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## UPDATED PROPOSALS FOR GAS DISTRIBUTION PRICE CONTROLS ARE PUBLISHED

- **Gas distribution networks (GDNs) will be set challenging cost-cutting targets**
- **£5 billion funding for investment so GDNs can develop networks and continue mains replacement**
- **£68 million for training apprentices**
- **An allowance of up to £60 million for research to promote sustainability issues**
- **New incentive to reduce greenhouse gas emissions**

Energy regulator Ofgem is keeping up the pressure on the gas distribution networks (GDNs) to operate more efficiently over the next five years.

Under the updated proposals for the 2008-2013 price controls published today (Monday), in total GDNs will be allowed an average each year of £628 million for operating costs – a 13 per cent reduction on the amount they had requested from Ofgem. Ofgem has listened carefully to responses from the GDNs since its initial proposals in May and overall it has allowed a small increase in the amount of mains replacement expenditure (see notes to editors). This will help the GDNs to continue a nationwide programme to replace ageing gas mains.

Comparing the performance of the GDNs owned by National Grid against the four GDNs under new ownership will result in efficiency savings being passed back to customers over successive price controls. Ofgem has set the revenue allowances including an annual efficiency saving of 2.5 per cent over the five years of the price control.

Ofgem Chief Executive, Alistair Buchanan, said: "Our latest proposals protect customers by requiring challenging cuts in operating expenditure. Overall the proposals allow the companies to invest £5 billion in delivering a safe, modern gas network while ensuring that costs to customers are kept to a minimum."

Ofgem is proposing two new initiatives to promote sustainability: an allowance of up to £60 million for research and development into sustainability issues; and an environmental emissions incentive that rewards GDNs for reducing their gas emissions. Ofgem also believes that developing employee skills is a significant issue for the GDNs. The updated proposals include £68 million for apprenticeships and training.

The overall effect of Ofgem's proposals will be an increase of around £1 a year in real terms on current gas bills. Final proposals for the price controls will be published this December.

\* All figures are in 2005-2006 prices.

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## Notes to editors

1. In June 2005 National Grid Gas completed the sale of four of its eight GDNs. The Scotland and south east of England networks were sold to Scotia Gas Networks. The Wales and south west network was sold to Wales & West Utilities and the network in the north east was sold to Northern Gas Networks.

The table below shows Ofgem's proposals for expenditure allowances and how they compare to companies' forecasts. The updated proposals reflect Ofgem's assessment of each GDN's actual spending in 2006-2007.

£m in 2005-06 prices	Average annual GDN forecast for 2008-13	Average annual Ofgem allowance over 2008-13 for initial proposals	Average annual Ofgem allowance for 2008-2013 for updated proposals	Difference between GDN forecast and Ofgem allowance in initial proposals	Difference between GDN forecast and Ofgem allowance in updated proposals
Operating expenditure	722.1	598.0	628.0	-17%	-13%
Capital expenditure	396.8	328.2	319.2	-17%	-20%
Replacement expenditure	784.5	654.0	678.6	-17%	-13%

The figures in the table do not take into account the information quality incentive which discourages the companies from bidding for higher capital expenditure allowances than they actually require. Under the incentive companies that put forward sensible projections will receive bigger rewards for outperforming the allowances than those who have bid for higher allowances

2. All gas distribution companies are required to carry out a **mains replacement** programme which has been approved by the Health and Safety Executive to address safety concerns. This programme, introduced in 2002, requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period. The GDNs face rising costs for delivering this programme due to several factors including increasing labour costs.

3 Ofgem sets the allowed rate of return the companies can recoup when they invest in their networks - this is the cost of capital. For the updated proposals Ofgem has kept its assumption of a weighted average cost of capital (with a pre-tax debt, and a post-tax equity component) of 4.84 per cent. This was the assumption used in the initial proposals. Final proposals will determine the cost of capital for the GDNs.

4. Through the price controls Ofgem has strengthened the obligations on the GDNs to offer good customer service. For example the existing targets for handling calls about gas leaks and attending them will be specified in licence conditions. This will enable Ofgem to take more appropriate enforcement action against GDNs if they do not perform as required. Other examples include a reduction from ten days to five days of the time allowed to complete reinstatement after a GDN has finished work on a connection or repaired a pipe.

5. 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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