SSEN Distribution

REGULATORY FINANCIAL PERFORMANCE REPORTING

Financial Year 2023/2024

Scottish & Southern Electricity Networks

CONTENTS

1. EXECUTIVE SUMMARY

This commentary summarises the regulatory performance of the Scottish and Southern Electricity Networks – Distribution (SSEN Distribution) licensees; Southern Electric Power Distribution plc (SEPD / SSES) and Scottish Hydro Electric Power Distribution plc (SHEPD / SSEH), as in line with the Regulatory Financial Performance Reporting (RFPR) Guidance[1]. The RFPR consists of two elements: 1) Ofgem's RFPR template for reporting data and 2) The RFPR commentary. This commentary, therefore, should be read alongside the RFPR template that includes data tables.

The primary focus of the RFPR is to summarise key components of the financial performance of regulated networks by way of the Return on Regulatory Equity (RoRE). RoRE is presented as an average over the RIIO-ED2 period rather than prioritising in-year, cumulative, historical or year-on-year performance. The RIIO-ED2 period ends 31st March 2028. As such the 2024 RFPR submission reflects outturn data up to regulatory year 2023/24 and forecasted data thereafter. Consequently, analysis of average expected RoRE over the period demonstrates the forecast outcomes for each licensee, influenced by improvements in service quality for customers alongside ensuring expenditure is incurred efficiently. It is important to therefore highlight the following for readers:

- RoRE is not a reflection of customer bills, whereby a higher RoRE does not equate to higher customer bills. RoRE is intended as a reflection of Network performance whereby higher RoRE is likely to mean greater cost efficiency which leads to lower customer bills while delivering better service levels;
- The RoRE measure does not include the interest costs on borrowing. Electricity network infrastructure is financed by both borrowing funds (debt) and shareholder investment (equity) and hence, a measure which only takes into account part of the business financed by investment is not a complete measure. The overall Return on Capital Employed (ROCE), or as we have referred to the Rate of Return (RoR), is an alternative measure which more appropriately reflects the costs to customers for the overall electricity network. This commentary therefore sets out the RoRE and the RoR for completeness; and,
- RoRE must be interpreted across the full RIIO-ED2 period considering any Enduring Value (EV) adjustments and interpretation is needed as to what RoRE means for customers. Ofgem refer to EV as adjustments that are required to reflect the performance after completion of the price control including true-up and close out adjustments. We have not reflected any enduring value adjustments for either RIIO-ED1 or from RIIO-ED2 that may be interpreted as affecting the RIIO-ED2 performance i.e. RoRE. At the time of publication Ofgem have published their minded position regarding RIIO-ED1 closeout adjustments, however as we are still in a period of discussion prior to Ofgem's final decision these adjustments are not reflected in our 2024 RFPR submissions.

We have briefly summarised our financial performance in this document, which corresponds to information provided to Ofgem set out in documents submitted under the Regulatory Instructions and Guidance (RIGs). Financial values required to be reconciled within the RFPR have been reconciled to the audited statutory accounts for each applicable year in accordance with the RIGs. Also, performance is reported mostly using the nominal price base. A statement has been made to notify readers where 2020/21 price base is utilised within the report.

[1] *Ofgem (2024) "Regulatory Financial Performance Reporting (RFPR) Guidance". Available at: https://www.ofgem.gov.uk/decision/decision-2024-modifications-regulatory-financial-performance-reporting-rfpr-riio-2*

2. KEY FINANCIAL AND OPERATIONAL PERFORMANCE

ABOUT SSEN

We are the electricity Distribution Network Operator (DNO) responsible for delivering power to 3.9 million homes and businesses across central southern England and the north of Scotland.

Our network serves some of the UK's most remote communities and also some of the most densely populated. Our two networks cover the greatest land mass of any of the UK's DNOs, covering 72 local authority areas and 75,000km2 of extremely diverse terrain. Through our Priorities Services Register, we help customers who may need additional support and partner with trusted and expert organisations in a range of initiatives to assist those living in fuel poverty. SSEN is part of SSE plc, a UK-listed energy company that operates throughout the UK and Ireland. SSE develops, owns and operates low carbon energy assets including onshore and offshore wind, hydro power, electricity transmission and distribution networks (SSEN), alongside providing energy products and services for businesses. As a provider of critical national infrastructure, SSE and its businesses play a vital role in accelerating the transition to a net zero world at a national and local level.

SSEN Distribution operats under licence as SSES and SSEH and is responsible for safely and reliably maintaining the electricity distribution networks across central southern England and the North of Scotland.

OUR DISTRIBUTION NETWORK AT A GLANCE

Over **3.9million** homes and businesses

More than **978,200** customers on our Priority Services Register

Over **128,000km** of overhead lines and underground cables

Over **460km** of subsea cables powering our island communities

Over **4,400** employees across the country

Figures as of September 2024

We have completed the first year of operation under the RIIO-ED2 price control period. Below is an assessment of key performance metrics for both licensees under SSEN Distribution for the financial year ended 31 March 2024. In addition to below metrics, the performance related to regulatory indicators are detailed in other parts of this report thus should be read alongside this section.

KEY PERFORMANCE INDICATORS	MAR-24			MAR-23		
	SSEH	SSES	SSEN DISTRIBUTION	SSEH	SSES	SSEN DISTRIBUTION
Adjusted Operating Profit (£m)	83	194	277	99	253	352
Regulated Asset Value (£m Nominal)	1,811	3,542	5,353	1,557	3,164	4,721
Capital Expenditure (£m)	239	398	637	194	293	487
Electricity Distributed – TWh	7	30	37	7	29	36
Customer Minutes Lost Average per Customer	66	58		59	46	
Customer Interruptions per 100 Customers	57	51		60	44	

Table 1: Key Financial and Operational Performance Indicators

Financial performance of the SSEN Distribution licensees are measured on adjusted operating profit which excludes non-recurring exceptional impairment costs and re-measurements arising from operating derivatives. SSEN Distribution's adjusted operating profit fell by 21% from financial year 2022/23 to 2023/24 mainly due to under recovery of the inflationary impact of costs which are expected to materialise through Allowed Revenue (AR) in financial year 2024/25, additional fault and repair costs from ten named storms during the year, an increase in operating costs reflecting the inflationary impact, and higher depreciation on an expanding asset base. The reduction in operating profit was partially offset by higher allowed Distribution Use of System (DUoS) charges compared to previous year.

The total volume of electricity distributed by SSEN Distribution during 2023/24 was 37TWh, compared to 36TWh in 2022/23. Under RIIO-ED2, the volume of electricity distributed does not affect the Company's overall allowed revenue. This only has an impact on the timing of revenue collection as any over or under recovery which arises as a result will not be fully unwound until 2026/27.

SSEH's Customer Interruption (CI) performance improved in the first year of RIIO-ED2 compared to the last year of RIIO-ED1, by 5%. SSES saw a decrease in its CI performance by 16%. Both SSEH and SSES's Customer Minutes Lost (CML) performance decreased from 2022/23 by 12% and 26% respectively. In the first year of RIIO-ED2, a penalty of £10.9m (20/21 prices) was incurred across both SSES and SSEH under the Interruptions Incentive Scheme (IIS). This penalty arose from the introduction of tougher targets under the IIS compared to RIIO-ED1. In addition to this, adverse weather conditions also had an impact on CI and CML performance.

Our licence areas were severely affected by several named storms, and significant investment in automation across network areas has had a tangible, positive impact on the Company's ability to reconfigure the system quickly and remotely, if a storm-related fault occurs. This, alongside cable replacement work to reinforce the network, has mitigated service interruptions in what has been an unsettled winter period. As our investment in network renewal and reinforcement increases, there is a need to initiate Planned Service Interruptions to enable the business to carry out the necessary works safely and efficiently. This investment is expected to significantly improve the performance of the network.

In addition to the performance measures listed above, performance against other regulatory indicators such as RoRE, RoR, Regulatory Asset Value (RAV), Output Delivery Incentive (ODI), and CAPEX are reported in the following sections.

3. RETURN ON REGULATORY EQUITY

WHAT IS RORE?

Return on Regulated Equity (RoRE) is the key measure Ofgem uses to evaluate the financial return achieved by shareholders during the price control period. RoRE is a measure of performance for the whole price control period; RIIO - ED2 and includes outturn information up to financial year 2023/24 and forecasted information for the rest of the price control period.

As shown in Figure 1, the measure is further divided into operational and financial components. Operational RoRE includes costs and allowances related to RIIO-ED2 regulated businesses, such as Totex, ODIs, and company-funded innovations. Financial component includes both financing and tax performance. RoRE is presented in terms of both notional gearing and actual gearing. Notional gearing is set by Ofgem as a reasonable level of gearing for DNOs given the level of investment risk, which is currently set at 60% for RIIO-ED2. RoRE calculated based on notional gearing reflects a comparative performance indicator, allowing benchmarking amongst DNOs. Actual gearing can be different to the notional gearing depending on company specific funding structure so can vary through time and between companies.

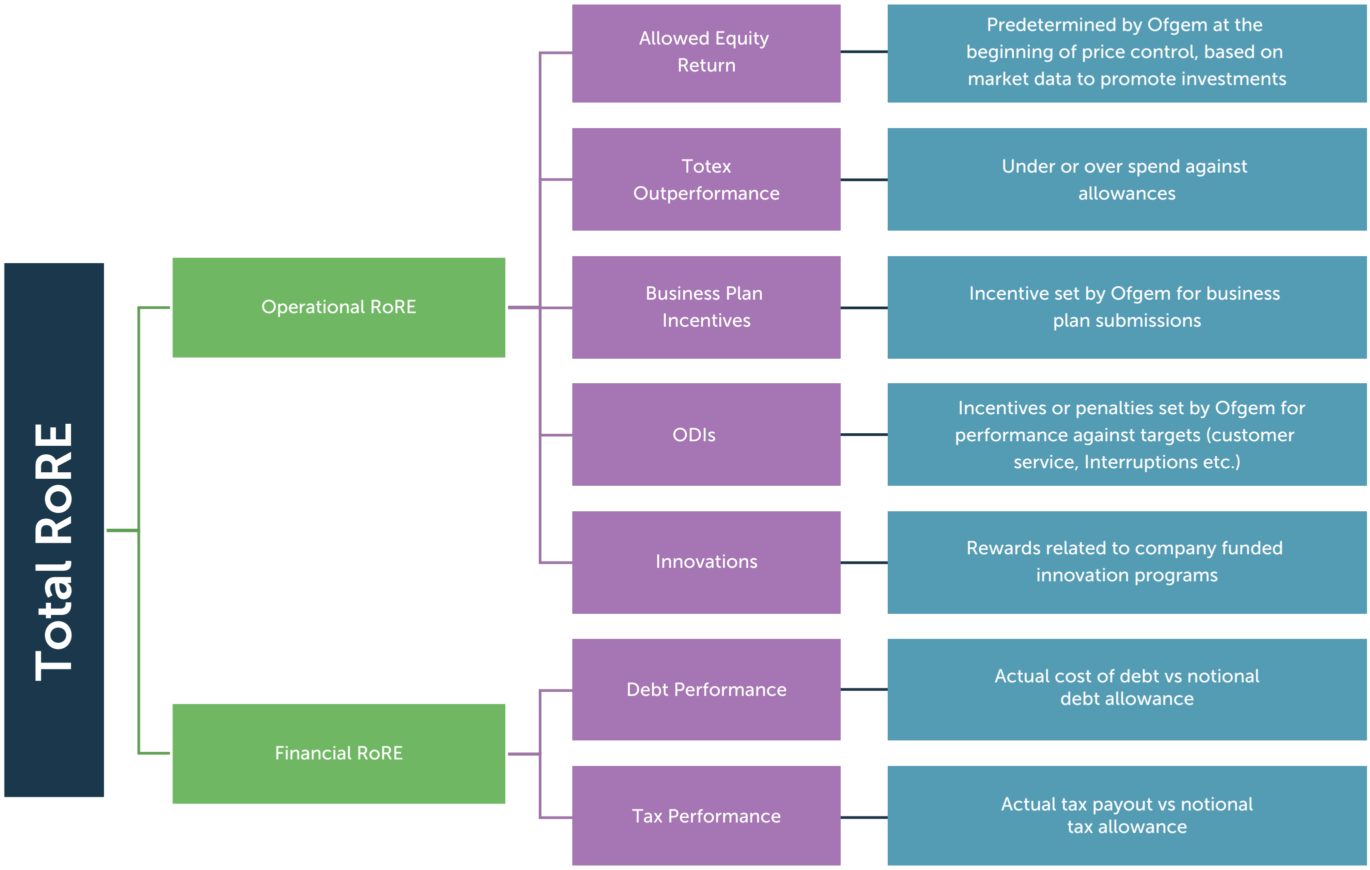

Figure 1: Elements of RoRE

Each of the licensees can earn above its base return on equity (allowed return on equity) through delivering efficiency savings on operating and capital expenditure (referred to as total expenditure or 'totex'). These efficiencies reflect our efforts to deliver contractual projects at a lower cost than allowances, ensuring lower customer bills. Additionally, if customer service levels improve against targets set by Ofgem, there is an opportunity to earn additional income through incentives. However, if service levels fall below targets set, a penalty will be incurred which reduces network revenue and therefore customer bills. This ensures that customers only compensate networks where they receive improving service levels. Furthermore, customers benefit from reduced bills when networks achieve efficiency savings on totex. In other words, if RoRE were to increase this translates to better service levels and lower consumer bills and not the opposite.

As Electricity Distribution Networks, we seek to improve customer service levels while also delivering efficiency savings. We believe this strategy ensures customers obtain a better service while targeting lower bills.

Our Performance

Average RoRE for the RIIO-ED2 period for SSES and SSEH can be seen in Figures 2 and 3 below. Disclosures are kept at notional gearing level to ensure comparability. RoRE based on actual gearing for each licensee are disclosed on the RFPR data template published along with this commentary and is not significantly different to the RoRE calculated based on notional gearing, as the Company aligns actual gearing to the notional gearing during the RIIO-ED2 period. Also, it is important to note that this is an average estimate for the RIIO-ED2 price control period which include forecasted data beyond financial year 2023/24 that often affected by the timing of the Allowed Revenue (AR) setting process as DNOs set their AR 15 months in advance. Forecasted data is also expected to change due to the timing of ongoing transformation activities taking place within the SSEN Distribution licensees. This is expected to result in efficiency savings, and the specific details and timing of these savings are currently being assessed. Further updates on forecasts will be available as part of the Price Control Financial Model (PCFM) submission in December 2024. More information on forecasted data is available in Appendix 1 of this commentary.

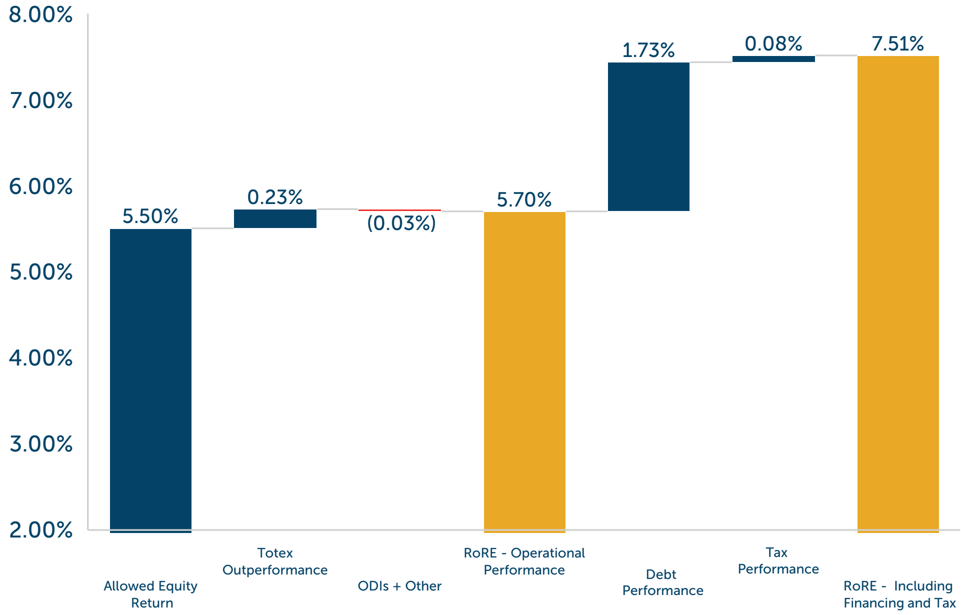

Figure 2: RoRE Based on Notional Gearing for RIIO-ED2 (2020/21 price base) – SSES

SSES is estimated to realise 0.20% above the baseline Allowed Equity Return, leading to an Operational RoRE of 5.70%. Expected penalty for the Interruption Incentive scheme (IIS), led by bad weather circumstances, notably in the year 2023/24 with 10 named storms disrupting our operations, has neutralised the incentives projected for other ODIs. Financing and tax performance raise SSES's overall return to 7.51%, mainly due to debt financing decisions made by the licensee. SSES has maintained its fixed rate debt profile at ~90% of total debt, protecting against the impacts from higher inflation, neutralising the impact of rising inflation in year 2023/24. More details on totex performance, ODIs, Debt and Tax performance can be found in Sections 5, 6, 7, and 9.

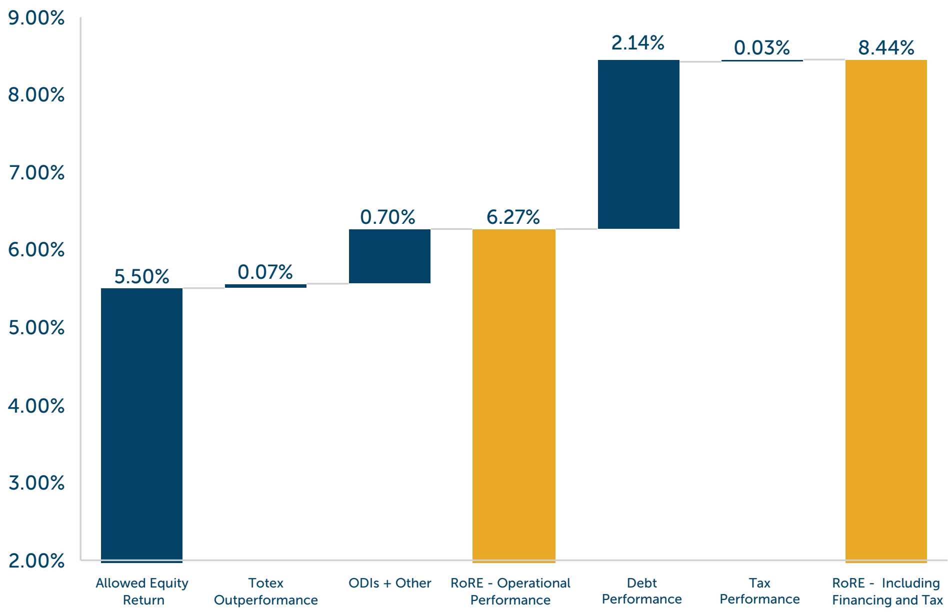

Figure 3: RoRE Based on Notional Gearing for RIIO-ED2 (2020/21 price base) – SSEH

As shown on Figure 3, efficiencies and consumer value additions are estimated to drive SSEH's operational RoRE to 6.27% from the baseline Allowed Equity Return of 5.50%. While the IIS penalty is still expected to negatively affect SSEH due to adverse weather conditions, increased focus on customer service is expected to yield better results in other incentive schemes, overall adding 0.70% to operational RoRE. The 2.14% debt performance is expected to increase SSEH's total RoRE to 8.44%, owing mostly to the economic benefit gained when inflation is deducted from actual interest costs in the financial year 2023/24. Similar to SSES, the premium on debt performance was mainly driven by a higher share of fixed debt compared to index linked debt within the company's financial structure, thereby insulating SSEH from high inflation persisted in recent years. More details on totex performance, ODIs, Debt and Tax performance can be found in Sections 5, 6, 7, and 9.

While RoRE is a measure of returns made to shareholders for the equity portion of regulatory asset base, we believe a measure that evaluates the performance of the total asset base would provide a better understanding of the overall performance of SSEN Distribution licensees. Figure 4 below sets out RoR as an alternate measure of performance that is measured by a Return on RAV instead on Regulated Equity. This is reflective of the gearing and cost of borrowing that customers pay for through use of the Distribution Networks, as opposed to a shareholder focused rate of return in the form of RoRE.

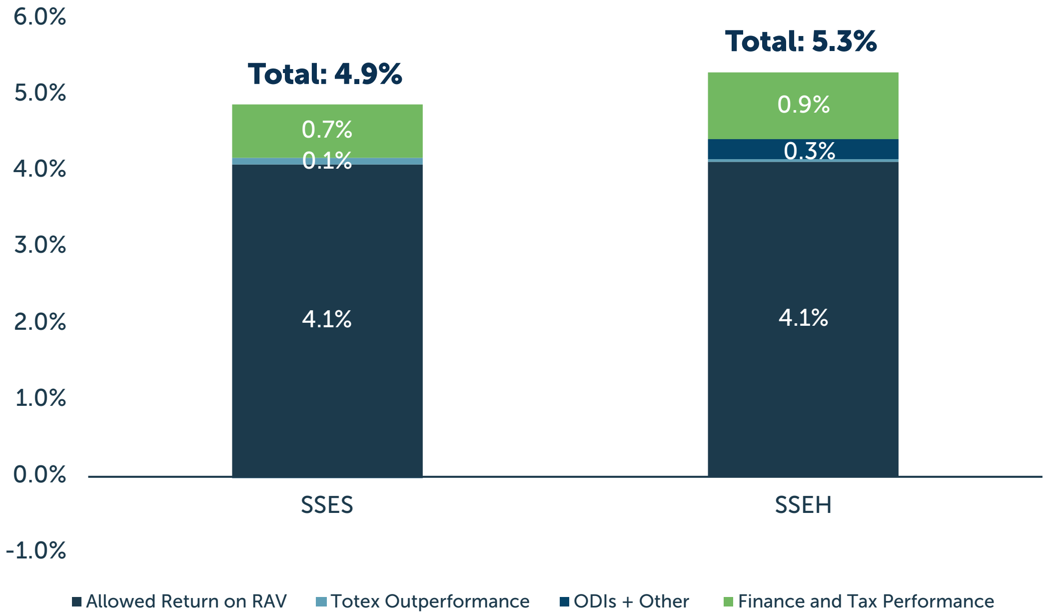

Figure 4 – Return on RAV (RoR) for the RIIO-ED2 (2020/21 price base).

At an operational level, SSES and SSEH are making returns at 4.2% and 4.4% respectively. Both SSEN Distribution licensees earn above the allowed Weighted Average Cost of Capital (WACC) operationally as well as when including the impact of financing and tax performance, generating additional value to investors and consumers. WACC is the return that Ofgem allows licensees to earn on debt and equity investments made on RAV. It is calculated using market data at the start of the price control period, with variable values updated annually. RoR over the WACC indicates value additions above the allowed return.

	SSES		SSEH	
	RIIO-ED1	RIIO-ED2*	RIIO-ED1	RIIO-ED2*
Allowed Equity Return	6.0%	5.5%	6.0%	5.5%
Totex Outperformance	(0.3%)	0.2%	(1.4%)	0.1%
ODIs + Other	1.0%	0.0%	0.7%	0.7%
RoRE - Operational Performance	6.7%	5.7%	5.3%	6.3%
Finance and Tax Performance	3.7%	1.8%	3.5%	2.1%
RoRE - Including Financing and Tax	10.4%	7.5%	8.8%	8.4%

**Estimated for RIIO-ED2 based on 2023/24 RFPR*

Table 2 – Comparison of RoRE RIIO-ED1 vs RIIO-ED2.

Allowed Return on Equity was reduced by 50 basis points from RIIO-ED1 to RIIO-ED2, decreasing the base RoRE from the previous price control period. Actual spend in RIIO-ED2 is expected to align with the allowances compared to overspent as seen in RIIO-ED1. Overall, finance and tax performance is predicted to decline compared to RIIO-ED1, with the high inflationary period phasing off by mid-RIIO-ED2 and returning to the Bank of England 2% target.

4. RECONCILIATION TO REVENUE AND PROFIT

This section outlines the reconciliation of revenue and profit stated on the statutory accounts against the regulated revenue and profit, as detailed in "R2 – Rec to Revenue and Profit" tab of the RFPR template. This reconciliation is only applicable for years that statutory accounts have been published hence only relevant for financial year 2023/24.

Collected regulated revenues are in line with the Price Control Financial Model (PCFM) last submitted to Ofgem (Dry Run 01 PCFM submitted in August 2024) and the revenue tariff setting process. The revenue under recoveries stated on the R2 tab; £17.1m and £137.9m for SSEH and SSES respectively are due to 2023/24 tariffs being set before the recent high inflationary period, the impact of which will be recovered during future years of the price control period. This is because DNO's tariffs are set 15 months in advance, allowing for adjustment of any under/over recovery of revenue in t+2.

SSEH's and SSES's regulatory profits were £32.8m and £72.5m higher than statutory profit for financial year 2023/24. These differences are mainly driven by the factors listed below and are detailed in the R2 Tab of the RFPR template published alongside this commentary.

Non-DUoS Income

- Directly remunerated services revenue: SSEH - £1.0m | SSES - £21.1m
- Connections - customer funded: SSEH - £8.2m | SSES - £6.9m
- Charging outside the Distribution Services Area (Out of Area Charges): SSEH - £6.9m | SSES - £29.7m

Costs not related to regulated business: SSEH - £40.4m | SSES - £123.0m

- Costs not related to regulated businesses are listed on the "R3 – Totex – Reconciliation" tab of the RFPR template under "Opex Reconciling Adjustments".

Depreciation of non-regulated assets: SSEH - £4.4m | SSES - £13.8m

5. TOTEX - RECONCILIATION

The purpose of this section is to provide an overview of the totex over / under performance and reconcile the totex with actual costs reported on statutory accounts. While totex over / under performance is explained for the whole price control period, with outturn for financial year 2023/24 and forecast numbers thereafter, the reconciliation is limited to years for which statutory accounts have been published. Totex performance is aligned with the Costs, Volumes and Revenue (CVR) Regulatory Reporting Pack (RRP) submitted to Ofgem in July 2024 and the PCFM for Dry Run 01 submitted on in August 2024.

Totex performance measures the efficiency of totex spend by evaluating the over / under spend on and above the approved allowance for the prevailing price control period. Any over / under spend is then shared with our consumers via the sharing factor which is currently 50.7% for RIIO-ED2. Any totex over performance (spend below the allowance) will therefore lead to lower consumer bills. Both SSEH and SSES are estimated to align the actual spend to RIIO-ED2 allowance, which is an improvement from the overspend reported in RIIO-ED1. However, the forecasted spend is expected to evolve as we move along the scheduled transformation activities within SSEN Distribution taking place in financial years 2024/25 and 2025/26 which will lead to efficiency savings in most areas, particularly in relation to Closely Associated Indirects and increased efficiency in delivery of Network Operating Costs, Load and Non-load related work. Further details on forecasted data are available in Appendix 1 of this commentary.

The total reported expenditure (sum of capital and operational expenditure) in statutory accounts for financial year 2023/24 is higher by £183.7m and £382.9m for SSEH and SSES respectively compared to regulatory totex. Reasons for this difference fall into two categories, items that meet the definition of statutory opex and capex but are not included in total regulatory costs, and regulatory costs which fall outside of the definition of Totex. While the detailed bridge for the difference is provided on the tab "T3 - Totex Reconciliation" of the RFPR template, statutory depreciation and amortisation which are included in statutory opex but do not form part regulatory totex, accounting adjustments per International Financial Reporting Standards (IFRS) that are limited to statutory accounts, and pass through costs which fall outside of the totex definition are the most common factors for this difference.

6. INCENTIVES AND OTHER REVENUE

This section details the performance of Output Delivery Incentive and other Revenue Allowances for the regulatory year 2023/24. Incentive values are sourced from the CVR RRP submitted to Ofgem. The forecast values reported in this section reflect our current indicative view and aligns with the PCFM submitted to Ofgem as part of the 2024 Dry Run 1. These values are subject to change between this submission and the next as the Annual Iteration Process (AIP) progresses and finalises in December 2024. Any such changes will be explained in detail in the next financial year's RFPR commentary.

Overall, SSEH earned an Incentive of £1.0m while SSES has incurred a penalty of £12.4m for the financial year 2023/24. These incentives are explained in 2020/21 price base unless otherwise stated.

Incentive income/penalty was driven by the Interruptions Incentive scheme (IIS) with a penalty of £1.6m and £9.4m for SSEH and SSES respectively for the year 2023/24. IIS incentive measures performance against the loss of electricity supply through the recording of the number of Customer Interruptions (CI) and Customer Minutes Lost (CML). Both licensees missed their CML targets due to adverse weather conditions with several named storms that made getting to and fixing faults cross the network challenging. SSEH outperformed CI target due to improvements made across a range of different performance aspects. However, SSES missed the CI the target. Investment in automation of our network will look to improve the performance of our networks over the course of RIIO-ED2. However, it is worth noting that introduction of tougher targets under the IIS compared to RIIO-ED1, alongside the adverse weather, has impacted our outturn under this scheme.

Total incentive reward against the Broad Measure of Customer Service Incentive was £0.9m for SSEH and a penalty of £3.7m for SSES, having an overall impact on increased penalty for SSES. Both licensees continue to address network resilience through its capital and operational investment plans, including a Climate Resilience Strategy published as part of the RIIO-ED2 business plan. We are also determined to embed learnings from various named Storm incidents in the year, to ensure continued improvement in storm responses, as well as delivering consistent 'above and beyond' levels of service to our customers.

Performance against other incentives is not addressed in this commentary because their contribution to our revenue is immaterial; nevertheless, details may be obtained on the RFPR template's "R4 - Incentives and Other Rev" tab.

In terms of income related to innovations, historic innovation information is sourced from the CVR RRP submitted to Ofgem. Innovation performance continues to be a priority across all licensees ensuring progression of innovations that will improve network reliability, efficiency and customer service as well as the transition to net zero. Details of revenue contributions from Innovation Allowances can be found on "R4 - Incentives and Other Rev" tab of the RFPR template. Further details on the projects funded through innovation are available on our innovation portfolio website[2].

[2] *Scottish and Southern Electricity Networks (no date) "Innovation Portfolio", Available at: ssen-innovation.co.uk*

7. FINANCING AND NET DEBT POSITION

This section details the information provided in the "R5-Financing" and "R6-Net Debt" tabs of the RFPR template. R5 tab reconciles the actual interest cost, or interest cost calculated as per the statutory accounting methodology with interest cost as per the regulatory definitions. These two interests are similar for both SSEN Distribution licensees.

The R5 tab further analyses the debt performance of the notional company and the actual company. A notional company is a hypothetical enterprise with financial parameters of an efficient network company that act as a benchmark to DNO's. However, according to UKRN guidance recommendation 09[3] licensees have the freedom to their own financing decisions. Companies are therefore incentivised to achieve financing structures which are more efficient compared to the notional structure and are permitted to take on exposures that match their preferences. Therefore, the financial structure of an actual company can be different to the notional company based on individual funding decisions. Accordingly, SSEH and SSES currently operate under a gearing of 55% and 52% respectively. Gearing has dropped below the notional company level because whilst the RAV has increased due to prevailing high inflation in the past few years, there has not been any adjustment to debt at this time. Not paying out dividends from financial year 2019/20 was another factor contributed to reduced gearing. However, SSEN Distribution is currently evaluating its funding options and both companies are expected to reach notional gearing; 60% by end of RIIO-ED2 period.

Cost of debt performance analyses the real finance cost and the allowed cost of debt per the last published PCFM. This performance varies across each network due to differences in financing decisions. For example, Ofgem recommended notional company ratio for fixed vs indexed linked debt is 75:25. The actual ratios for fixed versus indexed linked debt for SSEH and SSES are 78:22 and 90:10 respectively for financial year 2023/24, yielding additional benefits against high inflationary environments for SSES. It is also worth highlighting that the methodology does not reflect the cash cost of interest and is instead the economic form of outperformance due to removal of inflation from the effective interest rates. Overall, SSEH and SSES are expected to outperform cost of debt by £70.4m and £102.1m (2020/21 price base) respectively at notional gearing level, for the RIIO-ED2 price control period.

The purpose of the R6 tab is to report annual actual and forecasted Net Debt as per the regulatory definition and reconcile the actual Net Debt with statutory accounts, for years statutory accounts have been published. Calculation of regulatory gearing is based on the net debt per regulatory definition. Closing net debt per the regulatory definition for SSEH and SSES was £973.8m and £1,803.1m, respectively, as of end of financial year 2023/34 whereas, net debt per statutory accounts were £843.9m and £1,744.4m, for SSEH and SSES, respectively. The difference between regulatory and statutory net debt is mainly attributable to amounts owned to Group undertakings.

[3] *UKRN (2023) "UKRN guidance for regulators on the methodology for setting the cost of capita", p.33, Available at: ukrn.org.uk/app/uploads/2023/03/CoC-guidance_22.03.23.pdf*

8. RAV

This section includes a summary of "R7 – RAV" tab of the RFPR template, that details the annual Regulatory Asset Value (RAV) position based on the outturn and forecasted RAV as per the RIIO-ED2 PCFM submitted to Ofgem in August 2024.

The closing RAV balance is used in deriving actual gearing and the NPV (Net Present Value) neutral equity element of RAV that is used to calculate RoRE. As depicted on Figure 5, SSEN Distribution is expected to operate at a £7.6bn RAV in nominal terms, with 36.8% contribution from SSEH and 63.2% contribution from SSES by the end of the RIIO-ED2 price control period. The Compound Annual Growth Rate (CAGR) in RAV across RIIO-ED2 is estimated to be 9.4% cumulatively for SSEN Distribution.

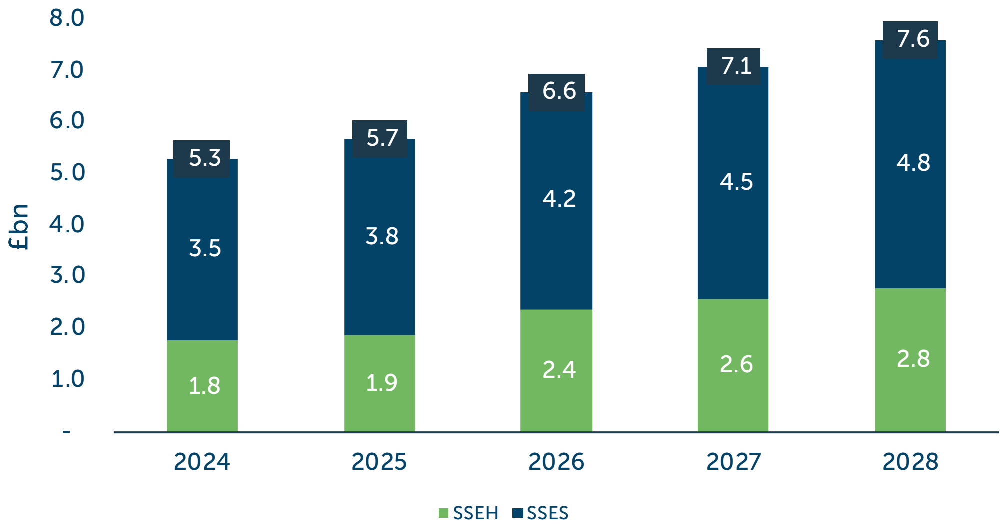

Figure 5: Estimated RAV at Nominal Prices (£ billion)

The increase in RAV from the financial year 2024/25 to 2025/26 is attributable to £204.9m (2020/21 price base) RAV transfer from SSEN Transmission to SSEH for the Shetland Link Contribution. Also, there have been no EV adjustments made to totex and therefore no adjustments for EV have been reflected in the RAV.

9. TAXATION AND TAX RECONCILIATION

This section details the "R8 – Tax" tab of the RFPR template which calculates the tax over / under performance based on estimated tax payout and the tax allowance passed to consumers, as stated in the PCFM.

The tax allowance is calculated through the PCFM, based on a fixed split percentage of tax pool additions, and forecast nominal financing costs (net interest paid). Both SSEH and SSES are broadly expected to align their tax payouts to the tax allowance passed to consumers with minor differences.

The purpose of "R8a - Tax Reconciliation" tab is to highlight differences between a licensee's CT600 actual corporation tax liability and the calculated tax allowance in the 'Finance and Tax' sheet of the latest PCFM. Due to the timing of CT600 submissions, this Reconciliation is to be submitted with a one-year lag, with first the submission for DNOs due in 2025. Therefore, "R8a - Tax Reconciliation", and accompanying commentary is not included within the RFPR template and this document.

10. CORPORATE GOVERNANCE

Purpose of this section is to provide details on licensee's corporate governance structure including its ownership, composition of the Board, key decision-making responsibilities, executive remunerations, and dividend policies.

Corporate Ownership and Governance Framework

SSEH and SSES are distribution licensees that operate in the north of Scotland and south of England respectively. SSEN Distribution Limited is the immediate parent of both licensees. Immediate parent of SSEN Distribution Limited is Scottish and Southern Energy Power Distribution Limited (SSEPD). Other than SSEN Distribution Limited, SSEPD owns 75% stake in Scottish Hydro Electric Transmission plc (SSEN Transmission), which operates the electricity transmission business in the north of Scotland. SSE plc is the immediate parent of SSEPD with 100% stake, hence is the ultimate parent of SSEH and SSES.

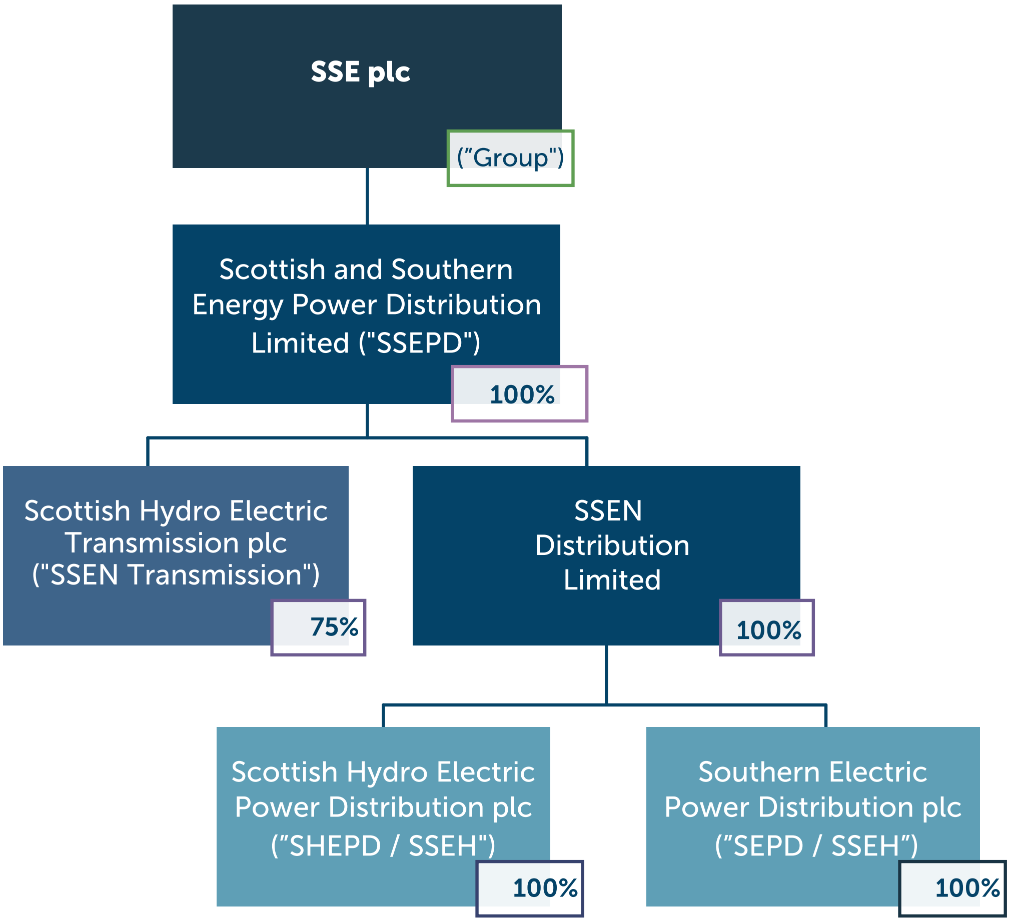

Figure 6: Ownership Structure

Both distribution licensees are governed by the SSEN Distribution Board. As of the time of this submission, the Company Board comprised of three Executive Directors and five Non-Executive Directors one of whom is the Chair of the Company Board, an Executive Director of the SSE plc Board and a member of the Group Executive Committee. Two of the Non-Executive Directors on the Board during the course of the financial year were Sufficiently Independent Non-Executive Directors as required under the terms of Standard Condition 43A of the Company's regulatory licence. The Directors believe that the Company Board is an appropriate size and has a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Company Board's decision making.

NAME	TYPE	APPOINTMENT DATE
Alistair Paul Morton Phillips-Davies	Non-Executive Chair	2 April 2023
Christopher Derek Dyne Burchell	Executive Director / Managing Director	24 August 2022
Dinesh Michael Manuelpillai	Executive Director / Finance Director	30 June 2023
Eliane Marthe Jeanne Marie Algaard	Executive Director / Distribution Operations South	3 April 2023
Klair Neenan	Non-Executive Director	1 October 2023
Samuel John Peacock	Non-Executive Director	1 May 2023
Maxine Frerk	Sufficiently Independent Director	1 May 2023
Paul Scott Brown	Sufficiently Independent Director	1 June 2024
Helen Elizabeth Mccombe	Secretary	24 August 2022

Table 3: Board of Directors

The SSEPD Board governed the Company's activities until 25 November 2022. All SSEPD Board members transferred to the SSEN Distribution Board on the 25 November 2022 and convened until the year ended 31 March 2023. A planned Board restructuring exercise subsequently took place from 3 April 2023 to align with the SSEN Distribution's current and future strategy plan. Gregor Alexander stepped down as Chairman of the Board on 3 April 2023 and Alistair Phillips–Davies, current SSE plc Chief Executive, was appointed to the role of Chairman of the SSEN Distribution Board as a Non-Executive Director on the same date. Other Directors who served and resigned during the financial year 2023/24 are Rob McDonald, Sandy MacTaggart, Maz Alkirwi, Rachel McEwen (Non-Executive Director), Gary Steel (Sufficiently Independent Non-Executive Director), Katherine Marshall (Non-Executive Director), Mark Rough, and David Rutherford (Sufficiently Independent Non-Executive Director).

The Executive Directors are experienced senior business leaders and are deemed to possess the appropriate breadth of knowledge and expertise to discharge their role effectively. Two of the executive directors are fully assigned to regulated businesses while, Managing Director of the SSEN Distribution Board; Christopher Burchell serves on the Group Executive Committee of the ultimate parent; SSE plc.

The Non-Executive Directors provide an appropriate degree of independent judgement and challenge to ensure balanced and fair decision-making and outcomes. The operation and effectiveness of the Board is the ultimate responsibility of the Chair, who is supported in their role by the Company Secretary. Agreed procedures are in place to manage and mitigate actual or potential conflicts of interest with Board or Company business.

The Board oversees matters including the Company's purpose, value and strategy, as well as dividend policy. The Board does not have a supporting Nomination, Remuneration or Audit Committee. These functions are dealt with, where required, in conjunction with the relevant committee of the SSE plc Board. Details on these committees are disclosed in Annual Report of the SSE plc available on SSE plc website[4]. Table 4 elaborates on the decision-making across the governance hierarchy.

DECISION	NARRATIVE ON WHO HOLD THE RESPONSIBILITY
Purpose, values and strategy	Both Licensees work within the purpose, values and strategy of the ultimate parent; SSE plc and the SSEN Distribution Board, as the parent company of both Licensees is responsible for the oversight.
Board director nominations	Changes to the structure, size and composition of the Board and Board Committees are matters reserved to the SSEN Distribution Board. In accordance with the Company's Articles of Association, the Company's shareholder; SSE plc may appoint and remove directors by ordinary resolution.
Board director evaluation	The Board evaluation process is a matter reserved for the SSEN Distribution Board. Separately to the Company, the Board of SSE plc complies with the provisions of the UK Corporate Governance Code in relation to its own evaluation.
Executive remuneration	Executive remuneration is a matter reserved to the Board of SSE plc / Remuneration committee.
Dividend policy	Dividend policy is a matter reserved to the SSEN Distribution Board. The Company will consult with the Board of SSE plc to form group dividend policy but the ultimate decision, in line with the Companies Act, rests with the Board of Directors of the Company.

Table 4: Decision Making Responsibilities within the Group

[4] *SSE plc (2024) "SSE plc Annual Report 2024), pp.138-177, Available at: sse.com/media/0aibgke4/sse_ar24_interactive.pdf*

As depicted on Table 5, the Board has delegated its responsibilities on day-to-day operational decisions to Distribution Executive Committee and Use of System Charges Sub-Committee.

BOARD SUB COMMITTEE	PURPOSE	BOARD DIRECTORS THAT SERVE ON THE COMMITTEE
Distribution Executive Committee	Manage daily operations of both SSEN Distribution licensees	Christopher Derek Dyne Burchell Dinesh Michael Manuelpillai Eliane Marthe Jeanne Marie Algaard (Other members represent senior management but are not part of the Board of Directors)
SSEN Distribution Board Use of System Charges Sub-Committee	To review and assess the matters related to DUoS	Dinesh Michael Manuelpillai Christopher Derek Dyne Burchell (Other members represent senior management but are not part of the Board of Directors)

Table 5: Board Sub Committees

On appointment, all Directors receive induction to the Board and briefings on areas pertinent to their role such as a director's legal duties. The ongoing effectiveness of the Board is supported by performance evaluation and a commitment to personal development and training by each Director. More information on the Governance process of SSEN licensees can be found within the Directors Report of the Financial Statements for financial year 2023/24 published on our website[5].

Executive Remuneration Policies

The SSE plc Group's Remuneration Committee is responsible for setting pay for members of the Group Executive Committee (GEC) and reviewing the remuneration arrangements for all employees across the Group. The GEC includes the Managing Director of Distribution. The details of how the Remuneration Committee operates is disclosed in the Directors' Remuneration Report in the SSE plc Annual Report[6].

The Remuneration Committee has responsibility for overseeing pay in both SSES and SSEH. Pay and remuneration is based on the following elements:

- The senior management population participate in annual and long-term incentive arrangements. In line with Executive Directors' arrangements, incentives for senior management have an emphasis on share awards
- All employees have the opportunity to be share owners through the Share Incentive Plan and the Sharesave Plan and those participating are able to express their views in the same way as other shareholders
- Pension planning is an important part of SSE's reward strategy for all employees because it is consistent with the long-term goals and horizons of the business, an approach it has been practising for a number of years. The terms of the funded final salary pension schemes apply equally to all members
- As part of its Employee Engagement Survey ("Great Place to Work") SSE invites all employees to provide a view on the benefits and pay that it provides

The Remuneration Committee keeps these arrangements under constant review. As directed by SSE's Remuneration Committee, 20% of the total Annual Incentive Plan (AIP) for Executive Directors is determined by the progress made in meeting SSE's four 2030 Business Goals which are focused on addressing the challenge of climate change. For SSEN Distribution, there is close alignment with the long-term goals of SSE: supporting renewable output, accommodating electric vehicles and championing fair tax and the real Living Wage. Individual performance in Distribution is measured against these goals along with other factors such as health and safety, licence compliance, business plan outputs and stakeholder engagement.

The Remuneration Committee appreciates the importance of an appropriate relationship between the remuneration levels of the Executive Directors, senior executives, managers and other employees within the SSE Group, although comparison metrics are not used to determine pay policy. Remuneration at all levels is designed to be consistent with the Group's core remuneration principles, long-term business strategy and, for Distribution, the goals set out in our business plan. More information on the basis of pay determination can be found in Table 6.

[5] Scottish and Southern Electricity Networks (2024) "Directors Report and Financial Statements - Scottish Hydro Electric Power Distribution plc", pp. 19-24,

Available at: ssen.co.uk/globalassets/library/financial-information/2024/fy24-shepd---signed-financial-statements-ey.pdf

and Scottish and Southern Electricity Networks (2024) "Directors Report and Financial Statements - Southern Electric Power Distribution plc", pp. 19-24,

Available at: ssen.co.uk/globalassets/library/financial-information/2024/fy24-sepd---signed-financial-statements-ey.pdf

[6] SSE plc (2024) "SSE plc Annual Report 2024", pp.158-177, Available at: sse.com/media/0aibgke4/sse_ar24_interactive.pdf

BOARD SUB COMMITTEE	BASE SALARY	BENEFITS	PENSION	SHORT-TERM INCENTIVES	LONG-TERM INCENTIVES
Executive Directors	Typically set with reference to the market and wider workforce considerations. Annual increases are typically in line with or less than the wider employee population.	A range of voluntary benefits in line with the wider workforce plus contractual car and private medical benefits.	All employees are a member of the SHEPS or SEPS defined benefit pension scheme, or the Pension+ defined contribution scheme unless they have opted or cashed out. The arrangements are diverse, and the employer cost typically ranges from 3% to 38% of salary when both defined contribution and defined benefits schemes are taken into account.	Annual Incentive Plan linked directly to business performance – 50% financial, 50% non-financial. 33% of the total award is deferred as career shares.	The Performance Share Plan is a share award with performance linked to strategic performance measures.
Group Executive Committee and Senior Management	Set with reference to the market and wider workforce considerations. Annual increases are typically in line with or less than the wider employee population.	A range of voluntary benefits in line with the wider workforce plus contractual car and private medical benefits.		Annual incentive Plan considering performance of the Group (directly linked to the above), the business area and the individual. 25% of the total award is deferred as shares for three years.	The Leadership share plan is also linked to strategic performance measures over the longer-term and those with direct impact on strategic output are eligible.
Wider Workforce	Base salary levels are subject to negotiation with recognised trade unions and/or are set in line with market requirements. Annual increases are subject to negotiation.	A range of voluntary benefits are available to all employees, such as a cycle to work scheme, a holiday purchase scheme, health benefits, and enhanced maternity, paternity and adoption leave.		Depending on role, a proportion of employees will participate in the Annual Incentive Plan (as above). 100% of the award is paid in cash.	All employees may participate in the Share Incentive Plan (SSE matches three shares for every three bought) and the Sharesave (SAYE) plan.

Table 6: Remuneration Arrangements, SSE Group

Dividends

Our dividend policy is based on a range of factors considered by the Board of Directors including delivering our business plan, maintaining our investment grade credit rating, complying with regulations, and providing an appropriate rate of return to shareholders. Given the significant capital investment planned in RIIO-ED2 business plan as well as other future investments, our dividend policy must have the capability to flex with these requirements such that shareholders will see cash dividends over the period in line with their required rate of return. The effect of this is that in some years, we may pay relatively low or zero dividends, and in other years we might pay higher dividends in line with standard treasury and cash flow management practices. Under our dividend policy, we consider the following factors on an annual basis prior to declaring a dividend:

- Availability of Resources for operating in the coming 12 months
- Company viability over the forthcoming three years in line with the UK Corporate Governance Code
- Maintaining investment grade credit rating including raising external borrowings at an appropriate credit rating
- Planned and committed capital investments
- Financial performance and the required return by shareholders
- The impact on customers of a dividend being paid including attracting and retaining investment to deliver our business plan

All dividends are approved by the Board of Directors prior to payment, with neither licensee paying a dividend since financial year 2019/20.

11. PENSIONS AND OTHER ACTIVITIES

Pension allowances and deficit repair payments are in line with the Pensions Reasonableness Review carried out and submitted in September 2023. No adjustments have been made post this review. Pension allowances do not directly affect the RoRE or RoR, except as part of a component of totex expenditure for ongoing service contributions.

12. DATA ASSURANCE STATEMENT

This submission has been completed in line with the Data Assurance Requirements under Standard Licence Condition 45. A Risk Assessment has been conducted with the Total Risk Rating being scored as Medium. The appropriate level of Data Assurance has been employed based on this Rating, including a submission plan, methodology and appropriate level of review and sign off.

APPENDIX 1 - BASIS OF ANY ESTIMATES AND ALLOCATIONS

Estimates are restricted to forecast information. Forecasts have been constructed as follows;

- Totex – forecasts match the latest 2023/24 submitted CVR RRP and PCFM Dry Run 01. Financial forecasts for totex are based on our latest iteration of the SSE NZAP+ 10-year plan. The values in our submission are based on a mixture of committed expenditure, planned expenditure, and stretch targets to deliver the overall business strategy and value for consumers. Due to our ongoing internal transformation activities that are expected to take place until financial year 2025/26, forecasts are likely to evolve as we realign deliverables and work areas to operate more efficiently.
- Incentives – forecast values reported under incentives reflect our current indicative view and are aligned with the latest 2023/24 RRP. However, the values could be subject to change between this submission and the submission of the final PCFM in December 2024 as the Annual Iteration Process (AIP) progresses.
- Innovation – forecasts are based on the average innovation revenues for the price control period to date.
- Financing – forecasts for interest on existing debt are based on SSE Treasury forecasts of interest payable based on the expected interest rate for each instrument. Forecast interest cost for new debt is based on the value of new debt multiplied by the price control cost of debt for the relevant year.
- Net debt – forecasts for existing debt are based on SSE Treasury forecasts of the movement in debt based on the arrangements in place.
- Tax – the forecast tax liability is based on the proportion of the average adjusted actual tax liability for the price control to date versus the forecast regulated profit for the remainder of the price control period.

As per the call with the ENA and Ofgem on 29 April 2024 with regards to forecast data in CVR RRP, it was agreed that DNOs could delay the submission of forecast information until the completion of PCFM Dry Runs. Therefore, we would like to caveat that because the forecast information contained in this submission is aligned to the CVR RRP submitted in July 2024 and the PCFM Dry Run 1 submitted in August 2024, information is indicative at present and values may be subject to change until the final stage of AIP, due in December 2024.

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