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National Grid
Gas Transmission System Operator

Regulatory Financial Performance Report Narrative for 2019/20

August 2020

Contents

National Grid Gas Transmission (SO) RFPR submission narrative – 2019/20

Introduction

The main purpose of this report is to provide a useful summary of National Grid Gas System Operator financial and operational performance and represents 'Year 7' of the eight- year RIIO regulatory period. This report will explain the Enduring Value Adjustments and their impact on RIIO Financial Performance, provide statements that the appropriate level of data assurance has been met and explain any material changes in performance when compared to the 2018/19 submission.

This narrative supports the submission of the National Grid Gas Transmission (NGGT), System Operator (SO) Regulatory Financial Performance Reporting (RFPR) pack. Given the current requirements of the Regulatory Reporting Pack (RRP) narratives overlap with those of the RFPR narrative. We refer to the published RRP narrative as required to avoid duplication.

As per the RFPR Regulatory Instructions and Guidance (RIGs)[1], the following sections are not required for input and thus have not been published or commented on within this narrative.

- R1 – RORE
- R6 – Innovation – Total NGGT (TO+SO) Innovation is reported within NGGT TO RFPR.
- R7 – Financing - The SO element is an allocation of TO net debt and financing cost and is reported in the TO RFPR.
- R8 – Net Debt - The SO element is an allocation of TO net debt and financing cost and is reported in the TO RFPR.
- R11 – Dividends

The required sections are the following:

- R2 – Revenue
- R3 – Rec to Totex
- R4 – Totex
- R5 – Output Incentives
- R9 – RAV
- R10 – Tax
- R12 – Pensions
- R13 – Other Activities

[1] https://www.ofgem.gov.uk/system/files/docs/2020/06/rfpr_-_guidance_2.0.pdf

Revenue

(2019/20 Price base)

The Maximum Allowed Revenue (MAR) for 2019/20 is £243.4m and is based upon the Revenue RRP. Full Break down of NGGT SO's MAR is provided in the below table:

Licence Term	2018/19 (18/19 price base)	2018/19 (Restated to 19/20 Price Base £m)	2019/20 (19/20 price base)	Commentary for year on year variance (Commentary in 19/20 price base unless otherwise stated)
Base Revenue (SOPU)	94.6	97.8	140.9	• +£2.8m increase in opening base revenue allowances (SOPU). • +£39.3m increase in MOD. Detailed MOD commentary is included in **Final Proposals base revenue against adjusted base revenue** section. • +£1.1m relating to TRU in 2019/20 as a result of the movement between forecast and actual RPI in 2019/20 compared to the movement in 2018/19.
Constraint Management (CM)	13.3	13.7	14.1	• The 2019/20 revenue includes the cost adjustment of £37.6m plus incentive revenue of £16.4m for 2017-18 performance. • Above values are quoted after WACC and RPIF uplifts have been applied. • The cost adjustment and incentive revenues are subject to a two-year lag from the year of performance.
Transportation Support Services (TSS)	(1.0)	(1.0)	(5.9)	• The 2019/20 revenue does not include any ex-ante allowance. The cost adjustment is -£-10.6m plus incentive revenue of £4.7m for 2017/18 performance. • Above values are quoted after WACC and RPIF uplifts have been applied. • The cost adjustment and incentive revenues are subject to a two-year lag from the year of performance.
Incentives (SOOIRC)	108.1	111.7	106.6	• Further detail on incentive costs and performance is included below.
Correction Term (-SOK)	(16.6)	(17.2)	(12.3)	• The correction terms in 2019/20 is based on the £11.7m over-collection of revenue in 2017/18 (as reported in the 2017/18 submission) subsequently uplifted as per the licence algebra requirements to £12.3m.
Maximum Allowed Revenue	**198.4**	**205.0**	**243.4**	

The MAR compares to collected revenue of £222.7m. The under-collection is mainly due to higher Shrinkage costs, an increase in Incentive performance and lower gas capacity prices as detailed in the below table.

Charge period	MAR £m	Commentary
April 2019 Charge Setting (Forecast)	243.8[2]	MAR forecast figure for charge setting
October 2019 Charge Setting (Forecast)	240.7[3]	Change due to an increase in forecast of SO External Cost Incentive including within Shrinkage (Compressor Costs) and Residual balancing costs.
July 2020 RRP submission	243.4	Change due to final Shrinkage costs and an increase in External Incentive performance coming in higher than forecast at October charge-setting, hence more in line with original April forecast.
Charge period	**Collected Income £m**	**Commentary**
July 2020 RRP submission	222.7	£8.5m and £2.3m increase in shrinkage costs and shrinkage incentive revenue respectively compared to final charge setting as well as lower gas capacity prices have resulted in under-recovery over the year.

Reconciliation to statutory accounts

The reconciliation to Statutory Accounts is based on our underlying accounting records, which report revenues separately between reported operating segments. They likewise hold separate information in the case of the TO and SO, which are reported under the same segment within our statutory accounts. As such the reconciling items disclosed in the table are sourced from our accounting records with no specific allocation or methodology adjustments for the RFPR tables.

The change in accounting standards to IFRS 15 *Revenue from Contracts with Customers* was implemented in 2018/19 and reduces statutory revenue for NGGT in 2018/19 and 2019/20. This created an additional reconciling item between statutory and collected revenue and a reduction in statutory revenue for agency income and a change in timing of revenue recognition for connections and diversions.

[2] April 2019 Charge setting Statement: Charging Information Provision - April 2019 Final https://www.nationalgrid.com/uk/gas-transmission/charging/transmission-system-charges (Published 1 Feb 2019)

[3] Oct 2019 Charge setting Statement: NTS Charge Setting Information October 2019 Final: https://www.nationalgrid.com/uk/gas-transmission/charging/transmission-system-charges (Published 1 Aug 2019)

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Totex Performance

(2019/20 Price base)

Overview

Per the Cost & Outputs RRP20 submission, the overall NGGT SO forecast Totex costs for the T1 period are £779m against allowances of £879m. The main areas of difference compared to RRP19 are:

- Capex – NGGT SO are forecasting to spend £69m less than allowances as a result of lower forecast spend on Xoserve and Telemetry separation. The lower Xoserve spend is driven by a change in strategy for Gemini investment and a lower level of EU driven Gemini change work.

- Opex – the underspend to allowances for Opex of £32m is largely driven by a higher proportion of Xoserve allowances being allocated to direct Opex following the outcome of the review of agency costs.

Performance for NGGT SO is £100m. Compared to the Cost & Outputs RRP19, the main movements are:

- SO Capex – NGGT SO performance compared to last year is higher by £11m mainly due to enhanced security costs. This is lower than allowances reported in 2018/19.

- SO Opex – performance is broadly in line with that reported in the prior year. Our Opex forecast for the eight years has reduced by £4m in real terms.

Further break down of Totex performance can be found in the Performance Summary in the Cost & Outputs RRP narrative. No additional judgments have been included within the RFPR tables that impact Totex performance.

Enduring Value adjustments

There are two enduring value adjustments;

a) Allowance Rephasing Adjustment: this is to align with the spend profile 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.

b) Recategorise Central Agency allowances: This moves allowances from Uncertainty rate to Non-uncertainty rate in order to align with spend within the Cost & Outputs RRP.

Totex Table

The R4 table begins with Totex forecasts per the Cost & Outputs RRP in row 12 and 40 and Allowances per the latest published PCFM (November 2019) in row 13 and 41.

Historically, NGGT TO depreciation was included in row 26, ‘Operational costs related to GTO per statutory accounts’, in 2019/20 this is reflected in row 38, ‘Depreciation, amortisation and other capex adjustments’.

Output Incentive Performance

NGGT SO has a number of Output incentives, performance on each is detailed below.

- Constraint Management
- Transportation Support Services
- Shrinkage Incentive
- Quality of Demand Forecasting Incentive
- Residual balancing
- Greenhouse Gas Incentive
- Maintenance Incentive

a) Constraint Management Incentive Scheme

The Constraint Management Incentive is designed to drive National Grid to maximise available network capacity and minimise constraint management costs through the efficient and economic planning and operation of the NTS.

NGGT SO therefore releases as much capacity as possible and develop effective constraint management strategies. This benefits National Grid's customers, and ultimately end consumers, as the costs of commercial constraint management actions to Industry are mitigated or minimised and balanced against NTS investment whilst maximising NTS capacity.

Running a constraint-free network provides choice for our customers to land and utilise the cheapest gas and has a positive impact on the market. A robust Constraint Management Incentive drives an effective strategy which delivers value to Industry and end consumers, who share in the benefit of strong performance.

The 2019/20 Constraint Management Incentive Reward was £14.8 in 2019/20 prices (10.2m in 2009/10 prices base) and is subject to a 2-year lag, therefore will be paid in 2021/22.

b) Transportation Support Services Incentive Scheme

The Transportation Support Services (TSS) scheme incentivised National Grid to minimise the cost of procuring specific tools to support gas demand in the South West as an alternative to network investment. This incentive ceased in October 2018 with no spend incurred during 2019/20.

c) Shrinkage incentive

The aim of the Shrinkage incentive scheme is to minimise the costs we incur in our role as NTS Shrinkage Provider. These costs are recharged back to users as part of NTS commodity charges.

The overall volume of shrinkage gas and electricity procured for the combined elements of Shrinkage (Compressor Fuel Usage (CFU), Unaccounted for Gas (UAG) and calorific value (CV) shrinkage) was 4,536 GWh gas equivalent in 2019/20. This represents an increase in overall volume of 1,313 GWh gas equivalent from 2018/19. This is largely due to an increase of 1,814 GWh in the volume of UAG, outweighing a decrease of 543 GWh gas equivalent in the volume of CFU.

The volume of CFU was 32% lower than in 2018/19, driven by a continued decline in the supplies at the St Fergus terminal, with NTS demand relatively low and higher LNG supplies.

In managing the NTS Shrinkage incentive scheme we incurred costs of £80.1m, including £60.4m for gas trades and £15.7m for electricity trades. This is higher than costs for 2018/19 (£77.5m), as higher gas volumes outweighed lower overall market prices. Against the total incentive target of £97.3m, this represents a £17.2m outperformance that is shared with customers.

This results in an incentive value of £7m in 2019/20 prices (5.2m in 2009/10 prices per Table R5)

d) Residual Balancing Incentive Scheme

The aim of the Residual Balancing incentive scheme is to incentivise National Grid's residual balancing activities in two ways:

- The Linepack Performance Measure (LPM) incentivises National Grid to minimise differences in Linepack volumes between the start and end of each gas day. This is to ensure that any system imbalances within the day are resolved, and that any associated costs are levied across those system users responsible for that day's imbalance.

- The Price Performance Measure (PPM) evaluates the impact National Grid has on the market in its Residual Balancing role by measuring the price range of its trading actions compared to the System Average Price (SAP). This incentivises the System Operator to minimise the impact it has on market prices.

In 2019/20 NGGT SO continued to manage the risks posed to the system both within the day, whilst also adopting a proactive approach by using trend analysis and forecasting to assess the future risk to the NTS. NGGT SO earnt an incentive of 0.94m in 2019/20 prices (0.7m in 2009/10 prices per Table R5).

e) Quality of Demand Forecasting Incentive

The national demand forecasts published by National Grid for day ahead (D-1) and for two to five days ahead (D-2 to D-5) are a key tool for the UK gas industry in ensuring the economic balancing of gas supply and demand. Timely and accurate forecasts aid in ensuring efficient operation from both a physical and commercial perspective, ultimately reducing operating costs which directly impact on end consumers gas bills. National Grid strives to continually optimise its forecasting processes, to deliver greater accuracy and increased consumer benefit.

In 2019/20, the weighted average error on the D-1 incentive was 8.55 mcm against a target of 9.12 mcm (Fixed target of 8.5 mcm + storage adjuster of 0.6205 mcm). The weighted average error has decreased this year from 8.90 mcm in 2018/19. The associated incentive revenue for 2019/20 is £1.01m, compared to -£0.86m in 2018/19.

The D-2 to D-5 incentive weighted average error was 12.90 mcm in 2019/20 against a target of 13.70 mcm. The weighted average error has decreased from 13.44 mcm in 2018/19[4]. The associated incentive revenue for 2019/20 is £0.58m, compared to £0.19m in 2018/19.

This results in a total incentive value of £1.57m in 2019/20 prices (1.2m in 2009/10 prices per Table R5)

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[4] The weighted average error was incorrectly reported as 12.44 mcm in the 2018/19 RRP, however the associated incentive revenue was accurate.

f) Greenhouse gas incentive

The aim of the GHG incentive scheme is to incentivise NGGT SO to reduce the amount of natural gas vented from our compressors (primarily methane), and to reduce the effect of our operational activities on the environment. This is important to us, our customers and stakeholders.

The emissions allowance is set each year by Ofgem, the allowance for 2019/20 is 2,897 tonnes. The total amount of natural gas vented from compressors in 2019/20 was 2,500 tonnes, which is 86% of the target allowance and the lowest level in the RIIO-T1 period to date. This is a reduction of 13% compared to the total amount of natural gas vented from compressors in 2018/19, and the second year running that we have not exceeded our allowance.

The average venting through compressors in the RIIO-T1 period including 2019/20 is 3,140 tonnes, with a maximum venting of 3,928 tonnes (2017/18) and a minimum 2,500 tonnes (2019/20).

The volume vented reduction was primarily due to two factors; continued high focus across our business to reduce compressor pressurisation and venting within operational and maintenance outage periods, and a reduction of compressor running hours.

The focus for 2019/20 was to further improve venting performance from previous years and build on the initiatives to reduce controllable emissions identified through project work completed from 2017 through to 2019. Specific strategies to focus on key controllable areas to reduce Static and Dynamic Seal emissions with collaboration between Operational Sites and Control room activities.

g) Maintenance Day Changes Incentive Scheme

The aim of the Maintenance Day Changes incentive is to reduce the impact our maintenance activities have on customers, should we make changes to our planned maintenance after 1 April for the forthcoming summer maintenance period. The incentive scope does not include changes which were initiated by customers, only those initiated by us.

In total, there were 152 days of planned maintenance in 2019/20, compared to 184 days in 2018/19. This decrease, driven in part by a higher volume of internally impacting works that do not have a third-party impact, led to an updated benchmark for changes of 11.02 days in 2019/20, which is 7.25% of all Maintenance Days and Advice Notice Days called. This compares to a benchmark of 13.34 days in 2018/19.

In 2019/20, there were six changes initiated by NGGT SO during the maintenance period. This is an increase from zero changes in 2018/19. The six cancellations were all related to the same cancelled In-Line Inspection, due to an issue with an inspection chamber, with the learning from this event being implemented across the relevant teams.

This results in an incentive value of £0.47m in 2019/20 prices (0.3m in 2009/10 prices per Table R5)

Forecast Incentive Performance

Forecast output incentives are assumed to be an average of the actual earned incentives in T1 to date, unless the incentive has ceased.

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 2020/21 has increased from £110.0m in RFPR19 to £114.3m in RFPR20 reflecting the change in performance since last year's submission.

Tax

(2009/10 Price base)

Forecast tax allowance for 2019/20 is £2.5m and forecast tax performance is £2.5m at both notional and actual gearing levels. Ignoring the impact of financing performance, residual tax performance continues to be minimal.

The allocation of the NGG tax attributable to TO and SO is in line with the allocations used within our underlying accounting systems and is reflected in the Statutory Accounts. There are no specific allocations made for the RFPR tables. The forecast tax allowance is derived from the PCFM after applying the enduring value adjustments detailed in R4 Totex.

Pensions

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

Basis of any estimates and allocations

Where allocation between NGGT (TO) and NGGT (SO) has been required, this has been done on a RAV basis, including Dividends.

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. The Financial year End RPI for 2019/20 in cell E24 has also been updated to reflect the RPI provided in the Cost & Outputs RRP.

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 Revenue

The 2019/19 MAR value has been restated from 197.7m to 198.4m, an increase of 0.6m as a result of updates to the Incentive revenue adjustment (row 15).

R5 Output Incentives

Constraint Management

Following a change in the RPIF the incentive earned value for 2018/19 increased from £8.7m to £9.1m.

Transportation Support Services

Following a change in the RPIF the incentive earned value for 2018/19 reduced from -£2.0m to -£2.1m.

Greenhouse Gas Incentive

An error in calculation due to a time lag issue has resulted in the removal of £0.5m for the 2018/19 incentive as no incentive was earned in year.

R10 Tax

In previous RFPR submissions, an adjustment was included within the table to remove tax relating to GSO 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.