



28th September 2007

John Lynch
Commission for Energy Regulation
The Exchange
Belgard Square North
Tallaght
Dublin 24

Our Ref: REV0702-003

Re. CER/07/145 – Consultation on Proposed Determination of Transmission Allowed Revenue

Dear John

EirGrid welcomes the opportunity to comment on the Commission's draft determination of transmission allowed revenue for 2008. We are now in the midst of the first 5 year revenue determination period, and EirGrid notes we have thus entered a more mature regulatory phase which provides for greater certainty and stronger incentives to the transmission business to drive efficiency, to the ultimate benefit of consumers. Notwithstanding this, the introduction of the Single Electricity Market (SEM) from 1 November 2007 means that adjustments that were not anticipated at the point of setting the control must be made for 2008. EirGrid has provided comprehensive submissions to the Commission in respect of the changes it anticipates and has engaged with the Commission over the past number of months, leading up to this draft determination.

While EirGrid welcomes much of what the Commission has to say in its draft determination, EirGrid is disappointed that the Commission believes it is appropriate to make a number of adjustments to the revenue sought by EirGrid. EirGrid has provided detailed submissions and supporting papers which evidenced its revenue requirements. EirGrid is concerned that the position taken by the Commission may lessen EirGrid's ability to deliver as effectively its additional obligations in the SEM environment than would otherwise have been the case. This response details EirGrid's specific concerns in respect of:

- TUoS requirements in the post-SEM environment;
- The treatment of carrying costs for SEM related investment; and
- The interest provision on unexpected over-recovery during 2007.

TUoS requirements in the post-SEM environment

While EirGrid welcomes the recognition by the Commission that the post SEM environment will result in the need for additional resources to be employed by EirGrid, including the resources sought by EirGrid for further IS support and additional market modelling, EirGrid is disappointed the Commission has cut back the proposed resource requirement sought by EirGrid in other areas.

EirGrid sought the provision of 2 additional FTEs to cover the additional requirements for south-north co-operation and collaboration in the post-SEM environment. For example, significant co-operation and collaboration is required in the areas of connection offers, tariffing, investment planning, regulatory arrangements etc. as well as the entering into and ongoing governance associated with the System Operator Agreement (SOA). In deriving its estimate of 2 additional FTEs, EirGrid took into account potential synergies and efficiencies both between functions and also between SONI and EirGrid. The Commission has proposed in its draft determination that only 1 FTE be allowed. This appears to EirGrid to be based upon very limited analysis and does not bear any reflection of the reality of the additional workload which will result. Indeed, the north-south cooperation required in the lead up to SEM has illustrated the significance of the extra work involved, especially when processes and practices are at the early stages of harmonisation.

The Commission's proposal to disallow 50% of the revenue requested by EirGrid in respect of the additional cost of carrying out functions on a 7 day basis is particularly concerning. The new market in SEM will be settled on a calendar day, or seven day a week, basis. Hence the TSO must support the operation of the market on a seven day basis. EirGrid provided both an initial and follow up paper to the Commission evidencing its requirements in this regard. In summary, persons are required on a seven day basis for the polling of meters, ex ante generator scheduling based upon nominations and ex post availability and other reporting to the Single Market Operator, and IT support associated with these and other interface systems between EirGrid as TSO and the SMO. EirGrid maintains that the revenue equivalent of 4 FTEs is required to carry out this work given the need to pay staff additional premia for working weekend and other non-social hours. This is something the Commission does not seem to have given recognition to in its draft determination.

The overall financial burden upon EirGrid of the movement to SEM is compounded by the inconsistency of removing staffing resources from the TUoS revenue base at a rate different to, and considerably higher than, that which was provided in the recent determination for the Single Market Operator. The Commission has argued that these two matters are entirely separate. EirGrid does not accept this position, believes it represents a fundamental inconsistency of approach by the Commission, and reminds the Commission that this is in many instances simply a re-designation of personnel from one price control to another, while carrying out broadly similar functions, as a result of industry structure change, for which EirGrid is effectively being penalised to the tune of over €300,000 per annum. While EirGrid does not accept this position EirGrid submits

that, if the Commission remains convinced that those functions that are being moved from the TSO to the new SMO require less expensive personnel, the average payroll cost for EirGrid as TSO must by definition increase, and EirGrid seeks recognition of this in future determinations.

EirGrid notes that the Commission has proposed that the post SEM costs be examined on an ex post basis. EirGrid does not believe this represents good regulatory practice for a business in the midst of a 5 year control, would create additional regulatory and accounting burden on the business and could lead to perverse incentives regarding the classification and allocation of costs. EirGrid therefore believes that any adjustments resulting from the Commission's determination in this regard should be factored into and included in the remainder of the 5 year control.

Treatment of Carrying Costs for SEM Expenditure

EirGrid acknowledges that the Commission has provided for Interest During Construction (IDC) on the investment it has made over the past two years in respect of preparedness for SEM. EirGrid also acknowledges that the Commission has accepted the arguments put forward by EirGrid that this should reflect not only the real cost of financing but also the time value of money. EirGrid had argued, and still believes, that in this instance the real Weighted Average Cost of Capital (WACC) is an appropriate rate to be employed reflecting the need to employ both debt and equity. The Commission however, has proposed only the debt component of the WACC should be provided for. EirGrid believes that in the future the Commission must recognise that, for the funding of many projects during the construction phase, financing on a 100% debt basis is not necessarily desirable – given the impact upon debt financing costs – and indeed in many instances is unlikely to be achievable.

Interest Provision on 2007 Over-recovery

EirGrid notes that the Commission has proposed that interest be applied to the unexpected over-recovery that resulted from movements in external costs and a windfall level of interconnector receipts during 2007, which could not have been anticipated at the time the submission for 2007 was made. The Commission has proposed that the interest be applied to the €40.5m of payback over 10.5 months at 3.9%. EirGrid would remind the Commission that it was EirGrid's desire to pay back this money to consumers as soon as possible, and within 2007, but it was the position of the Commission that it sought to spread this out over the 11 month period 1 November 2007 – September 2008 and beyond. This position is further exacerbated by the Commission's decision not to accept the totality of this payback over the period in question but to defer some until 2009 or later. EirGrid does not believe that it is appropriate that it should face penalty or other liability as a result.

Even if EirGrid were to accept the argument that interest should be applied to these monies, which it does not, it also believes that the assumption that EirGrid holds those monies for a full 10.5 months is not necessarily correct. In particular, there is by necessity

a several month delay in receiving interconnector receipts from North South auctions which must be taken into account. Therefore the Commission's approach has overstated the amount of interest which should be attributable.

In addition EirGrid believes that the symmetrical approach taken by the Commission to the application of interest to over and under-recovery fails to adequately reflect that, in the real world, the rates at which one borrows and that at which deposit interest can be earned are asymmetric. The rates proposed by the Commission may be difficult to achieve for short term deposit. In addition the Commission must recognise that EirGrid is liable for tax on any interest income received and this ought to be taken into account and a post tax rate applied.

EirGrid requests the Commission reconsider this matter in relation to this particular situation, and indeed the more general application of interest provision which may more appropriately be considered on a case by case basis.

Other Matters

In the Commission's draft determination the Commission has provided for €7.5m recovery associated with the continuation of the Demand Side Management schemes administered by EirGrid on the Commission's behalf. EirGrid can advise that, while the rates for these schemes for 2007/08 remain to be determined, it is EirGrid's best estimate that the costs of payments under the WPDRS and Powersave schemes is likely to be of the order of €7.8m. However, given past accruals and a corresponding desire that these be repaid to the customer in a timely fashion, EirGrid believes that a provision of €4m for the tariff period 2007/08 may be more appropriate with a corresponding reduction in the DSM tariff.

In relation to the Inter TSO Compensation scheme, the Commission will be aware of separate discussions between the Commission and EirGrid with a decision soon to be taken as to whether to enter a scheme for 2008/09. EirGrid estimates the cost of Ireland's participation in such a scheme to be of the order of €1.6-€2.0m per annum. EirGrid notes that the Commission has currently made no provision for the costs of such a scheme in its draft determination and seeks reassurance that, should such a scheme be advanced, EirGrid will be recompensed for any costs incurred. Furthermore, should it transpire in the coming days that it appears likely that Ireland will indeed enter such a scheme, a corresponding revenue and tariff adjustment should be made.

Concluding remarks

While EirGrid can reiterate its welcome for many of the things contained within the Commission's draft determination, EirGrid nonetheless notes its disappointment that the Commission has cut back the revenue requested by EirGrid in a number of areas. Of particular concern to EirGrid is the Commission's position in respect of additional requirements in the post-SEM environment. EirGrid reiterates that the position taken by the Commission gives rise to some concerns as to EirGrid's ability to deliver upon the

obligations imposed upon it under SEM as effectively as might otherwise be the case. In addition EirGrid re-emphasises that it does not fully accept the position taken by the Commission in respect of the application of Interest During Construction and believes this may need to be re-examined, both in this instance and most certainly in the event of other instances which may arise in the future.

EirGrid is happy to discuss any aspect of this response further with the Commission and looks forward to receiving the final revenue determination.

Yours sincerely

Andrew Cooke
Director, Grid Development and Commercial
EirGrid