

**SP DISTRIBUTION PLC and  
SP MANWEB PLC**

**REGULATORY FINANCIAL  
PERFORMANCE REPORT**

**2020/21**

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## Executive Summary

The RIIO-ED1 price control is forecast to reduce Domestic customer's bills over the price control period. For SPD this is forecast to be an average of 2%, from £110<sub>20/21 prices</sub> p.a. in 2015/16 to £107<sub>20/21 prices</sub> p.a. by 2022/23. For SPM this is forecast to be an average of 7%, from £133<sub>20/21 prices</sub> p.a. in 2015/16 to £123<sub>20/21 prices</sub> p.a. by 2022/23.

We have received a derogation to not produce and publish Regulatory Accounts for SPD & SPM for 20/21 onwards. In its place the Regulatory Financial Performance Reporting pack ("RFPR") will provide the required details on regulatory and financial performance for our stakeholders. Changes due to movements in base revenues allowed under RIIO-ED1 have resulted in revenue decreasing by £6.1m for SPD (2021 £446.9m; 2020 £453.0m) compared to the previous year and decreasing by £2.9m for SPM (2021 £407.6m; 2020 £410.5m). SPD's operating profit was £173.9m, a decrease of £4.2m compared to prior year and SPM's was £165.5m, a decrease of £5.1m. Net profit for SPD was £108.5m, an increase of £19.0m compared to prior year and £101.3m for SPM, an increase of £19.6m.

ScottishPower's investment strategy is to drive the growth and development of its regulated businesses through a balanced programme of capital investment. The scale of investment is consistent with the eight-year price review period allowed capital expenditure programme.

A separate report, the Distribution Annual Performance Report for 2019/20 provides the companies stakeholders with a comprehensive view of how the companies are performing against the commitments made in their RIIO-ED1 business plans. This information can be found on our website at:

[Distribution Annual Performance Report 2019/2020 \(spenergynetworks.co.uk\)](https://www.spenergynetworks.co.uk)

The companies have succeeded in a number of leading Innovation projects under the Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) mechanisms. These projects will ultimately allow us to develop more flexible and cost effective networks in the best interest of our customers. This was evidenced by SP Energy Networks (SPEN) winning a number of high profile industry awards.

The Companies have continued their strong start to RIIO-ED1 into the sixth year after a thorough review of work plans and contracts. We believe our results demonstrate a strong customer focus and that we are in the vanguard of allowing flexible access to our network whilst maintaining secure and resilient supplies. As we look ahead, the energy sector remains a key focus for government policy development, macroeconomic growth and we face greater challenges in terms of network resilience.

We continue to believe stakeholders are displaying a fundamental knowledge gap in relation to the cost of debt (CoD) allowance for Network Owners. There is a lack of understanding that companies' annual CoD allowance does not cover the actual annual cash outflows for interest and shareholders are required to fund interest payments in excess of allowance. We believe this should be addressed through actions including prominently explaining that the cost of debt is provided on a real basis while the interest rate on the majority of company's debt is on a nominal basis. We have therefore provided our version of financial performance in addition to Ofgem's view in table R7.

The consistency and comparability of the RFPR needs to be enhanced through continued development of the RIGs guidance. There are areas like taxation, forecast debt costs and enduring value adjustments where different approaches may be adopted. We believe enduring value adjustments should be completed by all companies.

Ofgem have previously said that consistency was applied in some areas but no specifics were mentioned. It would be beneficial for stakeholders for this to be quantified.

**Overview on Regulatory Performance****R1 RORE**

Return on Regulated Equity (RoRE) has previously been published as an operational performance metric on a notional gearing basis. The RFPR now extends RoRE to include enduring value adjustments, potentially impacting totex performance and includes performance on debt and tax. We have included the additional cashflow measure of debt in our submission to provide context around the gap between the Ofgem's measure of the full funding of debt over the depreciation period against in-year costs, versus actual in-year funding against costs.

Furthermore, RoRE is now presented on both a notional and actual gearing basis with cumulative-to-date and full ED1 period positions. SPD and SPM perform similarly on both a notional and actual gearing basis as summarised below.

RIIO-ED1 RoRE	SPD		SPM	
	Notional Gearing	Actual Gearing	Notional Gearing	Actual Gearing
	2020/21	2020/21	2020/21	2020/21
Allowed Equity Return	6.0%	5.6%	6.0%	5.7%
Totex Performance	-0.4%	-0.4%	-1.1%	-1.0%
IQI Reward	-0.3%	-0.3%	-0.3%	-0.3%
Output Incentives and Innovation	1.5%	1.4%	0.9%	0.8%
<b>RoRE - Operational Performance</b>	<b>6.7%</b>	<b>6.4%</b>	<b>5.5%</b>	<b>5.2%</b>
Debt Performance	1.7%	1.6%	1.8%	1.8%
Tax Performance	0.0%	0.0%	0.0%	0.0%
<b>RoRE - Including Financing &amp; Tax</b>	<b>8.5%</b>	<b>8.0%</b>	<b>7.3%</b>	<b>7.0%</b>

In terms of proposing a preferred metric to RORE at this point, we strongly advocate the Return on Capital Employed (ROCE) as the most appropriate performance metric for the purpose of reporting company returns. The ROCE metric is defined as the earnings before interest and tax (EBIT) divided by total assets less current liabilities. EBIT is used as it measures the return available to meet both equity and debt holders before the impact of taxation. It best reflects operational performance since it is unaffected by corporate and tax structures. It is a commonly used and understood measure of profitability across many industries. For example, the CMA used return on capital employed (ROCE) as a principal profitability measure in the GB energy market investigation (*Source: CMA (2016): Energy Market Investigation, Final Report, Appendix 9.9, Approach to profitability and financial analysis, para 23-25*).

## R2 Revenue

As DNOs are natural monopolies, Ofgem regulate how much they can earn by setting the maximum revenue to be collected from customers via Distribution Use of System (DUoS) charges.

This table summarises the component parts of the allowed revenue cap;

- Impact of maintenance and investing in the network (see *R4 – Totex*)
- Incentive revenue adjustments (see *R5 – Output Incentives*)
- Innovation related awards (see *R6 – Innovation*)
- Uncertainty mechanisms; indexation and pass-through items

Base revenue is the revenue agreed with Ofgem at final determinations to cover the cost (*R4 – Totex*) of delivering agreed outputs; including financing (*R7 – Financing*), taxation (*R10 – Tax*) and historical pension liabilities (*R12 – Pensions*).

Under RIIO, base revenues are revised annually as part of the annual iteration process (AIP). This adjustment is the *MOD* term found in row 11 and is published by Ofgem in November of each year.

To help mitigate price volatility, we provide forecast allowed revenues to suppliers who in turn price the resulting network charges into the contracts they offer electricity customers.

Given the timeline, the use of forecasts and other economic factors which can affect demand we may under or over collect (row 28) what the revenue cap outturns (row 26). Consequently we true-up, by increasing or decreasing, future allowed revenue under the correction factor term (row 25) as detailed in our licence.

The table has no requirement for forecast information.

In addition to DUoS charges, DNOs are allowed to charge customers directly for services that are specific to that customer. These services are called Directly Remunerated Services (DRS). They are not covered by the price control but the licence includes rules about how the charges must be calculated.

The table details all other turnover items before adjusting for those reported as Other Operating Income (OOI) in our *revenues* effectively resulting in reconciling revenues relating to revenue protection services (DRS5) and metering (DRS6 and legacy).

## R3 Rec to Totex

This table reconciles the expenditure incurred in 2020/21 by SPD & SPM as per our underlying accounting records with those reported in the 2020/21 Regulatory Reporting Pack (RRP). Please see table for line item detail.

## **R4 Totex**

Forecasts for SPD and SPM have consistently been prepared based on fully delivering our outputs for customers, managing emerging asset risks on our networks, and in line with our long-term asset management strategy. As outlined in previous years, reviews of our investment plan have led to a reprofiling of our expenditure and outputs across categories in both of our Licences over the RIIO-ED1 eight-year period. Following the passing of the midpoint, and our submission of the 2018/19 regulatory reporting pack, we undertook a comprehensive review of our RIIO-ED1 business plan. This included the evaluation of the business challenges that we have experienced during RIIO-ED1 to date, and those we foresee for the remainder of the price control period.

These challenges have had an adverse impact our ability to deliver our outputs within the agreed RIIO-ED1 allowances. Whilst we have delivered cost efficiencies via competitive re-tendering of Global contracts, Innovation, and Digitalisation, the level of efficiency achieved is not sufficient to offset the upwards pressure we have experienced, or to mitigate the emergent issues we have faced in managing network risks.

Upwards pressure on costs have predominantly affected our Indirect cost base due to the level of indirect staff required to support our outsourced investment delivery and increased personnel costs (including salary, pension and training costs). The turnover in our employee population, as well as the implementation of our Digitalisation strategy, will drive future efficiencies from the Business, and we continue to focus on achieving efficiencies across all categories.

### **Load Related**

In SPD and SPM, timing is the main factor in the enduring value adjustment, however we also identify opportunities in this area and expect to outturn with efficiencies in both Licences.

In SPD, after the 6th year of RIIO-ED1, the total value of primary substation schemes identified in the RIIO-ED1 Business Plan have been approved. Expenditure in the 2020/21 regulatory year increased by 20% to £24.4m compared to 2019/20. Only c£2m of projects remain at the technical approval stage and will be developed in time for delivery during RIIO-ED1. In SPM, 98% of planned schemes are financially approved. Some of the most notable projects are in delivery including Whitchurch, Lostock and Anglesey 132kV projects.

Totex efficiencies are being delivered through the application of innovative solutions, including procurement of flexibility rather than traditional solutions, and deployment of Active Network Management (ANM) schemes to enable quicker and more cost-effective generator connections. We are also deploying sophisticated weather correction tools to understand the need for, and timing of, interventions. These solutions deliver efficiencies however incur increased indirect costs in the planning phases. We also see and anticipate efficiencies from the detailed planning undertaken on these projects as they reach completion. We are maintaining our commitment to delivering our RIIO-ED1 outputs in both of our SPD and SPM Licences in our Load Programme.

### **Non-Load Related**

In SPD and SPM, timing is the main factor in the enduring value adjustment. We are maintaining our commitment to delivering our full RIIO-ED1 outputs in both of our SPD and SPM Licences. We expect to outturn with efficiencies in both Licences across our Non-Load Programme in order to offset the upwards pressure on costs experienced in our Network Operating Costs and Indirects.

Some of the timing impact experienced in the first half of RIIO-ED1 was due to elements such as lengthy contract negotiations, the bedding-in of our new District delivery model, and land rights/wayleaves issues affecting our overhead line programme. The lengthy contract negotiations and new District delivery model have enabled us to deliver efficiencies, and our land rights and Wayleaves issues have now resolved.

We have accelerated our overhead line modernisation programme to maximise the benefits to customers as early as possible in RIIO-ED1. At year 6, utilising the significant numbers of framework contracts placed prior to 2018, we have made substantial progress in delivering our RIIO-ED1 Non-Load programme. Major programmes such as the Rising Mains and Laterals and the Service Modernisation programmes have seen the benefits of the new framework contracts, and we have seen progress in other areas, including our civils and our refurbishment programmes.

One of the most significant emergent issues during RIIO-ED1 has been our proactive investment programme to address an emergent type failure issue with 33kV cable Triff joints. This has required significant investment and indirect cost increases that were unforeseen at the time of the RIIO-ED1 plan, to effectively manage the risk to our network and ensure supply security.

### **Network Operating Costs (NOCs)**

Within our Network Operating Costs (NOCs), the majority of our activities are delivering in line with RIIO-ED1 Business Plan. Both SPD and SPM continue to deliver our Inspection and Maintenance programme and our Trees programme in line with the commitments made.

In SPD, expenditure on NOCs is lower than allowance after 6 years, driven by underspends in our Tree cutting programme. We continue to deliver our tree-cutting programme in line with our 3-year cyclical methodology, with our outsourced contract strategy achieving sustained cost efficiencies. In SPD, faults expenditure is in line with allowance after 6 years. In SPM, faults expenditure is ahead of allowance after 6 years. Severe weather events have affected fault volumes during the RIIO-ED1 period, in particular in SPM where we have experienced significant weather-related activity that did not breach the threshold for an exceptional event. These weather patterns are affecting the nature of our faults compared to historical trends.

In addition, high ambient temperatures between May and July in the last three years have adversely affected fault volumes on our 33kV cable network. This has led to greater costs in both licences to resolve acute network risks, followed by an ongoing, proactive investment programme.

### **Closely Associated Indirects (CAIs)**

Across both our Closely Associated Indirects and Business Support categories, both SPD and SPM set themselves a challenging RIIO-ED1 target within their business plans, as SPEN sought the Information Quality Incentives and the opportunity for fast track. Efficiencies were built into every aspect of our costs. Given the final determination package set at the outset of RIIO-ED1, we are finding it very challenging to reach the levels required to meet our allowance levels without affecting our commitment to output and customer service delivery.

Closely associated indirects are sensitive to increases in salary and pension costs; with c10% of our closely associated indirects related to pensions. Pension costs during RIIO-ED1 have been higher



than expected due to ongoing pension contributions and pension deficit payments, which have increased to reflect macro-economic factors.

As part of our ED1 strategy, we have placed a significant focus on Digitalisation, and have developed and implemented our NAMS project. NAMS is a major investment to deliver a fully integrated work management and regulatory reporting system. The aim is to provide efficiencies through streamlining business processes, increasing integration in work management, and fully automating our regulatory reporting. NAMS went live in January 2018; and we continue to review our business practices to ensure full utilisation and delivery of all associated benefits. In the short term, our Digitalisation strategy has resulted in cost increases due to the level of indirect staff required to support, develop and implement these solutions, as well as re-training our wider organisation to utilise the technology. These increases will offset in the long term as the benefits of automation and digitalisation are realised.

We note from the data issued with Ofgem's RIIO-ED1 Performance Reports the majority of DNO's are experiencing cost increases in Indirects compared to DPCR5 levels.

### **Business Support Costs (BS)**

Business Support costs have increased in comparison to the level forecast for RIIO-ED1. Our increased focus on Digitalisation during RIIO-ED1 has increased our IT & Telecoms costs within Business Support, and we expect a continuation of this trend as we move towards a DSO and Flexibility model, as our enhanced systems require an increasing level of support and resilience in response to their strategic importance.

Looking ahead, we anticipate a continued focus on the enablers for decarbonisation, with data and digitalisation playing increasingly important roles in providing the evidence base for decisions. We welcome Ofgem's "Modernising Energy Data" initiative, and are investing in innovative projects, as well as are undertaking cross-sector collaboration to develop solutions that meet objectives.

We have partially offset cost increases through initiatives within SPEN to reduce costs incurred directly by the company, however have not been able to materially reduce the overall level of Business support costs which are required to deliver our business plan commitments.

## R5 Output Incentives

R5 shows the actual and forecast monetary incentive values relating to customer service, interruptions, connections and losses.

In 2020/21 we earned a £16.0m<sub>12/13 prices</sub> (SPD £11.2m, SPM £4.9m) reward for going above and beyond delivering a safe, secure and reliable service to our customers and meeting our stakeholders' needs. We have earned £108.9m<sub>12/13 prices</sub> (SPD £65.8m, SPM £43.1m) to date with a further £29.2m (SPD £17.0m, SPM £12.2m) forecast resulting in total forecast incentive reward of £138.1m<sub>12/13 prices</sub> (SPD £82.8m, SPM £55.3m) in RIIO-ED1, which we estimate to pay c£27.1m<sub>12/13 prices</sub> of tax on.

### Broad measure of customer service

Our vision for 2023 is to achieve a score of 9.42 out of ten for Customer Satisfaction in Ofgem's survey of DNO performance and to be a leader in Customer Service across the UK. This year's score of 9.23 in SPD (9.17 for 2019/20) and 9.24 in SPM (9.16 in 2019/20) are results we are proud of and puts us ahead of where we committed to be on our journey to a score of 9.42. These scores resulted in £6.5m<sub>12/13 prices</sub> (SPD £3.1m, SPM £3.4m) of additional incentive reward revenue.

### Stakeholder Engagement

From previous performance, our targets were met across the board, illustrated by positive assurance reports, stable stakeholder satisfaction scores and positive results in Ofgem's annual assessment. The associated rewards to 2019/20 are included in the Broad Measure of Customer Service incentive values with table R5.

Ofgem's independent panel assessment of our 2020/21 regulatory submission and subsequent Q&A session will be determined later in the year.

### Interruptions-related Quality of Service

SPEN have targeted the reduction of the volume and duration of interruptions over the course of RIIO-ED1. SPEN's investment plan is delivering on that promise; both licences are significantly out-performing against the regulatory target, and CI & CML have all significantly improved since the end of DPCR5.

By 2020/21 we have reduced the number of customers off supply by 17% and the average time off supply by 28%.

SPD have earned £42.8m<sub>12/13 prices</sub> to date. Future targets flex in accordance with historical performance, hence the forecast level of financial award decreases year-on-year.

SPM have earned £18.4m<sub>12/13 prices</sub> to date. SPM's Customer Interruptions (CI) absolute performance is amongst the best in the UK. The ED1 targets were set based on historical performance which reflects SPM's position as an industry leader therefore the ED1 performance is not as high as SPD.

### Incentive on connections engagement

This is a penalty only mechanism, where DNOs are evaluated on their adequate engagement and on satisfying the needs of large connection customers. Neither SPD nor SPM has incurred or is forecast to incur any penalty on this incentive.

### **Time to Connect Incentive**

For SPD, our average time to quote was 3.06 working days for single premises, and 5.86 days for multiple premises. The corresponding average time to connect was 48.24 days and 62.93 days, from accepted and payment - resulting in £0.6m<sub>12/13 prices</sub> of incentive reward.

For SPM, our average time to quote was 4.40 working days for single premises, and 8.29 days for multiple premises. The corresponding average time to connect was 43.15 days and 60.58 days, from accepted and payment - resulting in £0.1m<sub>12/13 prices</sub> of incentive reward.

### **Losses Discretionary Reward Scheme**

The Losses Discretionary Reward (LDR) is worth up to £32 million across all Distribution Network Operators (DNOs), spread over three tranches during the eight years of the RIIO-ED1 price control.

Tranche 1: In 2016, SPEN were awarded £770k –SPD £385k, SPM £385k.

Tranche 2: Submission not eligible for reward

Tranche 3 Submission not eligible for reward.

On a notional gearing basis, total incentives contribute +1.6% to SPD and +1.0% to SPM RoRE to date, slightly lowering to +1.5% for SPD and 0.9% for SPM over the full RIIO-ED1 period. This is mainly as a result of tightening targets within the reliability incentive.

## R6 Innovation

SPEN is dedicated to becoming the Utility of the Future, embedding innovation throughout our business in order to respond to the opportunities and challenges presented by the UK's evolving energy landscape. These changes mean we have to look at new innovative solutions to ensure that we can continue to deliver value to customers whilst ensuring that costs are fair and equitable for all. We stand ready to facilitate the Government's low carbon aspirations and are innovating to ensure that the smart networks of the future are flexible, resilient and accessible to all.

Our innovation strategy describes how we plan to innovate to meet the challenges and deliver benefits to customers and details the processes we intend to follow to ensure that we spend customers' money in the most efficient and effective manner. The strategy outlines how we will prioritise our innovation activities to ensure that our customers benefit from improved levels of service, whilst ensuring the network is flexible and resilient to changing future requirements. It outlines our three core priority areas, developed in conjunction with stakeholders, and goes on to highlight the opportunities and challenges we aim to overcome.

Our core priority areas:

1. Deliver Value to Customers
2. A Smarter Flexible Network
3. Sustainable Networks

Within each priority area, we highlighted the opportunities and challenges that our stakeholders have told us should be the focus of our attention over the remainder of this price control period through until 2030. We outline how interested parties can get involved through different platforms and help develop our Innovation Strategy. We will continue to engage with stakeholders and communities to ensure our Innovation Strategy is developing according to our customers changing needs.

### Network Innovation Allowance (NIA)

The Network Innovation Allowance provides limited funding to RIIO network licensees to use for two purposes:

- To fund smaller technical, commercial, or operational projects directly related to the licensees network that have the potential to deliver financial benefits to the licensee and its customers; and/or
- To fund the preparation of submissions to the Network Innovation Competition (NIC) which meet the criteria set out in the NIC Governance Document.

### Allowable Expenditure

Allowable NIA Expenditure is the total expenditure that can be recovered from the NIA. It includes Eligible NIA Expenditure (90% of the total expenditure incurred) and, in relation to NIC Projects which passed the NIC Initial Screening Process (ISP) in or before Relevant Year 2018/2019 only, Eligible Bid Preparation Costs.

The below summarises key aspects of the NIA portfolio at the end of 2020/21:

- 38 live projects and 23 closed projects
- 20 collaborative projects
- 41 projects undertaken solely by SPEN
- 11 projects led by other LNOs, including 3 by GDNs
- 50 projects led by SPEN
- £3.5m 'Virtual World Asset Management' being the largest project

SPD and SPM have been allowed to recover £10.0m<sub>nominal</sub> and £9.0m<sub>nominal</sub>, respectively, of allowable expenditure through DUoS charges to date, forecasting a further £1.6m<sub>nominal</sub> and £1.3m<sub>nominal</sub>, respectively, per annum for the remainder of ED1.

### **Unrecoverable Expenditure**

Unrecoverable NIA Expenditure cannot be recovered from Allowable NIA Expenditure.

Unrecoverable NIA Expenditure is any NIA Project Expenditure arising from a failure to conform to technical requirements or arising from an increase in payments associated with a reduction in standards of performance. No Unrecoverable Expenditure has been incurred to date, nor is forecast for the remainder of RIIO-ED1.

### **Low Carbon Networks Fund**

As part of the electricity distribution price control that ran until 31 March 2015, Ofgem established the Low Carbon Networks (LCN) Fund.

The LCN Fund allowed up to £500m to support projects sponsored by the Distribution Network Operators (DNOs) to try out new technology, operating and commercial arrangements. The aim of the projects is to help all DNOs understand how they can provide security of supply at value for money as Britain moves to a low carbon economy.

There are two tiers of funding under the LCN Fund. The First Tier allowed DNOs to recover a proportion of expenditure incurred on small scale projects. Under the Second Tier of the LCN Fund, Ofgem ran an annual competition for an allocation of up to £64 million to help fund a small number of flagship projects.

DNOs explore how networks can facilitate the take up of low carbon and energy saving initiatives such as electric vehicles, heat pumps, micro and local generation and demand side management. They also investigate the opportunities that smart meter roll-out provides to network companies. LCN Fund projects should provide valuable learning for the wider energy industry and other parties.

The LCN Fund has now been replaced and funding for new projects is either via the Network Innovation Competition or the Network Innovation Allowance.

### **Discretionary Reward**

In the LCN Fund, Ofgem seek to use the discretionary reward to imitate the commercial benefits of innovation by rewarding DNOs for successful innovation by relating these rewards to the risks that their shareholders have borne, typically 10 per cent of the expected costs.

As the potential learning from the LCN Fund Projects provides benefits to all Distribution Services Providers (DSPs), the projects were funded by all DSPs through Distribution Use of System Charges.

### Network Innovation Competition

The Electricity NIC is an annual opportunity for electricity network companies to compete for funding for the development and demonstration of new technologies, operating and commercial arrangements. Funding will be provided for the best innovation projects which help all network operators understand what they need to do to provide environmental benefits, reduce costs, and maintain security as Great Britain (GB) moves to a low carbon economy.

Some examples our current and previous NIC projects are listed below:

- **Angle DC (SPM) – 2015 NIC** - ANGLE-DC aims to demonstrate a novel network reinforcement technique by converting an existing 33kV AC circuit to DC operation. The technique could be used by DNOs as an efficient solution to create network capacity headroom and facilitate GB's objective for the shift towards a low carbon economy.

SPM were awarded £13.1m<sub>nominal</sub> in the 2015 NIC in respect of its Angle DC project.

- **Fusion (SPD) – 2017 NIC** - The Fusion Project will trial local flexibility market using an existing, structured and competitive market-based framework developed in Europe. The Universal Smart Energy Framework (USEF) has the potential, if successful, to support the DNO and all market actors to unlock the value of local network flexibility. The Project will demonstrate how DNOs could harness flexibility to manage a network constraint located in East Fife.

SPD were awarded £5.1m<sub>nominal</sub> in respect of its Fusion project.

- **LV Engine (SPM) – 2017 NIC** - LV Engine will carry out a globally innovative trial of Solid State Transformers (SSTs) within the distribution network at secondary substations (11kV/0.4kV) for the purpose of enhancing network flexibility and releasing additional capacity within our existing low voltage (LV) infrastructure and facilitating the increasing uptake of Low Carbon Technologies (LCTs).

SPM were awarded £7.3m<sub>nominal</sub> in respect of its LV Engine project.

- **Charge: Refuelling Tomorrow's Electrified Transport (SPM) – 2018 NIC** - The Charge projects centres around the optimisation of electric vehicle charging infrastructure planning with data from the Department of Transport and Transport Scotland. This project has great potential in realising and accelerating the EV roll out at the national level.

SPM were awarded £6.9m<sub>nominal</sub> in respect of its Charge: Refuelling Tomorrow's Electrified Transport project.

Both SPD and SPM forecast further successfully funded projects throughout ED1.

## **R7 Financing and R7a Financing Input & R8 Net Debt and R8a Net Debt Input**

Actual finance cost and debt figures are populated from our underlying reporting systems with further details reported within our published Statutory accounts for each licensee on a calendar year basis. This information can be found on our website at:

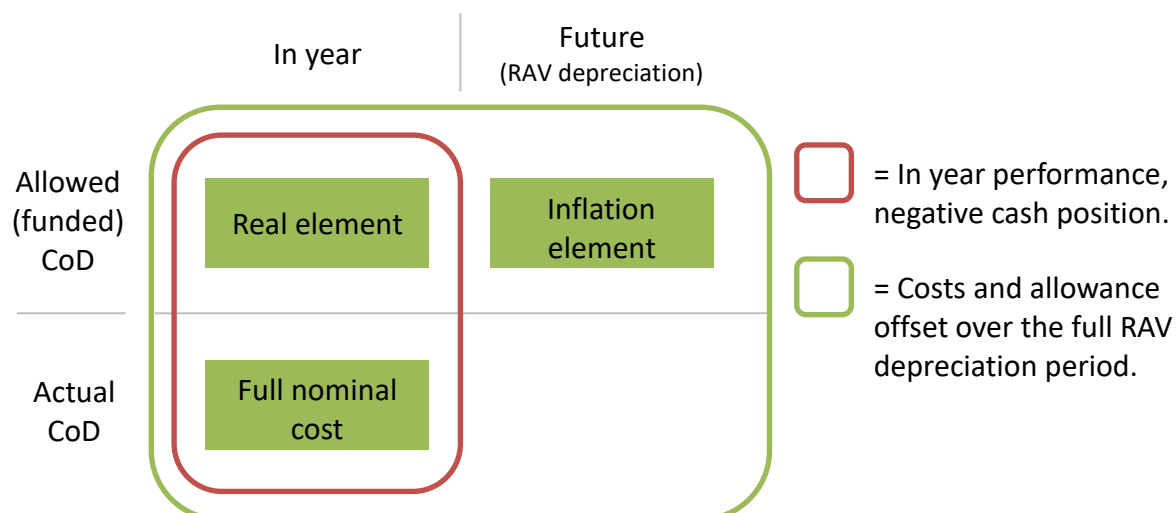
[Annual Reports & Accounts - SP Energy Networks](#)

Forecast finance costs and debt figures are derived from business long term plan projections of cash requirements, and assume that all new debt/refinancing will be via an intercompany on demand loan at a variable rate plus margin.

We have a licence derogation in place as agreed with Gas and Electricity Markets Authority (GEMA). SP Distribution Plc and SP Transmission Plc provide guarantees to Scottish Power UK plc with respect to their external debt holders outstanding as at October 2001.

The overriding rationale of the debt guarantee provided by SP Distribution and SP Transmission to the then Scottish Power UK plc external debt holders, at the time of business separation in October 2001, was to ensure that the existing debt holders, effectively had access to the same asset base, and cash flows that they would have had pre that imposed asset separation and that they had originally lent to. The companies providing the guarantees, ultimately, being responsible for the repayment of both the interest and principal of that guaranteed debt. If the guarantees were ever called the companies would assume that external debt obligation and therefore be required to generate sufficient cash flows to satisfy the external debt holders requirements.

As mentioned above, we believe there is a knowledge gap in the understanding of network companies' financial performance detailed within the report. It should be highlighted that companies annual CoD allowance does not cover the actual annual cash out flows for interest, due to the CoD allowance being set on a real basis while the majority of companies' debt is on a nominal basis. To this end we have included our own view of financing performance within the report, alongside Ofgem's standard view. Where our own view details the cash performance impact over the 8-year period, while Ofgem's view shows an estimated RIIO-1 performance over the full depreciation period. We believe other network companies, as well as Ofgem should adopt this cashflow performance approach.



## R9 RAV

The regulatory asset value (RAV) is a key building block of the price control review. RAV represents the value upon which the companies earn a return in accordance with the regulatory cost of capital and receive a depreciation allowance. Additions to the RAV are calculated as a set percentage (80%) of totex.

The latest Price Control Financial Model (PCFM) was published in November 2020 following the Annual Iteration Process (AIP). The AIP PCFM is designed to update future revenues as a result of past performance and the latest available debt index allowance. It does not forecast future total expenditure performance. Consequently, future RAV values and allowances (including debt and tax) are not necessarily representative of a network company's position through the remainder of R10-ED1.

This table addresses the above issue and updates RAV for the totex, allowances and enduring value adjustments reported in R4 – Totex. This allows revised allowances for which debt (R7 – Financing) and tax (R10 – Tax) performance is based upon.

SPD report a compound annual growth rate of 1.0%, a 7.9% increase from opening ED1 RAV of £1.522bn<sub>12/13 prices</sub> to an ED1 closing RAV of £1.642bn<sub>12/13 prices</sub>.

SPM report a compound annual growth rate of 2.4%, a 20.5% increase from opening ED1 RAV of £1.525bn<sub>12/13 prices</sub> to an ED1 closing RAV of £1.837bn<sub>12/13 prices</sub>.



## R10 Tax

We receive a tax allowance calculated through the Price Control Financial Model (PCFM), based on a fixed split percentage of tax pool additions and forecast nominal financing costs (*'net interest paid'*).

In order to compare like-for-like performance against the allowance, we have revised the tax calculation updating for actual capital allowances and financing costs. SPD and SPM have an accounting period to December, therefore our taxable profits, capital allowances and liabilities are on a calendar year basis. In order to convert our accounting period reported values to compare with a regulatory year allowance, we have assumed a 25%/75% split of capital allowances to date.

Most of our assets are Special Rate Pool items and will attract a rate of 6% from 1st April 2019 (previously 8%).

Our 2020 CT600 is not yet due for submission to HMRC, consequently the 2019/20 value in [R10 – Tax, F12] is a forecast to compare against the allowance. The additional *other adjustments* will be trued up in due course.

In respect of 2015/16 to 2019/20, SPD and SPM paid an additional £86.2m<sub>12/13 prices</sub> (SPD £45.6m<sub>12/13 prices</sub>, SPM £40.5m<sub>12/13 prices</sub>) in tax to HMRC above what we receive an allowance for, calculated by our tax performance (SPD £11.8m<sub>12/13 prices</sub>, SPM £12.7m<sub>12/13 prices</sub>) in addition to the tax we pay on incentives where no allowance is given in the licence (SPD £10.5m<sub>12/13 prices</sub>, SPM £7.0m<sub>12/13 prices</sub>) and the other revenue items where there is no tax allowance prescribed (SPD £23.3m<sub>12/13 prices</sub>, SPM £20.9m<sub>12/13 prices</sub>).

The RFPR RIGs commentary also requires us to detail our methodology for calculating the 'Tax on financing performance at actual/Notional gearing' included in the table. These entries have been calculated by taking the actual/notional financing cost (at actual/notional gearing) less the Tax allowance which is derived from the cost of debt multiplied by 65% of the RAV. The result is multiplied by the appropriate tax rate.

## R11 Dividends

A dividend is proposed annually and is based on distributable reserves at a level no greater than the notional gearing levels for Distribution (65%). This proposed dividend goes through a rigorous diligence process to ensure it is not in breach of any licence conditions (Licence condition 30) and in order to state that Distribution would not be in breach of these obligations in the future. Once satisfied the dividend is approved by the Board of Directors prior to payment.

## R12 Pensions

Figures in R12 Pensions reflect the total of established and incremental licensee costs associated with both the ScottishPower Pension Scheme (SPPS) and the Manweb Group of the ESPS (Manweb).

PDAM licensee provided information from the PDAM tables (tables P1.1/2.1) submitted in 2014 are used to calculate established and incremental deficit payments for regulatory years ending March 2014-2017. PDAM tables submitted in 2017 are used to calculate established and incremental deficit payments for the regulatory years ending March 2018-2020. PDAM tables submitted in 2020 are used to calculate established and incremental deficit payments for the regulatory year ending March 2021.

Results of the 31/3/19 valuation have been input in nominal terms (i.e. assumed price base 18/19) and are taken from the relevant PDAM tables submitted in 2020.”

## R13 Other Activities

Neither SPD or SPM have been subject to any investigations, fines or penalties as shown on Ofgem’s website: <https://www.ofgem.gov.uk/investigations>

### Quality of Service Guaranteed Standards

Payments under the guaranteed standards compensate for the inconvenience caused by loss of supply. A combined total of £135k (SPD £53k, SPM £82k) of Guaranteed Standards of Performance payments have been made to date.

## Data Assurance statement

Data assurance was conducted in accordance with SPEN’s “Regulatory Submissions Procedure” developed and implemented to ensure compliance with Ofgem’s DAG. The details of the accountabilities we have in place are contained in the SPEN NetDAR Submission, 26 February 2021, Section 1.4 Organisational Data Assurance Process.

Based on DAG methodology, a risk assessment was carried out on the submission and the result is as below:

Submission	Total Risk Score	Impact Score	Probability Score	Impact and Probability Breakdown
RFPR	Medium	‘3’	‘2’	<p><b>Impact:</b></p> <ul style="list-style-type: none"> <li>Financial category was allocated ‘3’</li> <li>Comparative Efficiency was allocated ‘3’</li> <li>All other categories were allocated ‘1’.</li> </ul> <p><b>Probability:</b></p> <p>Reporting Assessment:</p> <ul style="list-style-type: none"> <li>Complexity and Manual intervention ‘4’</li> <li>Completeness ‘2’</li> <li>Reporting rules 3’</li> </ul> <p>Control Framework Assessment:</p> <ul style="list-style-type: none"> <li>Control activities ‘1’</li> <li>Experience of personnel ‘2’</li> <li>Historical Errors ‘2’</li> </ul>

The minimum DAG was applied per table and based on the Total Risk Score and amount of data in the submission, we selected an Internal Data Audit and Director Sign-off as additional assurance. Also, due to parts of the submission being published, CEO Sign-off was deemed relevant.

The Internal Data Audit was performed by our Licence and Assurance Team and our Finance Department who are independent from table preparation. Assurance was performed on a sample basis on the following tables in the submission. No findings were noted.

Table No.	Table Name
R3	Reconciliation to Totex
R6	Innovation
R7/7a	Financing
R8/8a	Net Debt

In summary, the following assurances were completed:

- Method Statement
- Second Person Review
- Senior Manager Sign-off
- Internal Data Audit
- Director Sign-off
- CEO Sign-off

## Appendices

### **Reconciliation between regulatory year end and statutory year end**

In previous years, given that price controls are set on a March year end we would have reconciled to the March Year End publicised Regulatory Accounts. As of 2020/21, we have been given a derogation by Ofgem to not produce these as the intention of the RFPR was to replace these reports. Therefore, the financial values provided within the RFPR templates are sourced from our underlying accounting records. We still have an obligation to publish Statutory Accounts which are prepared on a calendar year basis. The main differences between these values and those published in the accounts will be due to the timing of expenditure and revenue differences. Our Statutory Accounts can be found on our website using the following link:

[Annual Reports & Accounts - SP Energy Networks](#)

### **Enduring value adjustments**

The enduring value adjustments we have made and the methodology of these adjustments are embedded within this document. Therefore we have not explained them in this section separately.

### **Basis of estimations and allocations**

We do not consider our Regulatory Financial Performance Report to contain any estimates and allocations nor does it include apportionments.

### **Other relevant information**

We do not consider any further information to be relevant in addition to the tables and this commentary.

We have provided our opinion above on a weighted average RoRE and consideration of other methods to be a more appropriate basis of evaluating performance.