National Grid Electricity System Operator RFPR Submission Narrative: 2020/21

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 2020/21.

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

This submission includes:

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

In line with the RIGs, the RFPR pack and narrative will be resubmitted at a later date but within 2 weeks of the ESORI incentive direction from Ofgem, at which point the pack will include the R2 Revenue and R5 Incentives tabs and associated narrative.

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

(2020/21 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

2020/21 Maximum SO Internal Revenue is £222.7m and is made up of £126.2m base revenue allowances, £36.3m MOD, £(0.1)m true up between forecast and actual RPI and £(1.4)m 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, 2019/20 and 2020/21. 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 and 2020/21 figures are based on NGESO's standalone accounts, hence the difference in values.

Totex Performance

(2020/21 Price Base)

NGESO's overall total expenditure as per the cost and outputs RRP for the RIIO1 period is £1,501.6m against forecast allowances of £1,449.2m. This spend is £10.5m lower than reported in the prior year.

NGESO spent £122.7m on opex in 2020/21, which is £8.8m lower than in 2019/20. The primary driver of the reduction in year on year cost is due to £10.0m decrease in restructuring costs as the multi-year efficiency programme is nearing completion. Other cost reductions are due to less RIIO2 activity and a reduction in travel, training and utilities costs following Covid-19 restrictions. These were partially offset by increased activity in developing NGESO's role in early competition and offshore co-ordination as well as a further reduction in income from Cadent as they fully transition to their own IT provision.

Reported Uncertainty Mechanism (UM) costs of £7.1m are significantly higher than in prior years. This is due to an adjustment of £4.1m to align NGESO's regulatory reporting to the final Enhanced Security Re-opener cost report, where they performed a deep dive on ongoing support costs for security specifically relating to the Re-opener to ensure that all relevant costs had been correctly classified. The £4.1m adjustment has the effect of reporting prior years support costs previously classified as IT to the security UM in 2020/21, with an offsetting decrease in 2020/21 IT costs. This has no impact on the overall 2020/21 IT costs (IT costs plus UM costs), which are fully reconciled to our underlying systems.

In 2020/21 NGESO invested £88.4m in their capex programmes, decreasing marginally by £0.2m from 2019/20. Total investment is £1.9m more than previously forecast.

NGESO continued to invest in, and maintain, critical IT infrastructure for Great Britain's electricity system, and to innovate in order to anticipate and respond to new demands in technology in de-carbonisation, de-centralisation and digitalisation to drive significant change across the energy sector. NGESO have also invested in technology to help support the business to meet its needs during Covid-19.

CNI Data Centres spend continued through 2020/21 and all RIIO1 deliverables were completed by the end of the year. Other key expenditure has been in European Future Energy Regulations, Platform for Ancillary Services (PAS) and Shared Services Systems.

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 PCFM (Legacy MOD1 PCFM agreed in November 2020) 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.

Enduring Value adjustments

The overarching principle of enduring value adjustments is to recognise performance that relates to the RIIO1 period. The below references are aligned to those in the R4 Totex tab.

a) Allowances in RRP: Allowances included in the RRP which are not already in the PCFM total to 2.2m (2009/10 prices). These allowances relate to
   - funding requested relating to CATO (£2.1m in 2020/21 prices, £1.52m in 2009/10);
   - Offshoring Activities (£0.8m in 2020/21 prices, £0.6m in 2009/10) and;
   - CMP345 (£0.2m in 2020/21 prices, £0.1m in 2009/10).

b) Allowance Rephasing Adjustment: NGESO rephases 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. NGESO 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 RIIO1 period.

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 (2018/19 onwards)

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

d) ESO Financial Incentive (2018/19 onwards): This incentive replaced the previous Balancing Services Incentive Scheme (BSIS). The 2020/21 incentive value is reflective of the £5m awarded by Ofgem following direction on the 30th July 2021.

Innovation

(2020/21 Price base)

Network Innovation Allowance

Eligible NIA Expenditure is the net costs per 2020/21 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 2020/21 the NGESO spent £2.6m of its £3.3m allowable NIA expenditure, 90% of which is funded through the allowance. 25 eligible NIA projects aligned to our new 2021 Innovation Strategy were progressed in the year. In the course of the year, NGESO received £0.3m in 3rd party income / contributions for the RecorDER and 4D heat projects.

Network Innovation Competition

In 2020/21 the Electricity System Operator spent £4.7m NIC expenditure. 4 eligible NIC projects were progressed in the year, two of these NGESO led 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 RIIO1, the historic allocation to NGESO from NGET, has also been populated.

Financing

(2009/10 Price base)

Assumed regulatory finance cost at actual gearing for RIIO1 is £4.1m, and £5.7m at notional gearing. This compares to allowances for the same period of £12.2m.

Net debt

(2020/21 Price base)

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

RIIO1 regulatory net debt is £91.3m. Actual gearing in 2020/21 is 33.1% compared to notional gearing of 60%.

The 'Loans from other group companies' of £120.6m in 2020/21 relates to the term loan from National Grid plc to enable Legal separation. Loans to other group companies are £185.9m, 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 2020 Legacy MOD1 PCFM agreed with Ofgem in November 2020 to calculate the adjusted RAV balances. The Opening RAV, Transfer, RAV for net additions (after disposals) and Depreciation lines are based upon the 2020 Legacy MOD1 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 above 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 decreased from £164.5m in the 2020 submission, to £163.3m in the current year submission. The primary reason for the change is the decrease in actual RIIO1 Totex compared to RIIO1 totex forecast in 2020 within the C&O RRP.

Tax

(2009/10 Price base)

Forecast tax allowance for 2020/21 is £4.1m and forecast tax performance is £0.1m at actual gearing and -£0.1m 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 NGESO for the period through to 2020/21. Prior to legal separation and separate reporting from 2019/20, dividends were declared and paid by NGET plc. Following the separation of NGESO from Electricity Transmission the NGESO 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 2020/21 RFPR is therefore an update to the valuation presented for 2019/20. The next scheme valuation is due during 2023/24.

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 NGESO has updated the 2020/21 Financial Year Average RPI and Year End RPI and the M3 New Forecasts RPI per the May 2021 publication as agreed with Ofgem.

Innovation tab

Within the Innovation tab NGESO has restated the Network Innovation Competition values (row 20 and 21) for 2016/17- 2019/20, this is as a result of increased funding for Power Potential (known as TDI 2.0), which is phased in line with spend. In addition, there was a minor error in the RPI uplift used in the prior year submission, this has been corrected and processes put in place to ensure this doesn't occur again in the future.