



Joint Committee on Environment and Climate Action

Tuesday, December 5, 2023

ESB Networks

Large Energy Users Rebalancing Subvention

1. Introduction

Cathaoirleach, members of the Committee, thank you for the invitation to today's meeting. My name is Nicholas Tarrant, and I am the Managing Director of ESB Networks. I am joined by my colleague Eddie Byrne, the Financial Controller for ESB Networks. We welcome the opportunity to speak to you today. Given the agenda of today's meeting we have focussed our opening statement on the Large Electricity User (LEU) subvention and we are here to address the Committee's questions on this matter. Given ESB Networks' wider role in supporting the delivery of Ireland's Climate Action Plan targets, we are happy to address any other questions as considered appropriate by Committee members.

2. Summary of Annual Distribution Use of System (DUoS) Revenue and Tariff Setting Process

2.1 ESB Networks is part of ESB Group, a commercial semi-state company, which is regulated by the Commission for the Regulation of Utilities (CRU) since 1999.

2.2 ESB Networks' role is to design, build, own, operate and maintain the electricity distribution network and, as transmission asset owner, to build and maintain the onshore electricity transmission network for all 2.4m customers. There is approximately 180,000km of electricity network across Ireland. We do not generate or sell electricity.

2.3 All electricity customers contribute to the costs of operation, maintenance and development of the electricity distribution network through a portion of their overall electricity bills. This annual process of calculating the Distribution Use of System (DUoS) network tariffs for different customers for a tariff year (which runs from 1 October to 30 September the following year) is done in two main steps, both of which are approved by CRU. The first step is the setting of the

overall DUoS revenue that ESB Networks can collect. The second step, the tariff setting process, determines how this revenue is allocated across the different customer segments in the market.

2.4 ESB Networks invoices each electricity retail company for these DUoS tariffs throughout the year, based on their customer mix and numbers. DUoS tariffs are one input to the cost of electricity and electricity retail companies, independent of ESB Networks, decide how to pass on these costs to their customers.

3. Background to Large Electricity Rebalancing

3.1 A government decision was made in June 2009 to operate an enduring LEU rebalancing arrangement to commence in the tariff year starting in October 2010. The objective of this mechanism was to deliver annual savings of €50 million for LEUs, which would be funded via a recalculation of domestic network tariffs. This was implemented in the tariff year October 2010 to September 2011 and remained in place until the end of September 2022.

3.2 In August 2021, CRU commenced a review of the necessity to retain LEU rebalancing and wrote to ESB Networks and EirGrid requesting analysis of the impact of the mechanism on different customer tariff groups, since it was first implemented in 2010. Following the completion of the initial analysis, ESB Networks informed CRU in September 2021 that an administrative error by ESB Networks had been identified with respect to the implementation of the LEU Rebalancing.

3.3 This error resulted in a misallocation of the tariffs between different customer groups in a calculation in a complex financial model. ESB Networks did not collect increased revenue and did not gain financially from this error in the allocation of the tariffs.

3.4 While the tariffs are submitted to CRU each year for approval, **this was an error in the calculation process for the tariffs made by ESB Networks. We regret that this happened and I would like to apologise to the Committee that it occurred.**

3.5 The total cumulative impact of this over-adjustment between customer groups covering the period from October 2011 onwards is €100.86m, which equates to approximately €54 per domestic customer in total since 2011.

3.6 The reversal of this misallocation is underway and is taking place across one year for domestic customers, over the tariff year October 2023 – September 2024. The recovery of the matching amount is taking place over three years for Large Users.

4. Lessons Learned and Improvements

4.1 The cause of this error was the changing of the calculation formulas in the financial model in the second year of implementation (October 2011 - September 2012) to one where a percentage change of total revenue was used in a calculation instead of a fixed annual amount. Over the years, as other variables changed, this adjustment unintentionally increased the tariff cost for domestic customers beyond a fixed €50m amount and correspondingly reduced the cost for LEUs.

4.2 With the complexity of the calculations together with the way it was programmed in the financial model, it was difficult to detect the error after the second year of implementation.

4.3 ESB Networks carried out a detailed review of the operation of the tariff model in 2022 to ensure it was fit for purpose and that appropriate “change control” governance was now in place. **ESB Networks has identified two key areas when considering lessons learned from this incident. The first relates to the need for stronger governance to oversee how changes are made to these financial models and to ensure there is a clear record of what, why and how a change was made. The second relates to the need for ESB Networks to enhance the engagement with CRU during the tariff setting process.**

4.4 There has been extensive engagement with CRU and its consultants on the calculation of the tariffs and on the nature of the error in the calculation. There has also been extensive engagement with CRU on the changes to customer tariffs both for the tariff year October 2022 – September 2023 and for the tariff year October 2023-September 2024. We will continue to work with CRU to ensure that the annual tariff process is operating effectively. We have included a copy of our report on the LEU Rebalancing as an appendix to our submission.

4.5 In addition, ESB Group Internal Audit, supported by its co-source partner, Grant Thornton delivered an Agreed Upon Procedures (AUP) Audit in June 2023 for the in scope audit period (2022/2023). The purpose of this AUP audit was to review and assess the governance and underlying operational controls that support the ESB Networks DUoS tariff setting process, specifically in the context of the 2022/23 DUoS tariffs review. The assessment of the integrity of key operational controls attaching to the selection, approval and application of Tariff Model assumptions, changes to the Tariff Model methodology and Tariff Model input calculations, for the in scope audit period (2022/2023) did not identify any material deficiencies.

4.6 ESB Networks is confident that the enhanced DUoS revenue and tariff setting process, as well as associated key controls and governance measures now in place, are fit for purpose. I’d like to conclude by again apologising for the error that occurred.