Hyder Gas Networks Limited

CONDITION 3 TRANSPORTATION CHARGING STATEMENT

Introduction

1. Hyder Gas Networks Limited (HGNL) is a wholly owned subsidiary of Hyder plc.

2. HGNL's License requires it to produce a Condition 3 statement outlining it's transportation charges and the methodology used to determine those charges. This paper sets out HGNL's statement and is intended for use on HGNL networks serving non daily metered customers.

General Principles relating to Charging Methodology

3. HGNL recovers its costs related to the provision and operation of its PGT networks using both Condition 3 and Condition 6 charging methodologies. These costs are allocated to either Condition 3 or Condition 6 on the basis of cost allocations listed in its Condition 3 and Condition 6 statement.

4. Condition 3 charges will not generally vary from site to site whereas Condition 6 charges are site specific and will therefore vary from site to site. Condition 6 charges are only applicable after a designation for a specific site has been granted by OFGEM. The charging methodology relating to Condition 6 is outlined in a separate document which is available on written request from:

   Hyder Gas Networks Limited
   PO Box 295
   Alexandra Gate
   Rover Way
   Cardiff
   CF24 5UE

The Charging Methodology – Condition 3

5. Condition 3 charges recover business set up costs, general business costs, operational and running costs. The suitability and application of Condition 3 charges will be reviewed periodically and an annual report submitted to OFGEM showing how the charges meet the relevant objectives outlined in Condition 4 of the License.

6. The costs reflect the day to day costs of running the business and cannot be clearly identified as "...referable in whole or part to laying of pipes for the purpose of conveying gas to a premise in a designated area..." neither are the costs demonstrably volume related. Therefore HGNL recovers these costs using a fixed charge per property which is not related to commodity throughput.

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7. The operating costs are however sensitive to the forecast number of supply point connections on any one particular development, and HGNL will review the charges periodically to ensure they are cost reflective as required by condition 4.5a of the license. The costs recovered under Condition 3 are listed below.

8. As HGNL is a new entrant it will incur set up costs that it will need to recover. It will also experience higher operating costs than those of a mature business. HGNL will recover those start up costs which are specifically identified on the attached list over the first five years of operation. These costs will be recovered as part of the condition 3 fixed charge for each Supply Point. Any under or over recovery of these set up costs owing to differences between the forecast and actual number of supply points or the size of these costs in any one year will be carried forward to the following year so that the set up costs are recovered in their entirety over the five year period. At the end of the five year period the Condition 3 charges will cease to include recovery of set up costs.

9. HGNL believes its Condition 3 charges are cost reflective. The non volume related method simplifies administration and billing leading to lower costs for both HGNL and shippers, which should be reflected in the prices charged to final customers. The charges will be uplifted by an appropriate level of profit and will be established on a daily basis and billed monthly.

10. Once determined the costs under Condition 3 will be independent of volume of gas transported. Costs may vary in future owing to the introduction of new technology or to changes in regulations from such bodies as the HSE. Any such changes will be reflected in the charges.

11. Any over or under recovery of operating costs under Condition 3, for any reason, will be carried forward, reducing or increasing charges under Condition 3 recovering such operating costs in the following year. As noted above, set up charges will be recovered over a period of five years.

12. Given the cost reflectivity of Condition 3, HGNL would not normally expect to reduce charges under this Condition unless there was an actual sustained increase in efficiency in relation to costs charged for under Condition 3.

Metering Charges

13. Meter provision and maintenance are, in principle, contestable activities. Meter provision will be separately identified and reflected in Condition 6 whilst meter maintenance will be included in Condition 3 and separately identified. If a shipper chooses to procure, install and thereafter maintain a meter, the appropriate charge under Condition 3 will be reduced to reflect the avoided meter maintenance costs-this is illustrated in the attached example.

14. Should the shipper request HGNL to undertake meter-reading activities, separate meter-reading charges will be levied on the shipper.

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Costs recovered under Condition 3

Set up costs:

Initial employee costs (direct, consultancy, agency, travel, subsistence)
Office costs (accommodation, office services, computers, software and peripherals, communications)
Company specific set up costs (legal and other fees)
Initial license application, safety case approval

Operating costs:

Salaries, travel, subsistence, training
Ongoing office costs
IT
Depreciation of "general" capitalised items such as IT hardware, office furniture etc.
Annual license fees unless project specific (in which case included in Condition 6)
Billing, Supply Point Administration, customer service
Administration (record keeping etc.)
Emergency and callout charges, call centre charges
Network operating costs (PRS maintenance, leakage detection, repairs)
Meter maintenance
Shrinkage and unrecovered theft
Legal, professional and banking fees
Financial costs (bad debt, audit)
Sales and marketing
Pre-contract design and planning
Obsolete assets
"Ineligible" Condition 6 costs
Rates on gas assets

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Example of calculation of Condition 3 charges

Condition 3 charges recover the costs of operating the HGN's business.

Ongoing operating costs

These are set each year to recover the costs of operating HGN's business with any under or over recovery one year being recovered or returned the following year. The following figures are for illustration only.

Forecast customers connected and operating costs

Year	1	2	3	4	5
Customers connected	5,000	5,000	10,000	20,000	20,000
Cumulative customers connected	5,000	10,000	20,000	40,000	60,000
Operating cost £000	50	100	200	400	600

This gives:

Operating charge in year 1	= 50,000/5,000
	= £10 for each property

At the end of year 1 the forecast and actual costs are reconciled. Assume that in year 1 8,000 customers were connected and the actual operating costs were £70,000. For year 1 this gives:

Forecast operating cost	= £50,000
Actual operating cost	= £70,000
Actual costs recovered	= 8,000*10
	= £80,000
Over recovery in year 1	= Actual recovery – actual costs
	= 80,000 – 70,000
	= £10,000

In this example the forecast was incorrect because the forecast number of connections were too low and the forecast cost per property connected was too high.

The over recovery of £10,000 needs to be paid back in year 2. Assume that the forecasts for number of new connections for year 2 onwards is unchanged and the forecast operating costs for year 2 onwards is:

Year	1	2	3	4	5
Customers connected	8,000	5,000	10,000	20,000	20,000
Cumulative customers connected	8,000	13,000	23,000	43,000	63,000
Operating cost £000		130	230	430	630

The ongoing operating charge in year 2 is given by:

Operating charge	= (130,000-10,000)/13,000
	= £9.23 for each property

Initial start up costs

There are certain one off costs incurred during the setting up of the business and these will be recovered over the first five years. The following figures are for illustration only.

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Initial start up costs = £500,000
Forecast customers connected

Year	1	2	3	4	5
Customers connected	5,000	5,000	10,000	20,000	20,000
Cumulative customers connected	5,000	10,000	20,000	40,000	60,000

Customers connected in year 1 will be connected for 5 years and the start up costs will be recovered for 5 years from them therefore the number of customer years the start up cost can be recovered over is given by the sum of the cumulative customers connected.

Customer years for which charge levied = 135,000

Start up costs per customer connected each year = 500,000/135,000
= £3.70

At the end of each year the actual and forecast recovery of set up charges will be reviewed and the charges for the following year reassessed. Assume that in the first year 8,000 customers were connected. Therefore the actual set up costs recovered would be:

Set up costs recovered = 8,000*3.70
= £29,630

Forecast recovery = 5000*3.70
= £18,500

Therefore the cost to be recovered over the next four years would be:
Cost to be recovered = 500,000 – 29,630
= £470,370

With unchanged forecasts for number of new connections for year 2 onwards the forecast of customers connected is:

Year	1	2	3	4	5
Customers connected	8,000	5,000	10,000	20,000	20,000
Cumulative customers connected	8,000	13,000	23,000	43,000	63,000

Since year 1 has passed there are four years to recover the start up charges and the sum of the cumulative customers from years 2 to 5 is:

Customer years for which charge levied = 142,000

Start up charge per customer connected each year = 470,370/142,000
= £3.31

This is repeated for the rest of the five year period.

Total Condition 3 charge
This is the sum of the ongoing operating charges and the start up charge. Using the examples above this will give the following for the first two years.

	Year 1	Year 2
Operating charge	£10.00	£9.23
Start up charge	£3.70	£3.31
Total	£13.70	£12.54

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