

RIIO-GD1
Regulatory Financial Performance
Reporting (“RFPR”)
Commentary

Year ended:
31 March 2020





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Executive Summary

The purpose of the Regulatory Financial Performance Reporting (“RFPR”) is to provide a framework to allow Ofgem to collect accurate and consistent information from licenced network operators (Licensees), in particular in the calculation of Return on Regulatory Equity (“RoRE”).

The RoRE calculation is presented on tab R1 of the RFPR. It should be noted that Wales & West Utilities Limited’s (“WWU”) RORE would be lower if it reflected only cash distributions to shareholders.

Enduring value adjustments have been entered into tab R4 – Totex. There has been a lack of detailed guidance in this area, which may impact the consistency of the enduring value calculations between each Licensee. WWU has included enduring value adjustments where the workload performed to date, as a proportion of the workload expected to be performed over the eight years of the RIIO-GD1 price control, is materially different to the equivalent proportion of the workload upon which the allowances were set under the RIIO-GD1 price control.

The RFPR Submission can be located on the WWU website, as required by Ofgem by following the link below:

<https://wwutilities.co.uk/media/3837/2019-20-wales-west-utilities-rfpr-tables.xlsx>

For further information, please refer to the WWU RIIO-GD1 Seventh Year Annual Report, Strategic Performance Overview, which was submitted to Ofgem on the 28 August 2020. The link to this report on the WWU website is as follows:

<https://wwutilities.co.uk/media/3833/2019-2020-wales-west-utilities-rp-strategic-performance-overview.pdf>





Key Financial Performance measures

Commentary on key financial performance measures can be found within the WWU RIIO-GD1 Seventh Year Annual Report, pages 8 – 17, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://wwutilities.co.uk/media/3833/2019-2020-wales-west-utilities-rpp-strategic-performance-overview.pdf>

Key Operational Performance measures

Key operational performance measures are discussed within the WWU RIIO-GD1 Seventh Year Annual Report, pages 22 - 29, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://wwutilities.co.uk/media/3833/2019-2020-wales-west-utilities-rpp-strategic-performance-overview.pdf>

Further detail can be found within the 2019/20 WWU Annual Stakeholder Report and WWU 2019/20 Statutory Accounts. The link to the Annual Stakeholder document is provided below.

<https://www.wwutilities.co.uk/media/3810/wales-west-utilities-annual-stakeholder-report-2019-20.pdf>





Overview of Regulatory Performance

R1 - RORE

Commentary on WWU's Return on Regulatory Equity (RoRE) can be found within the WWU RIIO-GD1 Seventh Year Annual Report, page 12 which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://wwutilities.co.uk/media/3833/2019-2020-wales-west-utilities-rrp-strategic-performance-overview.pdf>

2019/20 RORE on a notional gearing basis

1. Operational RORE (before the effects of financing and tax) decreased from 12.3% in 2018/19 to 11.8% in 2019/20, Totex outperformance declined by 0.6%, offset partially by higher incentive outperformance (relating to environmental emissions) of 0.2%.
2. RORE including financing and tax was 8.0%, a decline from 10.6% in 2018/19. The reduction of 2.6% is due to:
 - a. lower operational RORE of 0.5%, explained above
 - b. higher debt underperformance of 0.9%, explained by:
 - i. Revenue allowance declined by 0.6%
 - ii. Lower swap accretion expense and lower debt buyback costs together broadly offset lower net swap income, the latter two items representing measures taken to support GD2 financeability.
 - iii. Other items 0.2%, mainly underlying timing effects of new bond issuance and debt buybacks
 - c. lower tax outperformance of 1.1%

2019/20 RORE on an actual gearing basis

1. Operational RORE (before the effects of financing and tax) decreased from 13.9% to 13.1%. Lower return on equity of 0.2%, totex outperformance of 0.8%, offset partially by higher incentive outperformance (relating to environmental emissions) of 0.2%.
2. RORE including financing and tax decreased from 10.8% in 2018/19 to 7.7%. This 3.1% reduction is due to:
 - a. Lower operational performance of 0.8%
 - b. Higher cost of debt underperformance of 0.8%
 - c. Lower tax outperformance of 1.5%, including tax clawback causing a 0.4% impact.





R2 – Revenue

This sheet reflects the data contained within the Revenue Return 2019/20, submitted to Ofgem on 28 August 2020 in line with Licence Condition SSC A40.

For commentary on these figures, please refer to the WWU RIIO-GD1 Seventh Year Annual Regulatory Reporting Pack (“RRP”) commentary, page 11, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://wwutilities.co.uk/media/3833/2019-2020-wales-west-utilities-rrp-strategic-performance-overview.pdf>

R3 / R4 – Totex Performance

Data included within the R3 and R4 sheets was also included within the WWU RIIO-GD1 Seventh Year Annual Regulatory Reporting Pack (“RRP”) commentary, submitted to Ofgem on 28 August 2020 in line with Licence Condition SSC A40.

R3 - Rec to Totex reflects the data from the consolidated financial statements of Wales & West Utilities Limited reconciled to the Totex costs for the regulatory year.

The purpose of the R3 Rec to Totex schedule is to show a reconciliation of the statutory financial statements to Totex, (WWU has used audited regulatory accounts where the statutory year ends were not coterminous with the regulatory year – for the years ended 31 March 2013, 2014, 2015 and 2016 – which can be reconciled back to the statutory accounts after adjusting for timing). From 1 April 2016 onwards the statutory and regulatory year ends are coterminous. From 1 April 2018 the consolidated statutory financial statements of Wales & West Utilities Limited have been used as the basis for the reconciliation to Totex, following Ofgem’s consent to withdraw the requirement for Consolidated Regulatory Accounts.

WWU has made no further adjustments to Totex to achieve the reconciliation to the PCFM.

The consolidated statutory financial statements of Wales & West Utilities Limited for the current year are the starting point for the R3 Rec to Totex and can be found on the Companies House website.

Link below is to the Consolidated statutory financial statements for the year ended 31 March 2020.

<https://beta.companieshouse.gov.uk/company/05046791/filing-history>

R4 – Totex reflects the data contained within table 2.2 Totex costs summary: Summary tables, see link below

<https://wwutilities.co.uk/media/3832/2019-2020-wales-west-utilities-rrp-cost-and-volumes-tables.xlsx>





For commentary on the totex figures, please refer to the WWU RIIO-GD1 Seventh Year Annual Report, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://www.utilities.co.uk/media/3833/2019-2020-wales-west-utilities-rrp-strategic-performance-overview.pdf>

R5 – Output Incentive Performance

Data within this tab mirrors the data contained within the Revenue Return 2019/20, submitted to Ofgem on 28 August 2020 in line with Licence Condition SSC A40.

Please refer to the WWU RIIO-GD1 Seventh Year Annual Report, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://www.utilities.co.uk/media/3833/2019-2020-wales-west-utilities-rrp-strategic-performance-overview.pdf>

R6 – Innovation

Please refer to the WWU RIIO-GD1 Seventh Year Annual Report, pages 18 - 21, which was submitted to Ofgem on the 28 August 2020.

The link to this report on the WWU website is as follows:

<https://www.utilities.co.uk/media/3833/2019-2020-wales-west-utilities-rrp-strategic-performance-overview.pdf>

Further information on innovation at WWU can be found in our 2019/20 WWU Innovation Report. The link to this report on the WWU website is as follows:

[WWU Innovation Report 2019-2020](#)

R7 / R8 – Finance and Net Debt Position

Cost of Debt (excluding derivatives)

WWU continues to have a significant shortfall against the Cost of Debt allowance for GD1. WWU's cost of debt has been efficiently incurred but is not fully compensated for by the rolling 10 year iBoxx index used by Ofgem for calculating Allowed Cost of Debt.





R9 - RAV

Data reported within tab R9 reflects the latest published Price Control Financial Model (“PCFM”) results up to 2018/19 and then uses totex actuals for 2019/20 and totex forecast for 2020/21 to derive additions and depreciation in these years. The 2019/20 and 2020/21 figures are taken from RRP table 2.2 as submitted to Ofgem on 28 August 2020. The latest published PCFM was finalised in November 2019 following the 2019 Annual Iteration Process.

R10 – Taxation

Reconciliation to the Regulatory Year

For years prior to 2017, WWU's statutory reporting periods were not coterminous with the Regulatory Year. Accordingly, in preparing the R10-Tax submission the tax liability per latest submitted CT600 has been taken as the CT600 tax liability per the Regulatory Accounts for 2014 to 2016 inclusive. No CT600 tax liability arises under either the statutory reporting periods or regulatory years for 2014 to 2016 inclusive (as a result of the utilisation of brought forward tax trading losses) and accordingly no reconciliation of these amounts is provided.

Regulatory performance in respect of taxation

Prior to 2017, Wales & West Utilities had no regulatory tax liability, and accordingly no net tax allowance, as a result of the utilisation of brought forward regulatory tax losses.

The brought forward regulatory tax losses were utilised in full during 2017, resulting in regulatory tax liabilities and associated forecast net tax allowances arising in 2017 to 2021 inclusive. Wales & West Utilities forecast net tax allowances for 2017 and subsequent years are reduced by tax clawback as a result of actual gearing being in excess of notional gearing.

R11 – Dividends

WWU has not paid dividends in the current or prior years and is not forecasting to pay dividends in future years. However, shareholder loan note interest payments are classified as distributions as they are paid to Companies affiliated to WWU through the Group Structure.

WWU made shareholder loan interest payments in 2019/20 of £40m (2018/19 £34m); £20m in June 2019 (June 2018: £nil) and £20m in December 2019 (December 2018: £34m). The future forecast distributions for shareholder loan interest payments are based on the medium term plan and are forecast to be paid bi - annually in June and December, however it has been agreed to defer the June 2020 payment until later in 2020 following the Covid-19 pandemic.





Details of shareholder loan notes are included on page 58 of the WWU statutory accounts for the year ended 31 March 2020 within Note 13 (iv) – External Borrowings.

<https://beta.companieshouse.gov.uk/company/05046791>

R12 – Pensions

Please refer to section 9.2 starting on page 102 of the RRP Commentary (submitted to Ofgem - 28 August 2020) and the PDAM (submitted to Mick Watson, Ofgem – by email 28 August 2020).

Please refer to these submissions for explanations.

Narrative on Pensions should consider the Pension Deficit Allocation Methodology (“PDAM”) submission to Mick Watson, Ofgem on 28 August 2020.

R13 – Other activities

WWU has not incurred any Ofgem penalties or fines throughout RIIO-GD1 to date.

Guaranteed Standards of Service payments (“GSOP”) are statutory payments at rates set by Ofgem.

WWU incurred £27k of additional compensation for the year ended 31 March 2020 (2019: £24k) following the decision to double the Ofgem compensation rates from July 2017. This has been included within the return together with other discretionary payments.

The data to 31 March 2020 has been extracted from table 8.3 Guaranteed Standards of Service within the 2019/20 Regulatory Reporting Pack (RRP), submitted to Ofgem on 28 August 2020 in line with Licence Condition SSC A40.

The table 8.3 is also published on the WWU website – see link below

<https://www.utilities.co.uk/media/3832/2019-2020-wales-west-utilities-rrp-cost-and-volumes-tables.xlsx>

The forecast GSOP payments are based on a 7 year average of the costs incurred during the RIIO-GD1 price control to date.

The GSOP payments have been adjusted for tax within the return to show the net effect of the amount to be disallowed.

As per the instruction extract from Ofgem letter to GDN regulatory managers dated 22 October 2018, WWU resubmitted all RIIO-GD1 RRP for the period of 2013/14 to 2017/18 removing all associated discretionary payments, during 2019.





Data Assurance Statement

This is the second year that WWU has submitted Ofgem's RFPR return and Commentary. Ofgem require that the 2019/2020 submission be uploaded on the Company's website.

The 2019/2020 RFPR has been completed in line with the RIGs and on this basis a full DAG process has been conducted.

Management prepared methodology statements and completed risk assessments for each RFPR table and these were provided to Internal Audit for review. All tables were subject to the requisite first line assurance i.e. data preparer, second person review, business lead sign-off and executive sign-off, and these review stages included the following checks:

- Agreeing data to already published information where possible, including the RRP, Regulatory Accounts and Consolidated statutory financial statements, where such information has already been subject to varying levels of validation and data assurance;
- Agreeing data to the underlying workbooks;
- Reperforming calculations to ensure the correct results within the tables; and
- Ensuring the commentary is aligned with the tables.

A final review has been undertaken by members of the WWU Executive team including the Director of Regulation & Commercial and the Director of Finance.

Additionally, following review of the risk assessments and discussion with management a sample of submission tables were selected for review by Internal Audit. Independent data and process audits were performed which involved detailed reviews to agree the submissions details to source data on a sample basis and reperforming calculations where required to ensure correct results were recorded.





Appendices

- 1 Reconciliation where licensees have a different statutory reporting year to the Regulatory Year
- 2 Enduring Value Adjustments





Appendix 1

Reconciliation where licensees have a different statutory reporting year to the Regulatory Year

For the past data where the statutory and regulatory year ends were not co-terminus WWU has referenced the audited Regulatory accounts for the years ended 31 March 2013, 2014, 2015 and 2016, such Regulatory accounts having been subject to review by WWU's auditors. From 31 March 2016 onwards the statutory and regulatory year end are coterminous.





Appendix 2

Enduring Value Adjustments

Enduring value adjustments have been entered within tab R4 – Totex and tab R9 - RAV. These adjustments have sought to apply a re-phased allowance to items within Totex, for the calculation of outperformance and to calculate the impact these adjustments would have in RAV.

The re-phased allowance is based on actual and forecast workload over RIIO GD1. The re-phasing has been applied to Capex, Repex and gas holder demolition within Opex. The purpose of the rephrasing is to account for timing differences between workload delivery forecast in final proposals compared with latest actual and forecast workload data.

Overall WWU is set to meet, or exceed, its RIIO-GD1 targets and therefore the net adjustment over the whole of the RIIO-GD1 period is forecast to be nil.

Although enduring value adjustments have been entered, a caveat should be applied given the lack of detailed guidance in this area. In addition, no enduring value adjustments have been calculated in respect of non-controllable costs and incentives which are trued up within allowed revenue on a two-year lag basis.

WWU has not applied any enduring values in relation to close out mechanisms, such as NARMs (currently NOMs for RIIO-GD1). We are not expecting to submit any further reopener claims and do not currently forecast any significant impact as a result of NARMs.

