



**Ofgem Consultation Letter – Income adjusting event claim for Canatxx
incremental entry capacity signal at Fleetwood
AEP¹ Comments**

The Association welcomes the opportunity to comment on this consultation letter. This issue is of interest to our members since SO commodity revenue is recovered from both entry and exit flows and represents an increase in costs to customers for which there is no perceived benefit. The Association therefore supports the Centrica proposal that an income adjusting event should be triggered in respect of this issue.

The Association considers that an income adjusting event has occurred as a result of an unforeseen consequence of the current licence and code arrangements, which highlights the challenges of trying to address all planning, investment and commercial issues and uncertainties within the regulatory framework. The arrangements had reasonably assumed that parties having signalled for incremental capacity would secure the necessary credit arrangements else risk losing all capacity rights. This was found not to be robust for a single site shipper and led to Canatxx failing to put in place the necessary credit to support its incremental entry capacity signal at Fleetwood for capacity from October 2010. The arrangements also allow this capacity to roll forward until such time as credit is put in place, essentially providing the defaulting party with a free option.

It seems that in the absence of an income adjusting event an additional £10.89M will have been recovered from shippers and hence customers in the formula year 2010/11 absent the delivery of any additional capacity, essentially providing a windfall gain for NG. This will also occur each year for the following four / five formula periods.

NG will have undertaken some preparatory work to establish how the 650 GWh of incremental capacity at Fleetwood would have been delivered if the credit had been lodged at the correct time. Some information on these costs was provided on 24th March. The profile of expenditure peaks in 07/08 but tails off thereafter once the appeal to the Secretary of State was refused in October 07, demonstrating that NG acted appropriately in scaling back work after this date. However within that formula year it remains unclear how much expenditure was made or committed prior to the Secretary of State's decision. It would seem to be unreasonable to disallow or allow all these

¹The Association of Electricity Producers (AEP) represents large, medium and small companies accounting for more than 95 per cent of the UK generating capacity, together with a number of businesses that provide equipment and services to the generating industry. Between them, the members embrace all of the generating technologies used commercially in the UK, from coal, gas and nuclear power, to a wide range of renewable energies.

costs but Ofgem will need to request further breakdown of this information with respect to purpose and timing to determine and fully satisfy itself that such costs had been reasonably and efficiently incurred in order to determine which costs should be allowed with an appropriate rate of return.

With respect to the additional factors we are not convinced that NG was carrying any buyback risk in 2010/11, the year to which the IAE relates, since absent planning approval it was inconceivable that capacity could have been need at the Fleetwood entry point. Clearly hindsight shows us that there were no buybacks. Whilst not strictly relevant to this IAE, there is also little prospect of buybacks in future years unless and until planning permission is gained and the project proceeds. In any event NG would be likely to have adequate notice of this.

With respect to substitution we are not entirely clear when the 650GWh would become baseline or exactly how the substitution may or may not facilitate its relocation to a recipient point, particularly when the capacity has not been built. Also we wonder what exchange rate would apply since NG's substitution methodology statement refers to factors that NG will take into consideration but about which shippers have no visibility e.g. pressure commitments. Although, we understand that capacity can be provided commercially rather than physically, we contemplate a scenario where it is substituted to Barrow to simply be re-establishing the baseline that was reduced in the baseline review at the start of the current price control to be a rather bizarre outcome. So far as we are aware there have not been substantial changes at Barrow which would affect the technical capability at that point. At the same time we believe the incentive arrangements would reward NG for this.

We also have concerns regarding how these capacity rights feed into and affect future network planning, investment decisions, system modelling for revenue drivers and potential charging implications. It would seem bizarre for a network operator to model for 650GWh of daily flows which in reality were never likely to appear. We recall a revenue driver consultation that produced different numbers with different assumptions for Fleetwood reinforcement and flows (Ofgem doc 106/09).

We consider that given these circumstances it may also be appropriate for Ofgem to consider, what should happen to the SO incremental revenue for the future years, whether the 650GWh capacity should become baseline and whether in the future arrangements need refining to link allowed revenues to project key dates in some way.

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