Cadent
Your Gas Network

Regulatory Financial Performance Reporting (RFPR) Commentary

RIIO-GD1

July 2021

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Executive Summary

Overview

Our Regulatory Financial Performance Reporting (RFPR) comprises of information for each of our 4 networks in line with the Regulatory Instructions and Guidance (RIGs) and clarifications received during the course of preparation.

Our RFPR submission and our Strategic Performance Overview (SPO) both address the regulatory performance of Cadent. Consequently the 2 documents should be read in conjunction. Specific details of our key operational performance measures can be found within section 4 (pages 32-75) of our SPO. We have discussed the key financial performance measures below and have also discussed these within section 3 (pages 20-31) of our SPO.

The enduring value concept, the principles of which were discussed at length during the implementation of the RFPR in 2018, impacts the phasing of the historic and future annual RORE values across our networks; however, on an eight year average basis the operational RORE values are largely unaffected. Our methodology for each of the enduring value adjustments is described in more detail in section 3.1; as per last year the adjustments have the overall effect of deferring allowances from earlier years into later periods. These enduring value adjustments impact presentation of the RAV balance but are presentational and do not affect Cadent's actual closing RAV at the end of the RIIO-GD1 period which is reported through the RIIO-GD2 Price Control Financial Model.

For our reported debt costs, we include analysis below of adjustments which need to be made to properly reflect the true economic costs of our debt. These adjustments have a natural correcting effect on the debt outperformance. Full details of the rationale and basis of these adjustments are set out in section 6 of this document. Throughout this document our commentary refers to our performance inclusive of these debt adjustments.

COVID-19

Since the start of the pandemic, we have taken steps to make sure the safety, health, wellbeing and financial security of our employees was a priority. This has allowed us to continue to provide an outstanding service to customers in this difficult period. We committed to a number of key measures to ensure colleagues were safe; this included basic pay for all colleagues no matter what their circumstances until the 31 March 2021 without requirement to use the government furlough scheme.

Whilst the COVID-19 pandemic has had a significant impact on society and we have had to respond to the operational challenges associated with this, there has been a relatively small impact on our income statement, statement of financial position and statement of cash flows for the 2020/21 financial year.

As a result of self-isolation and shielding guidelines we experienced increased levels of staff absence, but this did not impact our ability to maintain high standards of customer response and service. We have incurred direct COVID-19 costs of £5m for items such as PPE and equipment, to enable our employees to continue working both in the field and from home and as a result of adapting our in-house training courses to ensure social distancing can be maintained, whilst delivering safety critical training to our workforce. We estimate that £3.5m of indirect costs were incurred as a result of large sections of our workforce being unable to complete normal work activities as planned during the early stages of the lockdown.

Early in the pandemic we actively engaged with Ofgem to help protect shippers and suppliers by supporting the 'COVID-19 Shipper Liquidity Relief Scheme' during 2020/21. This involved the relaxation of network charge payment terms for those suppliers and shippers who were facing cash flow challenges and met the terms of the scheme as a result of COVID-19, whilst ensuring that we were not exposed to any significant credit losses that might emerge should a shipper subsequently fail. We capped our exposure to the timing of these deferrals to £50m, all cash has now been received with the exception of £1.4m due from one shipper who entered administration. In addition, a further shipper (not participating in the liquidity scheme) failed in January 2021 with the credit exposure of £2m outstanding currently being recovered through our security arrangements from their parent company. Our existing security arrangements have reduced our exposure to £1.4m in total, which we will be able to recover in the RIIO-GD2 price control period through the newly implemented bad debt recovery mechanism.

Overall Performance

RORE (including financing and tax) forecast for RIIO-GD1 period is 9.52% (10.98% before adjustments to reflect the true economic cost of our debt) with the breakdown across our 4 networks set out in section 1 below.

Our overall RORE performance reflects our focus on ensuring that both delivery of our operational outputs for the 8-year price control period and the cost base being optimised to deliver the outputs as efficiently as possible.

Compared to the prior year the RORE has reduced by 0.39%. The reduction is due to a drop in Debt Performance which is measured real i.e. with out the inflation component. Given that the majority of our debt is fixed cost, the quantum of the inflation strip from the debt costs is significantly lower than forecasted last year as a result of COVID-19 impacting inflation. Offsetting this is a lower net debt position as we did not make any dividend payments and built resilience into the balance sheet in readiness for RIIO-GD2.

The adjustment to show our true economic costs of debt has not changed relative to our prior year submission and is detailed below.

Debt Performance

Cadent benefits from a comparatively low relative cash cost of ongoing debt as our debt was raised and refinanced largely in a single financial year when interest rates were low. As a result, we outperform the 10-year average Iboxx index used for allowance setting. To achieve this comparative low cost of debt significant one-off cash costs were incurred in FY2017. We have included in our analysis below the impact of incurring these one off cost as we believe this provides a fairer reflection of the true economic cost of our debt. However, currently the RIGs do not support reporting these costs in the RFPR.

Separately, Ofgem has completed cross checks on this adjustment which identified a comparable total quantum. Further details are provided in the detailed commentary below.

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Detailed Commentary

Data Assurance

As we became an independent business in 2016/17 and are now separated from National Grid, we have limited access to some elements of the historic information. Consequently, we have used the Gas Distribution totals from available information including the Regulatory Accounts, PCFM submissions and where available, extracts from the RRP submissions in replacement for the statutory account numbers requested. Starting with a Gas Distribution position instead of the statutory position is a deviation from the RIGs which has been separately agreed with Ofgem. For periods after 2016/17 we have provided actual performance information from our statutory accounts.

For the historic years throughout the tables, we have used either the Regulatory Accounts or the RRP data already submitted to Ofgem where possible. Where this has not been possible we have obtained supplementary information from National Grid. Ofgem has confirmed their agreement to us not including the detailed historic information on the financing tabs.

The information submitted in the RFPR has been subject to a high level of internal reviews including data accuracy and completeness checks as well as independent reviews wherever the table is deemed to be a high risk table.

Overview of Regulatory Performance

1. RORE

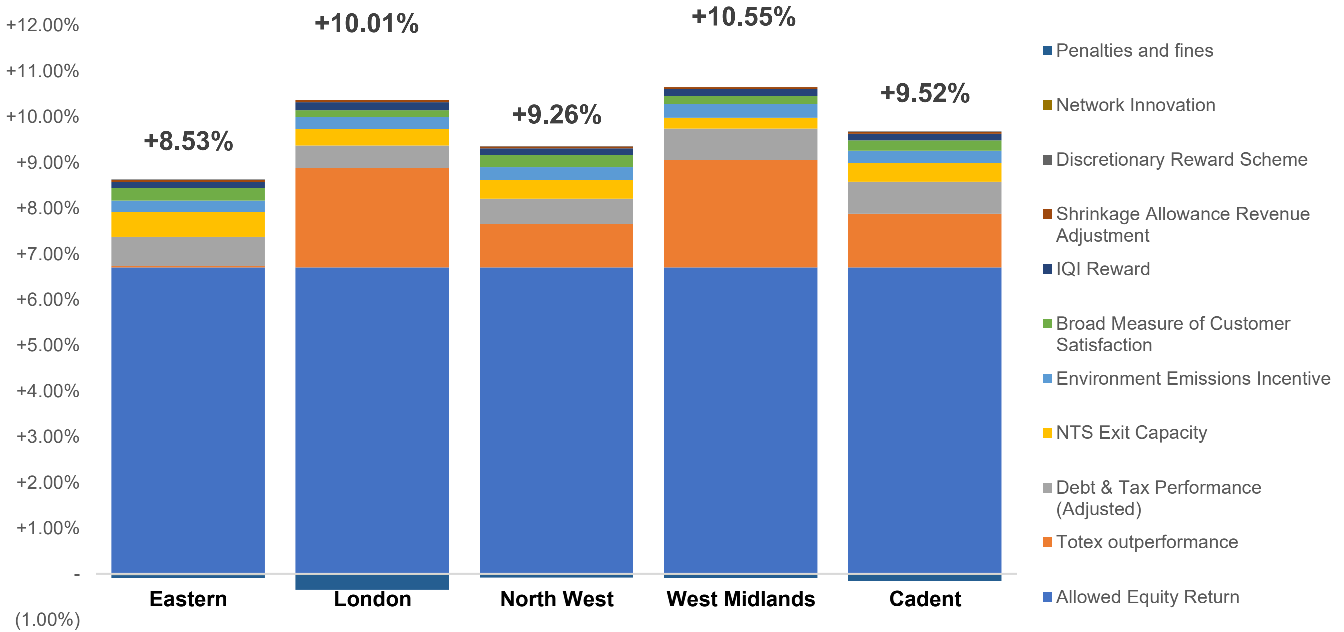
The RORE tab within the RFPR pack expresses the Return on Regulated Equity based on both notional gearing and actual gearing, as well as showing the monetary value of performance for each year of RIIO-GD1 in constant prices.

The overall operational RORE has increased from 8.78% in FY19/20 to 8.82% in FY20/21. The increase is driven by marginal improvements across Totex outperformance, broad measure of customer satisfaction, environmental emissions incentive and penalties & fines. Additional details are provided in sections 3, 4 and 11 below.

Our eight-year RORE performance is summarised in the table and chart below.

RORE Performance	RIIO-GD1				
Category	**Eastern**	**London**	**North West**	**West Midlands**	**Cadent**
Allowed Equity Return	+6.70%	+6.70%	+6.70%	+6.70%	+6.70%
Totex outperformance	+0.03%	+2.17%	+0.94%	+2.35%	+1.18%
IQI Reward	+0.13%	+0.17%	+0.14%	+0.14%	+0.14%
Broad Measure of Customer Satisfaction	+0.28%	+0.15%	+0.28%	+0.18%	+0.23%
Shrinkage Allowance Revenue Adjustment	+0.04%	+0.05%	+0.04%	+0.05%	+0.05%
Environment Emissions Incentive	+0.25%	+0.27%	+0.27%	+0.30%	+0.27%
Discretionary Reward Scheme	+0.00%	+0.00%	+0.00%	+0.00%	+0.00%
NTS Exit Capacity	+0.55%	+0.35%	+0.41%	+0.24%	+0.41%
Network Innovation	(0.03%)	(0.03%)	(0.03%)	(0.03%)	(0.03%)
Penalties and fines	(0.06%)	(0.33%)	(0.06%)	(0.07%)	(0.12%)
Operational RORE Performance	**+7.88%**	**+9.51%**	**+8.70%**	**+9.86%**	**+8.82%**
Debt performance - at notional gearing	+2.18%	+2.14%	+2.16%	+2.14%	+2.26%
Tax performance - at notional gearing	(0.09%)	(0.14%)	(0.15%)	+0.01%	(0.10%)
Total RORE Performance	**+9.97%**	**+11.51%**	**+10.71%**	**+12.01%**	**+10.98%**
Adjustment to Reflect the Economic Cots of Our Debt	(1.45%)	(1.51%)	(1.45%)	(1.46%)	(1.46%)
Total RORE Performance (Adjusted)	**+8.53%**	**+10.01%**	**+9.26%**	**+10.55%**	**+9.52%**

(All RORE numbers quoted above are based on notional gearing)



The table below considers the Operational RORE excluding and including Enduring Value adjustments split between the first half of RIIO-GD1 under National Grid Ownership and the second half of RIIO-GD2 under Consortia ownership.

RORE Performance	RIIO-GD1			
Category	**Cadent**	**Years 1-4**	**Years 5-8**	**Variance**
Operational RORE Performance Excluding Enduring Value	+8.8%	+10.0%	+7.6%	+2.4%
Operational RORE Performance Including Enduring Value	+8.8%	+9.2%	+8.5%	+0.8%
Enduring Value impact on RORE Performance	**-**	**+0.8%**	**(0.8%)**	**+1.7%**

(All RORE numbers quoted above are based on notional gearing)

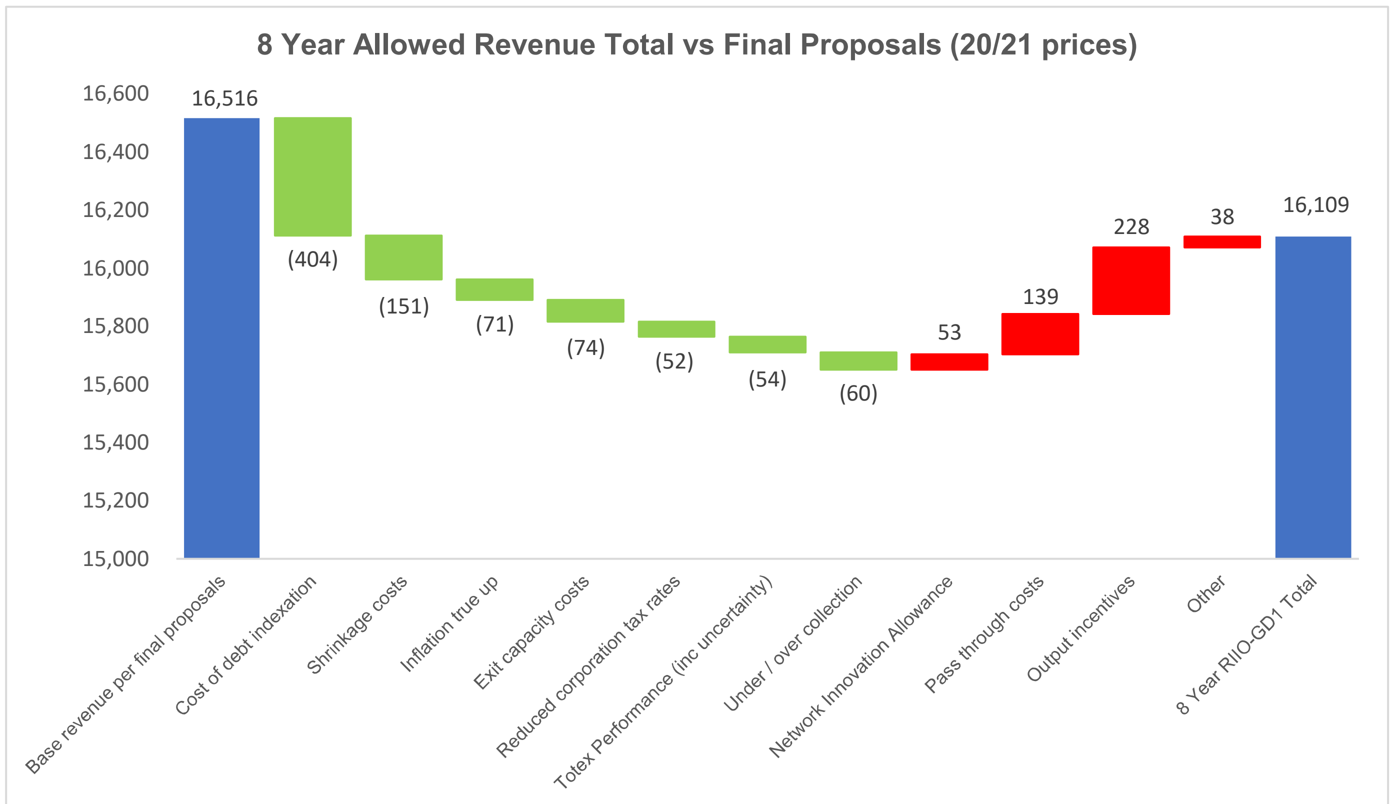
Once Enduring Value adjustments are taken into account which moves the allowances to be more consistent with operational delivery, there is a significant difference as noted in the table above.

The table shows that once enduring value adjustments are taken into account the performance is more normalised between the two halves of RIIO-GD1. In the second half of RIIO-GD1 we have driven significant Opex efficiencies (improving RORE) and delivered the more complex workload. The complexity of work and unit cost pressures experienced to deliver the 8-year outputs adversely impact RORE in the second half of RIIO-GD1.

We discuss the performance on the individual RFPR tables below.

2. Revenue

Our total allowed revenue for the RIIO-GD1 price control period was £407m (2.5%) lower in 2020/21 prices than our allowed Final Proposals. The chart below summarises the final allowed revenue position for RIIO-GD1 relative to the Final Proposals. For more detailed revenue commentary see section 3 (pages 24-26) of our SPO.



3. Totex Performance

Totex outperformance has improved in FY20/21 from the forecast in FY19/20. This is due to lower capex spend driven by ongoing efficiencies in delivery, the timing of IS investments and the impact of COVID-19 pandemic on our planned investment. This is broadly offset by higher opex spend driven by one off costs associated with our business transformation activities incurred to drive long term enduring efficiencies, cost pressure directly attributable to COVID-19 pandemic response as well as higher than expected workload and project activity.

As detailed in the section 3 (pages 20-23) of our SPO, when totex performance is compared to allowances there is a significant difference between pre and post separation from National Grid. In the first 4 years under National Grid's stewardship, the totex outperformance was c.11%. The outperformance was driven by low workload delivery and occurred despite significant Opex inefficiencies. This largely reverses in the 2nd 4-year period of RIIO-GD1 under the consortia ownership as the business concentrated on successfully transforming the operating cost base and delivering the 8-year regulatory output commitments. Our commitment to ensuring delivery of the 8-year output commitments, despite the low workload delivered in the first 4 years of RIIO-GD1 resulted in a materially higher spend in the second half of the regulatory period.

3.1. Enduring Value

As noted above, under National Grid stewardship the workload delivered in the first half of RIIO-GD1 was not consistent with the allowances provided. As such, we deemed it appropriate to make an enduring value adjustment for elements of Repex and Capex.

Repex

We have made an adjustment to re-phase the Repex allowances to follow our workload delivery. As described in section 3 (pages 20-23) of our SPO, Repex spend has broadly stayed the same, whilst the impacts of the pandemic have resulted in lower than expected delivery of the mains decommissioned length output. Despite these higher cost in the second half of the RIIO-GD1 period we have strived to deliver efficiencies against our allowances to continue delivering on-going benefits for our customers.

Capex

Allowances for Capex were originally set of the basis of the NOMs regime which has since been replaced by the monetised risk process which has been decided during RIIO-GD1. Consequently it is not possible to directly measure outputs against original price control allowances and the calculation of a bottom up enduring value adjustment is not practical. However, we recognise that the phasing for some of our Capex workload has differed from our allowance profile, as a result of our asset management strategy to optimise the economic lives of our existing network assets before committing to investment decisions /programmes to replace them, particularly around LTS and governors. We also note that our actual spend has decreased since last year largely driven by ongoing efficiencies an timing of IS investment as discussed in section 3 (pages 20-23) of our SPO. Consequently we have estimated an adjustment at an aggregate level using actual spend as a proxy, as it is not possible to calculate this at a detailed level without a large amount of uncertainty and estimations.

Gas Holders

During 2013/14 National Grid Gas (NGG – now Cadent Gas) implemented an initiative (known as "Project Nexus") with National Grid Property (NGP) to transfer the redundant gas holders and associated land out of NGG. The required number of redundant gas holders (i.e. 101) were transferred to NGP and upon the transfer NGG incurred a cost equal to the allowed unit cost agreed in the Final Proposals. As a result, the regulated business is expected to fully deliver the required output at allowed cost.

NGP have completed the programme more rapidly than the phasing included in final proposals because maintenance costs are incurred if disused gas holders are left in existence to ensure the that structures do not become unsafe and they remain secure. Consequently, we have adjusted the allowances to be in line with the sale of the sites and the recognition of Totex costs as reported in Cost & Volumes RRP table 3.9.

Uncertainty Mechanisms

Our actuals for smart metering are under the threshold for a re-opener, consequently we have not made an enduring value adjustment for future Smart Metering allowances in this year's RFPR.

Close Out Mechanism

We have delivered the Asset Health Network Output Measures (NOMs) which form part of the overall Risk Monetisation targets for each of our networks and therefore have not adjusted the overall allowance, but phased only for the timing of work delivery

4. Output Incentive Performance

Output incentives are a fundamental part of the RIIO price control and incentivise network companies to drive continuous performance improvements.

Output incentives are generally earned in a year and collected after a two-year time lag with relevant adjustments made for inflation and time value of money.

The RFPR requires an expression of earned incentive performance that is not defined by the Licence or the RIIO-GD1 Financial Handbook. However, taking the revenue outturn equivalents as defined by licence, a 2009/10 equivalent value stripped of time lagging, inflationary, interest bearing and time value of money adjustments can be calculated, but it is important to note that this is a stylised expression that does not fall naturally out of financial models or reporting templates provided by Ofgem. Instead we have utilised our internal financial models that are used for the purposes of internal business planning, Transportation unit price setting, and the quarterly revenue forecasts provided to Gas Shippers.

Output incentives feed into the RORE (on a post-tax basis using the tax rate based on year of collection) in the year they are earned rather than the year they are collected which is when they would form part of statutory revenues.

For analysis of our output performance please refer to section 4 (pages 32-75) in our SPO.

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5. Innovation

Expenditure under the Network Innovation Allowance is capped to 0.7% of each network's Base Revenue each year. Provided that expenditure is within this cap, and that a 25% / 75% ratio of internal / external expenditure is maintained then 90% of the eligible costs are funded in year. In addition to the 10% unfunded element, any excess of expenditure outside the cap, or the internal / external ratios is disallowed. As such the impact of the NIA on RORE for our networks is very limited, as it relates to a relatively low level of unfunded expenditure. For more information on our Innovation activity, please refer to section 5 (pages 76-80) in our SPO.

6. Financing and Net Debt Position

As noted above, we benefit from a comparatively low cash cost of debt. This is as a result of significant capital structure changes to create a separate Gas Distribution business (the "segmentation"). The low cost of debt results in an outperformance of the allowed funding for debt and an increase in reported RORE; however this excludes the one-off costs associated with the segmentation. If the repayment of old legacy National Grid debt had not happened then the current cost of debt for the Gas Distribution business would be higher over the medium term.

Cost of debt allowances are set assuming debt is raised evenly over a 10-year period to fund investment in the network over time. However, the majority of our current debt portfolio was priced largely in a single year (FY17) due to the segmentation when market rates were low.

The intent of the segmentation was to transfer National Grid's debt across to Cadent. However, due to the complexity and cost of this process, the novation of all debt requirements was not possible. As such, expensive National Grid legacy debt was repaid and new cheaper debt was issued at the low prevailing market rates. However, significant costs were incurred in order to repay the old legacy debt and secure a much lower ongoing cost of debt effectively accelerating future cash payments.

Bondholders and banks were paid the difference between the cost of the old expensive debt and the market rate of new debt as compensation. These one off costs incurred at various points during the segmentation are recorded in the statutory accounts of various entities, including the 2017 statutory accounts of National Grid Electricity Transmission plc ('NGET' or 'the electricity business') and National Grid Gas plc ('NGG' or 'the gas business'), as well as in the 2017 regulatory accounts for Cadent.

Current Ofgem RIGs do not support the adjustment to be included in reported results and as such we are providing RFPR tables with and without the adjustment. We firmly believe adjusting the cost of reported debt to reflect the true economic cost provides stakeholders with a more meaningful view on our performance.

The table below shows RORE including and excluding this adjustment.

8-Year Average RORE - Including Financing and Tax					
	Eastern	London	North West	West Midlands	Cadent
RORE Excluding Adjustment	+9.97%	+11.51%	+10.71%	+12.01%	+10.98%
RORE Including Adjustment	+8.53%	+10.01%	+9.26%	+10.55%	+9.52%

(All RORE numbers quoted above are based on notional gearing)

Ofgem has completed cross checks and note in footnote 11 of their publication "RIIO-2 Sector Methodology Decision – Finance" that the cross checks support the total quantum of the adjustment.

7. Taxation

Lower actual tax deductions overall compared to notional allowances and accordingly higher tax liabilities means that we have underperformance against the tax allowance. The main reason for the tax underperformance on the tax table across the 8 years is the effect of the notional interest deducted in the calculation of the tax allowance being greater than the actual interest deducted in the CT600 and so giving rise to a higher tax allowance.

The impact of enduring value adjustments results in tax underperformance in earlier years which broadly reverses in the last two years. There has also been an offsetting outperformance caused by the "deadband" adjustments, following a reduction in the tax rates.

8. RAV

The RAV has been impacted by the enduring value adjustments with a reduction of additions in the earlier years and an increase of additions in later years. See Section 3.1 above for details on the enduring value adjustments made.

Due to the transition of Repex to 100% slow money over the course of RIIO-GD1 this has resulted in a higher amount of Repex spend included in the RFPR RAV.

9. Dividends

Given the wider societal impact of COVID-19, we believed it was prudent not to pay a dividend to our shareholders in the year to March 2021. The company had more than enough distributable reserves including profit for the period, enabling us to make a distribution if required. The dividends in the first 7 years of RIIO-GD1 are broadly stable year on year with the exception of 2016/17 where the dividend paid of £95m for the four networks was lower due to the separation of the business from National Grid.

10. Pension

Prior to the separation of the business from National Grid and the subsequent sectionalisation of the Defined Benefit pension scheme, allowances were applied to National Grid Gas Transmission and allocated indirectly to each network via an NTS recharge. From 2017, following Sectionalisation of the National Grid UK Pension Scheme allowances, all liabilities are now applied to each network directly and there is no NTS recharge. This has led to an increase in the deficit contribution shown for 2017/18 onwards in table R12.

We have received confirmation that in compiling and reviewing Cadent's 2016/17 and 2017/18 RRP pension tables National Grid ensured that the total regulated deficit contributions (and PPF and Admin contributions) for the year for the scheme were split between Gas Transmission and Distribution in line with Ofgem's formal approach to allocating allowances between Transmission and Distribution.

11. Other Activities

Since 2017/18 we have experienced significant challenges in respect to multi occupancy high rise buildings, in particular in our London network. We have taken action to address these issues and have recognised the impact of our performance through additional compensation payments and a payment of £8.9m to the Energy Savings Trust to recognise the impact of these issues on our customers. This has been included across our four networks in the Other activities table.

The remainder of the table reflects the GSOP payments made across our four networks and is in line with the RRP table reported to Ofgem.

Appendices

1. Enduring Value Adjustments

Capex

The Capex allowances per RRP table 2.2 have been re-phased using the actual costs from RRP table 2.2. Original allowances for each year have then been deducted to give an enduring value adjustment which is entered onto R4.

Repex

The Repex allowances per table RRP 2.2 have been re-phased based on the actual workload submitted to Ofgem on RRP table 2.3. Using the final proposals to get a % split, the original allowances have been split between tier 1 allowances and other repex allowances. These two allowances have then phased based on the actual workload from RRP table 2.3. Original allowances for each year have then been deducted to give an enduring value adjustment which is entered onto R4.

2. Allocations and Estimates

Existing revenue and cost allocation methodologies have been used to populate the RFPR.

- **General**
  As a result of the separation of the DN business from National Grid Gas plc, the license was amended to discharge the DN business from its Metering and Meter reading obligation. As such, amounts relating to Metering and Meter reading are excluded from the DN regulatory accounts for 2016/17 and beyond. Therefore no adjustments are required to remove anything in relation to metering in tables requiring reconciliation to statutory accounts post 2016/17.

- **Revenue**
  The second section of the Revenue table involves adding back all items of revenue that are included within the statutory accounts but excluded from the collected regulatory network revenues. These items include:

  - De-minimis revenue
  - Excluded services
  - Consented activities
  - Other transportation revenue
  - Customer contributions
  - Xoserve revenue – included in stats for the first three years given it was owned 5/9ths by NGG
  - Inter-group trading elimination – the reported figure in the revenue RRP excludes this adjustment which relates to trading between Gas Distribution and Gas Transmission.
  - Metering – This business was included within the Gas Distribution total within the first three years
  - Other three networks – revenue relating to other three networks needs to be added to get back to the total amount for Gas Distribution

  For any revenue that is not network specific the revenue has been allocated in line with the methodologies used within the Regulatory Accounts and the Revenue RRP which are either subject to an audit or agreed upon procedures.

- **Totex**

For any costs that are not network specific the costs have been allocated in line with the revenue and cost methodologies set out in our cost allocation methodology statements which are reported to Ofgem annually and are applied to all regulatory reporting. This is subject to agreed upon procedures set by Ofgem.

For the reconciliation to totex on tab R3, each of the network tables start with the total Gas Distribution regulatory accounts (National Grid Gas Distribution element of the regulatory accounts for the opening 4 years) or statutory accounts. An adjustment is then required to remove the other three networks based on their RFPR table R3 submission.

The nature of the reconciling items for total expenditure are largely consistent with the combined OPEX, CAPEX and REPEX reconciling items from previous years - the principal adjustments relate to:

- The removal of non-cash items (e.g. depreciation/amortisation, provision releases/additions) reported within the statutory accounts as these are not part of operating costs within the RRP.
- An adjustment to fully reflect the costs relating to Excluded Services which are included in the statutory accounts operational cost figure but do not form part of the Totex figure in the RRP 2.1 table.
- The inclusion of cash spend against provisions (e.g. environmental provision utilisation) and any cash costs charged directly to exceptional items in the accounts.
- Adjusting for capital contributions received for new connections – these are included within turnover in the IFRS accounts (in line with IFRS15).
- The exclusion of GSOP payments as these do not form part of Totex.
- Adjusting for leases previously deemed operating but now under the new IFRS16 standard are capitalised as a Right of Use Asset.
- Reconciling items specifically in respect of the atypical events which are included in the Statutory Accounts but have been excluded from the RRP. Please see below
    - The removal of costs associated with the Grenfell tower investigation and public enquiry as these do not form part of the normal course of operating a GDN.
    - The exclusion of costs associated with high rise building recovery programme incurred over 2018/19 and prior year have been excluded from the 2018/19 figures, as these have been treated as atypical.
    - The removal of costs associated with the amounts committed to be paid to the Energy Savings Trust in support of its important ongoing work have been excluded from the 2018/19 submission, as these have been treated as atypical.
    - The exclusion of costs in relation to the establishment of a community fund to support customers in vulnerable areas.
    - The removal of costs driven by the separation of Cadent from National Grid (e.g. Information Systems, re-branding) which appear as exceptional costs within the Statutory Accounts but have been excluded from the RRP.
    - The removal of costs such as the legal fines from the HSE and the charitable donation to National Energy Action (agreed with Ofgem) form part of the opex within the statutory accounts but are excluded from our RRP opex submission.

- Pension costs in respect of the pension deficit recovery plan payment, which we have split between Established and Incremental. These are reported in RRP total expenditure incurred figure but not in the Statutory Accounts operational costs. Note the pension fund was sectionalised 1 January 2017 and therefore only applicable to 2018 and beyond.
- Non controllable costs' as reported in table 3.1 of the RRP which include costs such as Network Rates, National Transmission System (NTS) exit costs, Shrinkage – these form part of statutory costs but are excluded from totex.

Output Incentives

We have selected t+2 for the year of taxation for all output incentives. Strictly the licence uses the t0 tax rate for the exit capacity incentive, however it is collected and taxed in t+2 and thus t+2 has been selected to give the correct post tax incentive value for the RORE calculation.

Innovation

Given the projects are not network specific they are allocated to networks based on supply points consistent with previous RRP submissions.

The NIA and NIC actual information in this table has been extracted from the RRP tables already submitted to Ofgem. For the NIC section of the table, the contribution for the NIC projects due in the final year of the RIIO-GD1 period are split across the networks using the % apportionment for the current year projected forward for the forecast elements of the table.

Financing

For data pre 2017/18 the financing costs and net debt have been allocated to networks based on the same basis as for previous RRP submissions. For data in 2018/19 to 2020/21 financing costs and net debt have been allocated to networks based on the respective RRP submission.

Debt instruments that are expected to be refinanced in the medium-term are excluded from existing debt at the point in time of the planned refinancing and replaced with new debt.

New debt is forecast to support the Totex investment levels included in our RRP forecast. New debt instruments are assumed to be nominal debt with fixed rates.

RAV

Given that the Ofgem PCFM cannot be easily used to output values in the manner required by the RFPR templates, forecast positions are derived from our internal financial models developed to assess the RIIO-GD2 financial framework. Internal models are reconciled to the Ofgem PCFM on each iteration, to provide assurance over the output values they provide. The underlying totex positions that feed RAV additions are based on tables 2.1 and 2.2 for the July 2021 RRP submission.

The RFPR tables require an assessment of the impact of enduring value adjustments on the RAV. To derive post enduring value adjustments to the RAV, the approach is aligned to the methodology used to calculate enduring value adjustments for Totex (table R4). Totex allowances are reprofiled within our internal financial models with consequential effect to RAV additions and depreciation.

Tax

For periods pre-separation from National Grid it has been agreed with Ofgem that the table should begin with the tax liability pre group relief per the tax in relation to the Distribution Networks, as such these figures have been provided to us by National Grid. These liabilities were compared to the charge per the Regulatory accounts and there were no material differences.

Adjustments have been made where the tax in the CT600 is prepared on a different basis from the PCFM:

- Adjustments are made are to reflect where revenues and operating costs are recognised in a different period from it is recognised in the tax allowance.
- Adjustments have been made where a-typical items of expenditure included in the CT600 have not been included in the Totex and therefore feeding into the tax allowances.
- Adjustments have been made for other profits/ losses that are included in the CT600 but not in the tax allowance (transfer pricing and de-grouping charge) and for items included in the tax allowance but not in the CT600 (Regulatory losses).
- In the section to remove non-regulated tax liabilities an adjustment has been made to reflect the regulatory treatment of capex and repex contributions as the contributions are classified as excluded services. In 15/16, we have adjusted for a tax deduction following a change in accounting standards.
- Within the other adjustments section an adjustment is also been made for finance costs for which a deduction has been taken in the CT600 but do not come within the RIIO-GD1 definition of finance costs that can be included in the tax allowance. In 16/17 a large adjustment of £169m has been made largely as a result of losses on debt buy-back costs in this period.

The following assumptions have been made in the allocations of tax to the individual networks:

- For periods prior to 16/17, the tax charge per the CT600 by network has been taken from the RRP table 1.7 previously submitted to Ofgem.
- For 16/17 and 17/18 the CT600 tax liability by network has been based on the current year current tax charge in the Regulatory Accounts. The tax charge pre-exceptional was allocated to the networks on the basis of pre-exceptional profit before tax per network. The exceptional tax charge was allocated based on the exceptional charges per network.
- For 18/19 onwards we have used the RRP data as a proxy to get the profit before tax by network, to use as a driver to split the tax by network.
- For the forecast periods the tax liabilities have been allocated to the Networks based on estimated profit before tax by network.

Dividends

The regulatory accounts apportion dividends between the 4 networks based on profit before tax. 2016/17 is an exception where PBT (calculated on a look through basis) is adjusted for the exceptional interest and re-measurements.

We have completed the table with the dividends from the regulatory accounts up to 2017/18. From 2018/19, we have used a proxy driver to estimate the profit before tax by network using the data from the RRP, where possible, to split the dividends by network.

For all years we have then stripped out any non-regulatory elements (including metering, other activities and de-minimis columns in the regulatory accounts). For 2016/17 there is no adjustment as there was a loss in the non-regulatory activities.

A final adjustment is made to remove the dividends relating to the other three networks for each individual network RFPR submission.

- **Pensions**

  The network splits within this table have been based on the PDAM methodology.

  Within the table the deficit payments have been based on amounts paid to the scheme. These payments have then been split into the established and incremental deficit elements of the scheme.

  The pre cut-off assets and liabilities have been based on the PDAM submission, with these lines being completed based on the overall pension scheme (section a, b and c).

  The post-cut off assets and liabilities have also been based on the PDAM submission, but have been populated for our scheme only (section C).

  The licensee elements of the total incremental deficit on line 35 has been determined using an allocation driver based on wages and salaries reported in the RRP in line with the cost allocation methodology.

  The licensee established deficit based on the gas distribution networks element of the total deficit, which has been allocated in line with the PDAM methodology.

3. Revenue Analysis

Transportation Revenue - Allowed Revenue

Existing revenue and cost allocation methodologies have been used to populate the RFPR.

Allowed Revenue Summary	RIIO-GD1				
(2020/21 Prices)	East of	London	North	West	Cadent
Opening Base Revenue	684.7	479.1	497.6	372.6	2,033.9
Annual Iteration Adjustment	(46.9)	(44.0)	(39.7)	(31.9)	(162.5)
RPI True Up	(0.5)	(0.4)	(0.4)	(0.3)	(1.6)
2020/21 Base Revenue	**637.2**	**434.7**	**457.4**	**340.4**	**1,869.7**
Pass through costs	(18.0)	16.6	7.0	5.2	10.9
Exit Capacity incentive	10.5	4.6	5.6	2.4	23.0
Shrinkage incentive	0.7	0.7	0.5	0.4	2.3
Environmental Emissions incentive	3.1	3.2	2.2	1.9	10.4
Broad Measure of Customer Satisfaction	4.2	1.5	2.9	1.6	10.2
Discretionary Reward Scheme	-	-	-	-	-
Network Innovation Allowance	2.6	1.5	1.7	1.3	7.1
(Over)/ Under Recovery brought forward	(3.4)	(2.4)	(1.2)	(1.5)	(8.5)
2020/21 Allowed Revenue	**637.0**	**460.3**	**476.2**	**351.6**	**1,925.1**

The annual iteration adjustment represents updates to opening base revenue, primarily composed of the impact of Cost of Debt indexation, Tax Trigger adjustments, actual Totex performance and adjustments to cost allowances in respect of uncertainty mechanisms. This adjustment has been discussed further in section 3 (pages 24-25) of our SPO.

The RPI True Up is the two-year lagged revenue adjustment arising from the variance between forecast inflation (RPIFt) and actual inflation (RPIAt) for 2018/19.

The Pass Through cost adjustment of £10.9m is comprised of the following elements:

- Increases to actual business rates costs in 2018/19 versus allowances: +£49.8m
- Increase to Ofgem Licence fees in 2018/19 versus allowances: +£0.3m
- Decrease to NTS pension deficit costs in 2018/19 versus allowances: (£3.6m)
- Supplier of Last Resort claims: +£3.0m
- Decreases to actual exit capacity costs in 2018/19 versus allowances: (£33.4m)
- Decreases to actual shrinkage costs in 2018/19 versus rebased allowances: (£5.2m)

For the output incentive revenue adjustments (Exit Capacity, Shrinkage, Environmental Emissions and Broad Measure of Customer Satisfaction), these represent the two-year lagged incentive performance achieved in 2018/19. A section dedicated to cumulative actual and future forecast incentive performance is included later in this report.

Unlike the vast majority of revenue adjustments, the Network Innovation Allowance adjustment is not two-year lagged, and represents expenditure levels incurred in the year. In 2020/21 we spent £7.8m on innovation projects, which was 60% (up from 46% in 19/20) of the spend cap. Networks are allowed to recover 90% of eligible spend (subject to maintenance of a 75/25 external/internal cost ratio), resulting in the £7.1m adjustment shown in the chart and table above.

2020/21 Allowed Revenue also included the lagged repayment of the 0.4% over recovery of transportation revenue in 2018/19, inclusive of interest adjustments.

Other Turnover Items and Adjustments

The second section of the table involves adding back all items of revenue that are included within the statutory accounts but excluded from the collected regulatory network revenues. We have listed these adjustments in the table.