

Managing Director Report 2022

Special Licence condition 9.16

As part of the Special Condition 9.16 of SP Transmission's licence, it is required to appoint a Managing Director of Transmission (MDT) to be responsible for the conduct of the Transmission Business. SP Transmission plc (SPT) is required to arrange for the MDT to be provided with the services of persons, premises, systems, and other resources as may be reasonably required by the MDT for the efficient and effective management and operation of the transmission business in accordance with SPT's statutory duties and licence obligations.

This report has been prepared as soon as reasonably possible after the calendar year 2022, the timing of this report follows the completion of the 2022-23 financial and regulatory year end allowing all the assurance and governance to be attained.

Overview

The UK has experienced significant changes within the energy landscape since the submission of our business plan in December 2019. We have seen an increased focus on Net Zero, which has resulted in increasing levels of interest in connecting low carbon generation and storage to our network. We created our plan to have the flexibility to respond to this changing landscape and have successfully adapted and delivered in year under this new reality. We recognise that this trend will continue throughout T2 and beyond including new developments in offshore wind seeking to connect in Scotland and the increasing prevalence of battery storage, as well as onshore wind and solar generation which we have seen for a number of years.

To facilitate these connections and wider changes to enable Net Zero, the announcement of the Holistic Network Design in late 2022 was a welcome step forward and we are progressing with the development of these projects and how this will integrate with our T2 plans. The level of investment in these projects surpasses our RII0-T2 plans and requires a step change in many fronts to realise this ambition.

With this increasing level of activity, constraints on several fronts are becoming evident including supply chain capacity and outage availability. We have engaged extensively with the supply chain as the lead times for equipment continue to extend substantially for all types of equipment as well as significant cost escalation. This is due to inflationary pressures and global demand for equipment as countries across Europe and further afield seek to decarbonise and transform their electricity networks. We are also still seeing constraints in the supplies of subcomponents such as circuit boards and microchips from Asia which is delaying circuit breakers and protection and control equipment. Due to the variety of challenges, since 2020, we have seen the lead time for transformers doubling from 12 months to 24 months, circuit breakers increase from 6 months to 16 months and 132kV cable from 6 months to 12 months. We continue to review our delivery model to reflect these challenges and how we contract with the market, however many of these factors are changing on a monthly basis.

The changing generation landscape is also having an impact on the operation of the network and ability to secure outages which are essential to allow major works to take

place. Over the winter of 2022, we had outages cancelled by the ESO due to generation availability. This has had an impact on the delivery of our plan as works were re-scheduled into spring and summer of 2023. This will have a subsequent impact on those projects which were planned in this period and cannot be undertaken at the same time. We are also expecting similar restrictions through the winter of 2023 and engaging with the ESO for their long-term plan to mitigate the impact as far as reasonably possible.

We have and continue to work closely with the Scottish Government on their planning framework to look at how this process can be improved to better facilitate upgrades to electricity infrastructure as well as working with the Electricity Networks Commissioner on the reforms that we consider necessary to avoid such extensive delays. Our response to the National Planning Framework 4 consultation highlighted the need for a different approach to enable timely investment. We have experienced substantial delays on the Kendoon to Tongland reinforcement Project (KTR) as a result of the existing planning framework. This project which is critical for the connection of an array of renewable generation has been subject to a Public Inquiry which has led to a two-year delay to the project and without change, similar delays on other projects will be inevitable.

As a result of these pressures, our spend in year 2 has continued to be below that envisaged in our original business plan. In our non-load activities we have made progress including the completion of the 400kV ZA overhead line major refurbishment which is one of our largest OHL projects in T2, and BC 132kV OHL major refurbishment. Good progress is being made on a number of other projects, and we are forecasting this will recover in year three and subsequent years. Due to cost increases, we expect a net overspend across the five years of RIIO-T2 for non-load investment.

T2 has brought many changes, including a greater focus on sustainability, customer service and whole system coordination. This is reflected in the incentive mechanism package, which we had a leading role in proposing. We have performed well across the full suite of incentives in year 2, with highlights including the highest ever level of system reliability, strong performance on customer service and positive savings for the ESO through our coordination to minimise system constraints. From an environmental perspective, significant progress has been made with our Scopes 1 and 2 Business Carbon Footprint (excluding losses) being 62% lower than our business plan forecast, totalling 9,340 tCO₂e for the last year.

We have a range of innovation projects at the discovery phase which also supports the changes we are seeing on the network and for users of the system. These projects include the use of AI, providing additional services to the ESO, and working with users on the whole system impact of the electrification of transport such as rail and HGVs.

Company Strategy

As part of the RIIO-T2 framework, the company has an agreed set of outputs it will deliver, and several incentives aimed at reducing network costs for both current and future customers.

The key strategies for the company to the end of the RIIO-T2 price control period and beyond are outlined in our strategic goals.

- A sustainable, Net Zero future
 - We will take the lead to build a healthier, more accessible energy model – one which leaves the carbon economy behind. We will meet carbon targets, customers' low-carbon ambitions, and make a large, proactive contribution towards Net Zero
- Increase efficiency through constant innovation
 - We will continue to improve our performance through a continual cycle of innovation. With smarter solutions, we can do more with less – deploying new technology, processes, and ways to share data. Innovation will help us deliver uninterrupted supply, faster connections, and meet the ambitions of consumers, network users and wider stakeholders.
- Adapt our world-class, resilient network
 - This is a critical time for networks. Demand is changing, generation is evolving, and new threats are emerging. We will adapt our world-class network to meet these challenges, including extreme weather, cyber security, and black start events – delivering ever-higher performance for consumers, network users and wider stakeholders
- Keeping network users and consumers at the heart of our decisions
 - We will listen and learn even more from our stakeholders. This will allow us to continue to raise our efforts as we work to improve lives, create jobs, and protect vulnerable consumers. In everything we do, we aim to do more

We have seen progress to date across all areas, and continue to focus on these key areas to achieve our RIIO-T2 objectives successfully.

Network Reliability

A comprehensive Outage plan is maintained by the Operational Planning team within the Customer Service Directorate. This plan is reviewed regularly with the investment delivery and operational functions within SPT, and then sanctioned by the System

Operator NGESO. For the 2023 submission this plan contains detailed outage requirements for all of SPT's major projects up to December 2030 in line with the current Holistic Network Design (HND) timescales. System access is becoming increasingly challenging as the System Operator seeks to balance the need for network outages to undertake reinforcement, modernisation and maintenance while ensuring the network remains secure and network operating costs remain acceptable as generation and demand patterns change alongside fluctuations in the global energy markets. Winter 2022/2023 was especially challenging due to energy security concerns across GB, however experience has shown that through comprehensive engagement with the System Operator and key stakeholders supported where necessary by escalation to NGESO's senior management, acceptable amendments can be made to the outage plan to mitigate significant impacts on SPT's ability to undertake its business

Resources

SPT's Resource Plan for the deliverability of the RIIO-T2 business plan was laid out in our Availability of Resources statement, which was issued in May and certificated in July 2023. This confirmed the reasonable expectation that SPT would have sufficient resources for the subsequent 12 months.

SPT continued a recruitment campaign during 2022 to meet the growth in customer connection activity and to enable the delivery of the RIIO-T2 Business Plan. This resulted in an increase to our headcount, bringing the overall headcount for SP Transmission to 798 FTE for the regulatory reporting year 22/23. The campaign has extended into 2023 as part of the 1,000 green jobs that Scottish Power will fill during 2023 for SP Transmission to deliver the £5bn investment as part of the ESO's Holistic Network Design (HND) plan. In addition, SP Transmission increased the pool of trainees in 2022 for particular skillsets to create a sustainable pipeline of internal resources to help deliver the UK's 2030 offshore wind targets. As in previous years, there was access to a number of contingent workers through an established framework agreement which supplemented our staff resource to meet demand.

General risk management strategies are in place to limit the impact of supply issues including multiple suppliers in place for equipment and materials, logistics stocking strategies, SPEN forecasting demand and active contract management of supplier delivery.

As a result of current economic turbulence within contracts, where fixed pricing is not supported by the supply base, we are agreeing a combination of fixed and variable elements. The variable elements are isolated to cost components that have high volatility and are monitored via official indices such as currency, metals, and energy. This approach ensures we can access the supply base and ensures we pay prices that are fair within the market.

Finance

Adequate finance was available to SPT during the year ending 31 December 2022. In accordance with Licence Condition B7, Directors approved, on 27th July 2023, the Certificate of Availability of Resources that confirmed their reasonable expectation that SPT would have sufficient financial resources and financial facilities for the subsequent 12 months.

For the regulatory year 2022/23, revenue decreased by £37.4m to £371m compared to the prior year of £408.4m mostly driven by the changes such as removal of TIRG revenues as well as under recovery of revenues in 22/23. SPT's operating profit was £191.3m, a decrease of £38.0m compared to prior year. Net profit was £110.7m, an increase of £18.9m compared to prior year. The main cause of this increase year on year is the drop off in deferred tax charge which in 2022 increased income tax value in the P&L as a result of upcoming changes in the corporation tax rate.

SPT's net capital investment for the year was £208.1m (2022 £188.3m) consisting of fixed asset additions and transfers from inventories of £228.2m (2022 £207.2m) less capital contributions received of £20.1m (2022 £18.9m)

The Company is largely on track to deliver its investment plan and agreed commitments. The profiling of expenditure over the five years has changed as a result of changes in the generation connections landscape and other external factors including consents and supply chain availability. A significant number of projects are in progress and after two years of RIIO-T2, we have now completed a number of our asset replacement projects including ZA 400kV OHL re-conductoring, our largest OHL project in RIIO-T2.

Looking Forward

ASTI Projects – Summary, Challenges, and Stakeholder Engagement

To meet the UK's and Scotland's offshore wind targets, acceleration of strategic transmission infrastructure is urgently required. SPT has therefore collaborated closely with Ofgem, Government, the other Transmission Owners (TOs), and the ESO to develop an updated regulatory framework to enable the timely development and delivery of major transmission projects. This streamlined regulatory process, the Accelerating Strategic Transmission Investment (ASTI) framework, enables faster regulatory decisions on projects and earlier access to funding to develop projects. We welcome the developments in Ofgem's recent decisions on the ASTI regulatory framework to support the TOs as they look to undertake delivery of a significant portfolio of strategic transmission works.

However, SPT faces significant challenges in delivering our four strategic ASTI projects, as well as the wider set of transmission works required by 2030. A key

challenge is the planning and consenting framework for electricity transmission projects, which can be one of the longest and most uncertain stages in a project's development. Alongside SSEN Transmission, we have been working closely with the Scottish Government on reforms to the overhead line planning process in Scotland, exploring ways to accelerate the process to secure a determination within one year of a planning application being submitted. We have also engaged with UK Government and Ofgem on planning, given the need for a coordinated approach to updating legislation and reforming the planning process.

The recent Electricity Networks Commissioner report, commissioned and published by UK Government, set out that acceleration in planning is required, with clearly defined timescales. We strongly support this request and have welcomed the clear consensus across the industry and policymakers that reform is required to support the delivery of strategic projects in the interests of consumers.

Following a dramatic increase in global demand for critical transmission network components as countries worldwide seek to decarbonise their electricity system, TOs are experiencing longer lead times for assets and greater challenges securing supply chain capacity. SPT is therefore working closely with industry partners, the regulator and government on issues relating to the supply chain to manage and mitigate risks associated with supply chain constraints. Whilst the challenges to delivery as we look ahead to 2030 are significant, we will continue to engage with our stakeholders and communities to support the delivery of the transmission infrastructure required to meet national and devolved government ambitions, whilst ensuring the safe and secure development of the energy system.

Conclusion

In view of the arrangements and activities described above, and the resources made available, I am satisfied that adequate arrangements have been in place to as far as possible secure compliance with statutory and licence obligations in the year 2023.

Vicky Kelsall,



CEO, SP Energy Networks