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

15/04/2011

Re: CER 11/027 (Consultation on Financing of the SO Preferred Connection Method in Contestable Builds)

Dear John,

Thank you for the opportunity to submit this joint response from EirGrid (the Transmission System Operator, TSO) and ESB Networks (the Asset Owner and Distribution System Operator, DSO) in response to the comments received by CER for paper CER11/027.

Guiding Principles

The guiding principles used by EirGrid and ESB Networks in preparing the original joint policy paper were:

- Assuring the UoS customer receives responsible protection in terms of risk and cost, and that any asset delivered under this process meets specifications and is fit for purpose
- Consistency with regulatory precedent and compatibility with the existing regulatory framework
- Standards and methodologies understood within the context of the existing regulatory model (e.g. approved standard charges, approved WACC for current price review etc)
- A consistent and transparent approach equally applied to all IPPs
- Above all minimal impact to the UoS customer.

Our response to the comments received is equally premised upon the basis of the application of these same principles. If it is the principles themselves which are in question then it may be that the matter needs to be re-visited. However, it is also the case that it is these principles which underpin a number of other Commission approved policies and if the arrangements were to be put in place on the basis of a different set of assumptions/ principles in this instance then these other policy areas would also need to be reviewed.

Funding Mechanism

A number of respondents indicated that their initial preferential funding mechanism for the additional works would be through a "stage payments" approach, although we note that none of the respondents ruled out the other mechanisms proposed. Having reviewed the remarks and concerns of the respondents, ESB Networks and EirGrid would like to make the following comments:

Stage Payments

We do not believe that "stage payments" represent a viable approach:

1) Contestability exists so that ESB Networks and EirGrid can step out of a construction project and the IPP can deliver. Should stage payments be introduced it would be necessary to step back into the process. Such involvement would have to be by its very nature considerable and to require a role and oversight in the contractual arrangements underpinning the developer's finance and sub contractor arrangements: essentially it would no longer be a contestable build.
2) Stage payments on a contestable basis increase risk to the UoS customer compared to a non-contestable basis. From a due diligence point of view and a sustainably and effectively managed electricity system, EirGrid or ESB Networks would be unable to agree to operate or own an asset that has yet to completed, commissioned or declared fit.
3) There is a regulatory precedent in CER 10/056 addressing a similar issue (ref Clause 2.7). To introduce stage payments for the SO preferred build would run contrary to this position. We would contend that a consistent business process informed by consistent regulatory decisions is the best way forward for all stakeholders.
4) There is a significant risk to the UoS customer that should a developer (not a contractor) fail to proceed with the project, the investment may not deliver the projected benefit.

Recommended Approach

ESB Networks and EirGrid would submit that having taken into consideration the points made by the respondents, our position remains that as laid out in our paper.

That is to say, a guarantee to make payment for additional works (driven by the system operator preferred connection method) at the completion and asset transfer stage, enshrined into our respective connection agreement/offer documents represents the most effective approach.

ESB Networks and EirGrid's connection agreement/offer documents are standard documents, which are applied consistently to all customers and represent a legally binding agreement with the respective customers. A written guarantee built into a standard contract represents a commitment to address the financing of the preferred build (over LCC/LCTA) at asset transfer stage, and in our view provides the necessary surety for the IPP and its financiers.

Cost of Debt and Standard Project Costs

Having reviewed the remarks and concerns of the respondents, ESB Networks and EirGrid would like to make the following comments:

1) It is important that any form of payment, made to an IPP, is made on a consistent basis and applying a consistent methodology. The application of standard charges and agreed costs of capital (WACC) figures, such as under the Price Review 3 process, represents such a consistent approach.
2) The UoS customer should not be exposed to a specific banking arrangement of an IPP. The unique and customer specific debt facility arrangements agreed between an IPP and their financier is entirely a matter for those respective parties and is not in any way a matter for the UoS customer. EirGrid and ESB Networks do not believe it is appropriate to socialise private banking, or other financing arrangements, to the UoS customer over which that customer has no influence or control.
3) There would be likely to be significant governance issues for EirGrid and ESB Networks in making payment to IPP's on a "vouched" basis; and furthermore, should not be liable for costs or issues arising outside their direct management control on-site. Payments made on basis of standard charges (as opposed to outturn costs) are the most equitable for the UoS customer.
4) EirGrid and ESB Networks cannot therefore accept a process whereby they are effectively paying on a "vouched" basis the unique and bespoke cost of banking for an IPP. The UoS customer must be insulated from such arrangements.

Recommended Approach

Therefore having reviewed the remarks, the model proposed under "option 2" in section "4b" is in our view a reasonable approach. Those respondents who commented and expressed a preference among the options that seek to protect and be neutral to the UoS customer expressed a preference for Option 2. This approach confers the economic benefit that would have accrued to the asset owner by completing the work non-contestably as well as index linking the rate of return This approach:

- Allows a calculation using a transparent and consistent values (the WACC and HICP rates)
- The IPP accrues the economic value (and more) in the initial timeframe of the project build that the SO would have obtained
- The overall approach is neutral to the UoS customer

Threshold

The respondents make some points regarding the thresholds as proposed in our paper (currently €1m or 25% of capital outlay). Upon reflection EirGrid and ESB Networks accept that these thresholds could be modified and therefore we propose that the paper is adapted to state thresholds of:

- €250,000 above

Or

- 5% of Capital Outlay

consistent with that sought by the greatest number of respondents to the consultation.

Should you have comments or queries, please do not hesitate to contact either Bill Thompson or Enda Feeley at EirGrid or Paul O'Brien or John O'Sullivan at ESB Networks.

Yours Sincerely,

John O'Sullivan
ESB Networks Ltd.

Bill Thompson
EirGrid plc.