



Paul O'Donovan
Head of Gas Transmission
Office of Gas and Electricity Markets (Ofgem)
9 Millbank
London
SW1P 3GE

E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
West Midlands
CV4 8LG
eon-uk.com

Richard Fairholme
Trading Arrangements
T: 02476 181421
richard.fairholme@eon-uk.com

29 March 2011

Dear Paul,

RE: Consultation Letter: Fleetwood Income Adjusting Event

E.ON UK fully supports the Income Adjusting Event notice raised by Centrica Energy on behalf of affected parties. If the IAE is not progressed, it will mean that Shippers (and ultimately consumers) will be paying, via increased SO Commodity charges, for incremental entry capacity which does not exist and which carries no credible buy-back risk for NG NTS. Fundamentally, we do not believe it is tenable for NG NTS to be able to continue to effectively claim costs for work which has not taken place, nor is required in future.

Q1 a) Do you consider that an IAE has occurred? b) What is the basis of your conclusion?

We consider that an IAE has occurred and that there is a need to protect customers from unnecessary costs. The refusal of planning permission for the former Canatxx storage project and no reasonable expectation that the Shipper will, as a result, require the entry capacity in future has materially changed the circumstances under which National Grid NTS operates the System.

The entry capacity bought at the Fleetwood entry point relates to the former Canatxx gas storage project, which we would not expect, even in its revised format and based on publicly available information, to be in need of entry capacity in the next four to five years. Moreover, if this IAE relates only to the year 2010/11, the prospect of a new, previously unknown project turning up and expecting to make use of the capacity between now and the end of the formula year 2011 is not a credible assumption.

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

We do not believe there remains any further work for NG NTS to do in respect of this entry point: either in terms of physical provision of capacity or managing commercial risks (i.e. buy-back). As a result, NG NTS should not be allowed to recover revenue which is intended to cover the costs of undertaking these duties. There remains no “risk-reward” for NG NTS to manage for this entry point and as a result the allowed revenue represents a windfall gain.

Q2. Do you consider that any or all the costs saved by NG NTS are associated with the IAE?

By not investing, NG NTS has avoided the majority cost of physically providing entry capacity which due to exceptional circumstances is no longer expected to be required. Given the size of the incremental capacity signalled in the QSEC auction, we believe that if NG NTS thought that it needed to build it would have done so. This is on the basis that the buy-back risk in the event of the project actually turning up would be very high and potentially very costly, so the physical reinforcement option would be significantly more economic and efficient. Since NG NTS is low-risk regulated business, it would be reasonable to assume that NG NTS shared the view of Shippers that the likelihood of a Shipper requiring the use of the capacity was (and remains) extremely slim. We do not believe NG NTS realistically expects to have to undertake any buy-back of capacity and therefore should not be allowed funds to manage this risk.

Q3. Has the IAE increased or decreased the relevant system operation costs by more than the £2 million threshold?

We believe that the circumstances described above have reduced NG NTS’ liabilities – either in terms of physical build / delivery or entry capacity buy-back, and as such, the costs of running the system are also reduced. The exact amount by which circumstances have reduced SO costs is ultimately for the Authority to determine based on the evidence provided, but it could be described as the allowed revenue associated with this entry capacity less actual, reasonably-incurred expenditure.

In term of defining what amount the relevant system operation costs have decreased by, much depends on what period the IAE is deemed to apply to. NG NTS has quoted actual incurred costs of £9.895M from 06/07 to 09/10. The allowed revenue relating to this capacity for 2010 (only) is £10.89M. On these numbers alone, it might be construed that the difference is less than £2M. However, we do not believe that treating the numbers in this way would be logical. The costs of £9.895M relate to the whole period 06/07 to 09/10; not just 2010. If the allowed revenue for all relevant periods is taken into account the total is £48.38M

and the difference between allowed revenue and actual expenditure for this entry point is £38.485M – evidently much more than the £2M threshold.

Alternatively, if the IAE is deemed to apply to 2010 only, the sum of all actual costs incurred historically should not be used when assessing the extent to which SO costs have reduced under the IAE in 2010. It would be more rational to spread the actual costs across each year for which an IAE is required, so that a proportion of the total, actually incurred costs is recognised.

Q4. If the Authority concludes that an IAE has occurred, how should we calculate an adjustment figure that ensures that the financial position and performance of NG NTS is, so far as reasonably practicable, the same as if the IAE had not occurred?

Actual reasonably-incurred costs should be reimbursed; subject to more detailed review of the cost breakdown, as outlined below. This should maintain the incentive on NG NTS to act in an economic and efficient manner.

Q5. Are there any additional factors or evidence which you think Ofgem should take into account to inform the Authority's decision?

We would expect much more detail to be provided by NG NTS in relation to the costs incurred, as described in the Addendum. For instance, it is unclear why £2.6M of cost was incurred in 08/09 and 09/10 in relation to “Land/Compensation” after planning permission for the Canatxx project was refused in 07/08. Furthermore, NG NTS does not detail any costs associated with “Project Management” or “NG staff” during the same period, which on the face of it, suggests that significant expenses were being incurred without any oversight. Finally, we would expect NG NTS to provide more detail on the £400,000 which comprises “Other” / “Miscellaneous” costs.

If you wish to discuss this response in any more detail, please do not hesitate to contact me on T: 02476 181421.

Yours sincerely,

Richard Fairholme (by email)
Trading Arrangements
E.ON UK