Electricity System Operator RFPR Submission Narrative: 2019/20

Contents

Introduction

This narrative supports the submission of the Regulatory Financial Performance Reporting (RFPR) pack for National Grid Electricity System Operator (NGESO) for the regulatory reporting year 2019/20.

As per the RFPR Regulatory Instructions and Guidance (RIGs)[1], the RORE tab is not required for completion.

This submission includes:

- R2 Revenue
- R3 Reconciliation to Totex
- R4 Totex
- R5 Incentives
- R6 Innovation
- R7 & R7a Financing
- R8 & R8a Net Debt
- R9 RAV
- R10 Tax
- R11 Dividends
- R12 Pensions

RoRE

Overview

The Return on Regulatory Equity (RoRE) figure is a key measure by which Ofgem compare operational and financing performance across asset based Network Operators. The methodology is not a useful comparator for assessing the performance of System Operators as they are service based, not asset based, organisations. Ofgem has agreed that the RoRE for System Operators does not need to be completed.

Revenue

(2019/20 Price base)

NGESO has two streams of Revenue, BSUoS (Balancing Services Use of System) and TNUoS (Transmission Network Use of System) which is largely pass through.

Allowed Revenue

The Allowed Revenue table only includes internal BSUoS revenue as the RFPR tables are not set up to include external BSUoS revenue or TNUoS. Network Innovation Allowances are collected through TNUoS, but flow through to the R2 Allowed Revenue table hence there is an adjustment included on line 23 to remove it from Network Allowed Revenue.

[1] https://www.ofgem.gov.uk/system/files/docs/2019/04/rfpr_guidance-decision_2.pdf

Internal System Operator Revenue

2019/20 Maximum SO Internal Revenue is £303.1m and is made up of £169.4m base revenue allowances, £131.7m MOD, £0.5m true up between forecast and actual RPI and £1.5m EMR incentive.

Revenue Reconciliation

The reconciliation to Statutory Accounts is based on our underlying accounting records, which report revenues separately between reported operating segments.

The change in accounting standards to IFRS 15 *Revenue from Contracts with Customers* was implemented in 2018/19 and reduces statutory revenue for agency income in 2018/19 and 2019/20. This creates an additional reconciling item between statutory and collected revenue.

Prior to the legal separation of ESO at the start of 2019/20 financial year, NGET's statutory accounts included revenues associated with ESO, therefore historic values included within this R2 Revenue Reconciliation are based on NGET's statutory accounts. 2019/20 figures are based on NGESO's standalone accounts, hence the difference in values.

Totex Performance

(2019/20 Price Base)

NGESO's overall total expenditure forecast as per the cost and outputs RRP for the RIIO1 period is £1,494m against forecast allowances of £1,432m. This forecast spend is £50m higher than reported in the prior year due to additional IT investment across the final two years of the RIIO1 period.

NGESO spent £130m on opex in 2019/20, which was £16m lower than in 2018/19. The primary driver of lower spend was the completion of legal separation programme, which delivered the infrastructure, systems and processes for NGESO to comply with the new obligations as a legally separate entity within the National Grid group. Additional ongoing opex costs associated with a separate ESO were more than offset by the continued delivery of multi-year efficiency savings. NGESO also saw further upward cost pressure due to the new role in looking at the introduction of early competition in in transmission networks and higher EMR auction costs following the resumption of the Capacity Market.

In 2019/20 NGESO invested £91.1m in their capex programmes, with the same level of spend planned for 2020/21. Total investment is £41m more than previously forecast, with higher expected costs to deliver changes to IT systems resulting from EU legislation changes and additional investment planned for the cyber infrastructure, platform for ancillary services and finance system enhancements. NGESO continue to invest in the capabilities to deliver their forward plan commitments and position us to take on an expanded role in RIIO2.

Prior to the legal separation of ESO at the start of 2019/20 financial year NGET's statutory accounts included totex associated with ESO, therefore historic values included within the R3 Totex Reconciliation are based on NGET's statutory accounts. 2019/20 figures are based on NGESO's standalone accounts, hence the difference in values.

Totex Table

The R4 table begins with Totex forecasts per the Cost & Outputs RRP in row 12 (*Latest Totex actuals/forecast*) and Allowances per the latest published PCFM (November 2019) in row 13 (*Totex allowance including allowed adjustments and uncertainty mechanisms*) This includes;

- Re-opener allowances set as per the May 2018 reopener decisions.
- NGET (SO) legal separation allowances are set as per the August 2018 decision.
- EMR allowances as per the September 2019 decision

Enduring Value adjustments

The overarching principle of enduring value adjustments is to recognise performance that relates to the T1 period. The below references are aligned to those in the R4 Totex tab.

a) Allowances in RRP: These allowances related to funding requested relating to CATO (£2.5m in 2019/20 prices, £1.86m in 2009/10) & Offshoring Activities (£0.6m in 2009/10 prices, £0.47m in 2009/10). These were included within the Cost and Outputs RRP submission.
b) Allowance Rephasing Adjustment: We rephase allowances compared to those in the PCFM. This better matches allowances to the level of incurred or forecasted expenditure, providing a more accurate view of in-year performance. We have presented the impact of the re-phasing allowances as a single line on the R4 Totex tab. This is appropriate as re-phasing does not affect the overall level of allowances recognised over the RIIO-T1 period, thus does not materially impact the RoRE (R4 Totex enduring value adjustment a)

Incentives

Throughout T1, NGESO has had four incentives which are reflected within the R5 Output incentives tab;

a) Electricity Market Reform incentive revenue
b) Balancing Services Incentive Scheme – No longer in place
c) Renewable wind forecasting incentive – No longer in place
d) ESO Incentive (FY19 onwards)

a) Electricity Market Reform Incentive: The 2014/15 to 2019/10 Electricity Market Reform incentive is based on actual incentive earnt within the period, 2020/21 has been forecast based on the average of historic performance. Further break down of this incentive can be found in the Revenue RRP narrative.

d) ESO Financial Incentive (FY19 onwards): This incentive replaced the previous Balancing Services Incentive Scheme (BSIS). The 2019/20 incentive value is reflective of the £1m awarded by Ofgem following direction on the 31st July 2020. The 2018/19 inventive value has been updated to £0.86m to reflect the direction on 9th August 2019 (after RFPR19 was submitted). No 2020/21 forecast has been provided for this incentive as it subjective and not derived from licence algebra.

Innovation

(2019/20 Price base)

Network Innovation Allowance

Eligible NIA Expenditure is the net costs per 2019/20 C&O RRP. This includes internal expenditure but excludes Bid Preparation Costs for the Network Innovation Competition Fund. In line with NIA Governance, Eligible NIA Expenditure is reported net of external funding. NIA annual summaries are published on the National Grid Electricity System Operator website[2].

In 2019/20 the Electricity System Operator spent £2.9m of its £3.3m allowable NIA expenditure, 90% of which is funded through the allowance. 21 eligible NIA projects aligned to our new 2020 Innovation Strategy were progressed in the year.

Network Innovation Competition

In 2019/20 the Electricity System Operator spent £4.2m NIC expenditure. 5 eligible NIC projects were progressed in the year, three of these NGESO led EFCC (known as SMART Frequency Control), TDI 2.0 (known as Power Potential) and Blackstart from DER (known as Distributed Restart) NIC projects. NGESO provided input into and receives NIC funding for two other projects, Phoenix that is led by Scottish Power Energy Networks and EFFS that is led by Western Power Distribution.

Financing and Net Debt

Overview

As agreed with Ofgem, for the purposes of completing the RFPR, regulatory net debt for NGESO relates to the BSUoS part of the NGESO business only, therefore the Financing and Debt tables have been completed on this basis. There are a number of lines within the tables which remove items relating to TNUoS.

Changes in assumptions and methodology from 2019: Legal Separation

NGESO was legally separated from NGET (TO) on 1st April 2019. From 2019/20 onwards, the debt and financing costs relating to NGESO are no longer shown as an allocation within NGET (TO) tables, these are now in the NGESO tables. For ease and to provide a consistent view across T1, the historic allocation to NGESO from NGET, has also been populated.

Financing

(2009/10 Price base)

Assumed regulatory finance cost at actual gearing for T1 is £3.0m, and £3.9m at notional gearing. This compares to allowances for the same period of £12.2m

Net debt

(2019/20 Price base)

T1 regulatory net debt including forecast for new debt is £132.8m. Actual gearing in 2020/21 is forecast at 42.5% compared to notional gearing of 60%.

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[2] https://www.nationalgrideso.com/innovation/projects/network-innovation-allowance-nia

The 'Loans from other group companies' of £121.0m in 2019/20 relates to the term loan from National Grid plc to enable Legal separation, this is forecast to remain the same in 2020/21. Loans to other group companies are £346.3m, most of this relates to TNUoS cash and is therefore removed from the regulatory defined Net debt.

RAV

(2009/10 Price base)

The RAV table utilises the PCFM published in November 2019 to calculate the adjusted RAV balances. The Opening RAV, Transfer, RAV for net additions (after disposals) and Depreciation lines are based upon the 2019 PCFM updated with Totex per the Cost & Outputs RRP submission.

To calculate the impact of Enduring value adjustments and updates to Totex and allowances, the 2019 PCFM is updated to include; Totex actuals and forecasts per the Cost & Outputs RRP, forecast allowances per Cost & Outputs RRP and Enduring Value adjustments. The enduring value adjustments are explained in the Totex Performance section above.

The closing RAV in 2021 has increased from £159.5m in the 2019 submission, to £164.5m in the current year submission. The primary reason for the change is the increase in the Totex forecast compared to 2019 within the C&O RRP.

Tax

(2009/10 Price base)

Forecast tax allowance for 2019/20 is £3.4m and forecast tax performance is £0.1m at actual gearing and £0.9m at the notional gearing level.

The forecast tax allowance is derived from the PCFM post enduring value adjustments.

Dividends Paid and Current Policy

There is no dividend disclosed for ESO for the period through to 2020. Prior to legal separation and separate reporting from 2019/20, dividends were declared and paid by NGET plc. Following the separation of ESO from Electricity Transmission the ESO Board will submit separate accounts and set any future dividends.

Pensions

(2009/10 Price base)

Pension deficit payments were broadly in line with the prior years. The pension scheme valuation is performed tri-annually, the valuation presented in the 2019/20 RFPR is therefore the same valuation as that presented for 2018/19. The next scheme valuation is due during 2020/21.

Data Assurance statement

The RFPR submissions have been completed in line with the Ofgem Data Assurance Guidelines (DAG) process. This mandates a fully documented 2 level review process. The overall submission and regulatory judgments have been signed off at Director level.

In summary, the following assurances were completed:

1. Assurance Template completed by Data Provider
2. First Level Reviewer
3. Second Level Reviewer
4. Independent Expert Reviewer/ Internal Data Audit
5. Manager & Senior Manager
6. Director Sign Off

Appendix

Table Changes / Restatements

Data tab

Within the Data tab National Grid has updated row 39 *MR New Forecasts RPI* per the May 2020 publication and cells E24 and F24 per Ofgem's request.

National Grid has also updated the Cost of Debt allowance in 2021 on rows 66 and 68 to reflect the correct values per the PCFM.

R2 Rec to Totex

Two lines relating to pensions (IAS19 PV accrual and Pensions payments relating to post cut off data service) have been removed from the Reconciling Items to Totex section for prior years. The RRP Totex includes values associated to these items and therefore they are not reconciling items.

R5 Output Incentives

There have been some small restatements to the EMR incentive revenue data compared to last year's submission, this is as a result of more accurately reflecting when the incentive is earnt rather than when it is received through revenues.

R7 Financing

Formula error corrected as requested by Ofgem. Old, incorrect formula:

Cell D37 = ('R8 - Net Debt'!D54-AVERAGE('R8 - Net Debt'!D8,('R8 - Net Debt'!E10-'R8a - Net Debt input'!T18)))*(Data!C36-1)

Correct updated formula:

Cell D37 =('R8 - Net Debt'!D54-AVERAGE('R8 - Net Debt'!D8,('R8 - Net Debt'!D10-'R8a - Net Debt input'!T18)))*(Data!C36-1)

R10 Tax

In previous RFPR submissions, an adjustment was included within the table to remove tax relating to ESO incentives, this was an oversight as the tax on incentives is already included within the blue 'Tax on incentives' line, the tables have been updated to correct this.