Graham Craig
Gas Directorate
Queens House
14 Queen Street
Belfast
BT1 6ED

ESB welcomes the opportunity to respond to the proposals from UR with regard to BGE (NI) Cost of Debt.

As the owner of NIE, ESB has a particular interest in price control decisions for utilities operating in Northern Ireland, as well as the implications such decisions may have on price control in the wider context on the island of Ireland.

In assessing the proposals we have considered two main criteria:

1) Whether the proposals take account of NI specific investment risk
2) Whether the proposals take account of the relatively small scale of NI utility companies/networks vis a vis GB counterparts

We note that UR is not convinced of a risk premium for investing in Northern Ireland rather than Great Britain. However within the same paragraph in the consultation document, UR goes on to tacitly acknowledge that such a risk could indeed exist with regard to recently issued NIE bonds - issued at levels slightly above those of other UK utilities, due to factors including "Northern Ireland specific risk".

This point is emphasised by the First Economics report on NIE's cost of capital (prepared for UR in advance of its draft determination on RP5), whereby a 50-60 basis point difference between NIE's cost of debt and those of its GB peers may be explained by a range of factors including NI specific risk factors that might be of concern to lenders and NIE's relatively smaller size.

Furthermore ESB would point to the recent SEM Committee Decision Paper on BNE Peaker for 2013[1], where a Northern Ireland risk premium (50bps) has been included in the WACC parameters (debt premium) reflecting observed differentials between NIE and UK utility bonds.

In isolation the debt premium (1.2%) proposed by UR is on the low side. NIE's current secondary market bond levels have a credit spread of between 270-290 bps above UK Gilt

[1] http://www.allislandproject.org/en/cp_current-consultations.aspx?article=75c548a7-34ee-497c-afd2-62f8aa0062df

Yields (risk free rates). While this is of course just a snapshot of current premium levels, the credit spread for NIE tends to be higher than for other British utilities. This is most likely due to the aforementioned NI specific risk but also due to the fact that any NI utility is going to be smaller than a counterpart GB utility and is therefore subject to a debt premium due to its relative scale.

ESB would argue for consistency in regulatory determinations on this matter and that, as has been reflected in observed NIE bond issues, an investment risk premium for Northern Ireland as well as a premium due to relative scale does in fact exist and consequently should be applied to all cost of debt/WACC calculations for NI related utility price controls.

John Lawlor
Corporate Regulation, ESB