initial Proposals” are available on the Ofgem website www.ofgem.gov.uk. Hard copies can be ordered from the Ofgem distribution centre on 020 7901 7116 or by email from distribution@ofgem.gov.uk

5. Annual gas distribution charges for the average customer bill are £86.

6. Following consultation, in March 2004 Ofgem set out its intention to extend the current gas distribution price control by one year to 31 March 2008. This was to provide a more balanced workload for companies and Ofgem and to allow gas distribution and transmission issues to be considered separately. The one year control also creates an opportunity for Ofgem to review an additional year’s data when setting the main price control.

7. The final proposals for the one year extension represent a small change from our initial proposals published in September when we indicated that GDN revenue on average would be allowed to increase by 9.7 per cent and 38 per cent of the additional investment would be funded by shareholders compared to an increase in revenue in final proposals of 11.5 per cent and 37 per cent of the additional investment being funded by shareholders.

8. A very small amount of gas is lost as it is transported through the networks. This is known as shrinkage and the GDNs have to replace this gas by purchasing it in the wholesale market. Currently

0.7 per cent of all gas transported through the distribution networks is lost as shrinkage and this figure is in line with other gas networks in European countries. In Britain shrinkage will fall as a result of the 30 year mains replacement programme for all the networks which is presently underway.

9. The distribution companies are currently operating under price controls set in 2002 when the networks were all part of National Grid Transco.

- 2002: start of previous Transco distribution price controls running to 2007
- 2005: four of eight distribution networks sold
- 2006-7: consultation on one-year price controls for separate distribution networks
- 2007: one-year price controls begin with consultation on first full five-year review
- 2008-13: first full gas distribution price control period.

Information on costs gathered during the one year price control review will feed into the first and subsequent full five-year reviews. Over time, the collection of this information will allow Ofgem to make more meaningful comparisons between companies and identify increased efficiency savings which can then be passed back to customers in future reviews.

10. Ofgem has also today announced final proposals for price controls for the four electricity and gas transmission companies which own Britain's high-voltage national networks and the national gas pipeline. These companies are: National Grid Electricity Transmission (NGET), National Grid Gas NTS (National Transmission System), Scottish Power Transmission Limited (SPTL) and Scottish Hydro-Electric Transmission Limited (SHETL)

11. Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. The Authority's functions are set out mainly in the Gas Act 1986, the Electricity Act 1989, the Competition Act 1998 and the Utilities Act 2000. In this note, the functions of the Authority under all the relevant Acts are, for simplicity, described as the functions of Ofgem.

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