



**SP DISTRIBUTION PLC and  
SP MANWEB PLC**

**REGULATORY FINANCIAL  
PERFORMANCE REPORT**

**2018/19**

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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 12%, from £103<sub>18/19 prices</sub> p.a. in 2015/16 to £90<sub>18/19 prices</sub> p.a. by 2022/23. For SPM this is forecast to be an average of 11%, from £124<sub>18/19 prices</sub> p.a. in 2015/16 to £110<sub>18/19 prices</sub> p.a. by 2022/23.

The increase in base revenues allowed under RIIO-ED1 has resulted in revenue increasing by £29.6million for SPD compared to the previous year, while for SPM it remains in line with the prior year. SPD’s operating profit was £180.9 million, an increase of £15.6 million compared to prior year and SPM’s was £125.1 million, a decrease of £12.7 million. The net profit for SPD was £117.0 million, an increase of £13.0 million compared to prior year and £69.1million for SPM, a decrease of £11.0 million.

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 2017/18 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: [https://www.spenergynetworks.co.uk/userfiles/file/SPEN\\_Distribution\\_Report\\_2018.pdf](https://www.spenergynetworks.co.uk/userfiles/file/SPEN_Distribution_Report_2018.pdf)

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 fourth 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 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 the cost of debt is provided on a real basis however the interest rate on the majority of company debt is on a nominal basis. We have therefore provided our version of financial performance and 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.

In the Ofgem annual report for 2017/18 Ofgem 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 removed debt performance from our submission as it requires further consideration for comparability and consistency throughout the industry.

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
Allowed Equity Return	6.0%	5.7%	6.0%	5.7%
Totex outperformance	0.0%	0.0%	0.0%	0.0%
IQI Reward	-0.3%	-0.3%	-0.3%	-0.3%
Output Incentives and Innovation	1.5%	1.4%	1.0%	0.9%
Penalties and fines	0.0%	0.0%	0.0%	0.0%
<b>RoRE - operational performance</b>	<b>7.2%</b>	<b>6.9%</b>	<b>6.7%</b>	<b>6.4%</b>
Tax performance	-0.4%	-0.4%	-0.3%	-0.3%
<b>RoRE - including tax</b>	<b>6.8%</b>	<b>6.5%</b>	<b>6.4%</b>	<b>6.1%</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

### Allowed Revenue

As DNOs are natural monopolies, Ofgem regulate how much we 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 RII0, base revenues are revised annually in 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.

### **Reconciliation to the Accounts**

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 the *Income Statement* in the accounts 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 recorded in the Regulatory Accounts with the RRP. There are reconciling items costs in the Regulatory Accounts not in the RRP as Totex such as;

Low Carbon Network Funds (LCNF) payments made to other DNO's to fund their LCNF programmes. These are reported within operational costs of Regulated Accounts but not reported through the RRP Cost & Volumes pack.

Depreciation of SPPS non-system assets are recharged to Licensees and are therefore in their Regulated Accounts.

For OOI only some elements are carried onto the RRP (eg recovery of 3<sup>rd</sup> party damage claims which appears on faults table (CV26)). A reconciliation of OOI which is undertaken for the Revenue Return provides an analysis of OOI (mostly Non-Price Control activity) which is recorded in the Regulated Accounts but not recorded in the RRP.

Non-System capex which is the responsibility of SPPS (under the terms of the SLA) and the costs of which are therefore borne by them and not the licensees, however the RRP must disclose the actual underlying cost.

Pension Deficit Repair payments currently do not appear as a transactional charge through the Regulated Accounts (the charge is effected through dividends) but must be reported in the RRP.

The net book value written-out on disposal of assets, which is in the Regulated Accounts but is not carried onto the top section of R3. As the RRP (Table C23) reports the gain/loss on disposal, the NBV becomes a reconciling item.

The final section in this table seeks to reconcile items not recognised in Totex.

Non Price control Cost are then removed from the total Cost to obtain the PCFM Totex (excluding enduring value), these are namely

- a. Pass through
- b. Other Non-Activity Based Costs
- c. Total Costs outside Price Control
- d. Related Party Margin
- e. NIA & IFI/LCNF
- f. Cash proceeds from sales of assets and scrap
- g. Value added services (DRS 8)
- h. Income from theft recovery (SPM only)

## R4 Totex

Forecasts for SPD & SPM have been prepared on the basis of delivering our outputs for customers and managing any emerging asset risks on our networks over the next four years.

We expect our future expenditure will closely follow our forecast investment plans for Load, Non-Load and NOCs.

For Closely Associated Indirects & Business Support costs, we continue a drive to achieving efficiencies across all categories. The turnover in our employee population, as well as the implementation of our new NAMS IT system, will drive further efficiencies from the Business, which will assist us in meeting our overall ED-1 allowances.

There are no significant variances from last year's forecasts for SPD & SPM.

Below is a detailed update on our current position and forecast outturn for each licence.

### **Load Related Expenditure:**

In SPD, timing is the main factor in the enduring value adjustment. At the half way stage of ED1, the total value of primary substation schemes identified in the ED1 Business Plan submission have been approved. Expenditure in the 2018/19 regulatory year: increased by 75% year-on-year as a significant number of reinforcement projects reached the delivery stage; with £38m in execution; £28m in pre-engineering (the schemes have financial approval to secure long lead time items and develop detailed contractor costs); £16m of projects have technical approval; and are being developed in time for delivery in the second half of ED1. Overall our reinforcement plans are in line with allowances and the development pipelines are healthy.

In SPM, timing is also the main factor in the enduring value adjustment. SPM's load reinforcement programme delivery is slightly under allowance cumulatively and is tracking in line with expectations. After the fourth year of ED1, more than three quarters of the £127m of schemes

identified in the ED1 Slow Track Business Plan submission have been technically approved. At the end of 2018/19 over 90% of these reinforcement projects were financially authorised for delivery. We are forecasting to deliver the ED1 allowance in this area.

#### **Non-Load Related Expenditure:**

In both SPD and SPM, timing is the main factor in the enduring value adjustment. We are maintaining our commitment to delivering on our ED1 outputs in both of our SPD and SPM Licences. Some of this timing impact in the first half of ED1 was due to elements such as lengthy contract negotiations, land rights/wayleaves issues impacting our overhead line programme, and the bedding-in of our new District delivery model.

In SPD, we have driven our overhead line modernisation programme to maximise the benefits to customers as early as possible in ED1. In year 4, utilising the significant numbers of framework contracts placed prior to 2018, we have made progress in delivering our ED1 Non-Load programme. Major programmes such as the Rising Mains and Laterals and the Service Modernisation programme have also seen the benefits of the new framework contracts, and we have seen significant progress in other areas, including our civils programme and our refurbishment programmes, where our switchgear retro-fit programme and 33kV tower modernisation programmes have now successfully cleared the development phase. We are forecasting to meet our ED1 outputs commitments and allowances in this area.

In SPM, timing is also the main factor in the enduring value adjustment. 2018/19 costs are tracking higher than the previous 3 years of ED1 demonstrating the traction we have gained in this area after the placement of significant framework contracts. In addition, diversions contributes to an overspend in allowance due to increased market driven activity and other factors outside our immediate control. The Overhead Line programme has seen continued progress with a healthy development/delivery pipeline. We are forecasting to meet our ED1 outputs commitments and allowances in this area.

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

In SPD we continue to deliver our inspection and maintenance plan volumes in line with allowances. Our fault costs are over allowance in 2018/19 regulatory year but cumulatively remain under allowance. Overall fault volumes during 2018/19 were slightly higher than experienced than in previous years mainly due to the extreme weather experienced during 2019. The high winds during storm Ali, Callum and Hector impacted our overhead line network and increased overhead line fault volumes. In addition, the high ambient temperatures between May and July increased faults in our underground network and in particular triggering a one-off exceptional event in our EHV underground network. Despite this, we anticipate that we will meet our overall ED1 allowance in this area.

In SPM, NOCs are currently ahead of allowance cumulatively. Specifically, SPM fault costs are over allowance mainly due to exceptional weather events in the ED-1 period. During 2018/19 SPM experienced significant weather related activity, that didn't quite breach the HV fault threshold for an exceptional event on each occasion. The resilience of our network, coupled with these weather patterns is impacting the nature of our faults costs compared to historical trends. In addition, SPM

were also affected by the high ambient temperatures between May and July, which also increased faults in our underground network.

### **Closely Associated Indirects:**

Both SPD and SPM set themselves a challenging ED-1 indirects target within their business plans as we targeted the opportunity to achieve a fast track business plan. Efficiencies were sought in every aspect of our indirects costs.

However we are finding it very challenging to reach the level of indirect costs within our allowance. We believe the benchmarking worked against our SPM business in particular setting allowances at a level below which a network company can operate effectively. However we are currently challenging our business to meet our overall ED1 allowance in this area and have reflected this in our current forecast.

### **Business Support Costs:**

As mentioned within our CAI cost commentary above we believe the benchmarking of indirects worked against our SPM business in particular setting allowances at a level below which a network company can operate effectively. In addition, compliance actions have impacted our allocation of corporate costs. BS costs have increased in comparison to the level forecast for ED1.

We have partially offset the increase through initiatives within SPEN to reduce the BS costs incurred directly by the company, and continue to challenge the business to meet our ED1 allowance in this area.

### **Non-Operational Capex:**

To date we have spent £53m compared to an allowance of £60.7m. To date in aggregate SPEN's non-operational asset expenditure is 13% under allowance. Within the sub categories we are under allowance by £11m for vehicles offset by being over allowance by £3m for Small Tools & Equipment. We anticipate that we will meet our ED1 allowances in this area.

## **R5 Output Incentives**

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

In 2018/19 we earned a £14.2m<sub>12/13 prices</sub> (SPD £8.4m, SPM £5.8m) reward for going above and beyond delivering a safe, secure and reliable service to our customers and meeting our stakeholders' needs. We have earned £74.9m<sub>12/13 prices</sub> (SPD £44.3m, SPM £30.6m) to date with a further £67.6m (SPD £37.0m, SPM £30.6m) forecast resulting in total forecast incentive reward of £142.4m<sub>12/13 prices</sub> (SPD £81.3m, SPM £61.1m) in RIIO-ED1, which we estimate to pay c£25.4m<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 8.95 in SPD (8.76 for 2017/18) and 9.0 in SPM (8.83 in 2017/18) 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 £6.1m<sub>12/13 prices</sub> (SPD £2.8m, SPM £3.3m) 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 2017/18 are included in the Broad Measure of Customer Service incentive values above.

Ofgem's independent panel assessment of our 2018/19 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 outperforming against the regulatory target, and CI & CML have all significantly improved since the end of DPCR5.

By 2023 we aim to have reduced the average amount of time our customers are off supply by 25%, by reducing interruptions by 16% and the duration of interruptions by 27%. By reducing average time off supply by 7% in the past year, we are well on the way to exceeding this target.

SPD have earned £30.4m<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 £14.8m<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 outperformance 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 2.9 working days for single premises, and 5.7 days for multiple premises. The corresponding average time to connect was 54.3 days and 69.3 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 4.8 working days for single premises, and 9.6 days for multiple premises. The corresponding average time to connect was 52.8 days and 66.6 days, from accepted and payment - resulting in £0.6m<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: Forecast achieving £583k reward in both SPD and SPM.

On a notional gearing basis, total incentives contribute +1.7% to SPD and +1.1% to SPM RoRE to date, slightly lowering to +1.5% for SPD and remaining the same at 1.1% 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 new 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 2018/19:

- 28 live projects and 17 closed projects
- 11 projects led by other LNOs, including 3 by GDNs
- 34 projects led by SPEN
- £3.5m 'Virtual World Asset Management' being the largest project

SPD and SPM have recovered £6.3m<sub>nominal</sub> and £5.6m<sub>nominal</sub>, respectively, of allowable expenditure through allowed revenues DUoS charges to date, forecasting a further £1.5m<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. Up to £70m per annum is available through the Electricity NIC.

### **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 finally 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 taken from regulatory accounts information for each licensee. This information can be found on our website at:

[https://www.spenergynetworks.co.uk/pages/accounts\\_information.aspx](https://www.spenergynetworks.co.uk/pages/accounts_information.aspx)

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.

## **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 2018 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 0.7%, a 5.5% increase from opening ED1 RAV of £1.522bn<sub>12/13 prices</sub> to an ED1 closing RAV of £1.607bn<sub>12/13 prices</sub>.

SPM report a compound annual growth rate of 2.0%, a 16.7% increase from opening ED1 RAV of £1.525bn<sub>12/13 prices</sub> to an ED1 closing RAV of £1.780bn<sub>12/13 prices</sub>.

The difference in RAV growth arises from SPM spending £165m<sub>12/13 prices</sub> more than SPD and the end of a 15 year depreciation smoothing adjustment applied to pre-vesting assets.

## 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 2018 CT600 is not yet due for submission to HMRC, consequently the 2017/18 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 and 2016/17, SPD and SPM contribute a further £43.9m in tax to HMRC for activities where we receive no tax allowance, for example incentives and non-regulated activities.

## 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 payments across both the ScottishPower Pension Scheme (SPPS) and the Manweb Group of the ESPS (Manweb) for each licensee. Similarly, the latest pension scheme valuation results at 31/3/16 are based on the total of the SPPS and Manweb scheme figures.

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 year ending March 2019.

Results of the 31/3/16 valuation have been input in nominal terms (i.e. assumed price base 15/16) and are taken from the relevant PDAM tables submitted in 2017.

## 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 £43k (SPD £80k, SPM £67k) 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, 28 February 2019, 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	High	‘3’	‘3’	<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>All categories were allocated ‘4’</li> </ul> <p>Control Framework Assessment:</p> <ul style="list-style-type: none"> <li>Control activities ‘0’</li> <li>Experience of personnel ‘1’</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
R10	Tax

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

Given that price controls are set on a March year end we have reconciled to the March Year End publicised Regulatory Accounts. Our Statutory Accounts are prepared on a calendar year basis. Our Regulatory Accounts can be found on our website using the following link:

[https://www.spenergynetworks.co.uk/pages/accounts\\_information.aspx](https://www.spenergynetworks.co.uk/pages/accounts_information.aspx)

### 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.