

NORTHERN ELECTRIC DISTRIBUTION LIMITED
REGULATORY ACCOUNTS
FOR THE YEAR ENDED
31 MARCH 2009

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2009

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NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF

DIRECTORS' REPORT

Cautionary statement regarding forward-looking statements

The Regulatory Accounts have been prepared in accordance with standard condition 44(5) (Regulatory Accounts) of the electricity distribution licence granted to the Company by the Secretary of State (the "Licence"). The Company, its directors, employees or agents do not accept or assume responsibility to any person in connection with this document, other than in respect of the obligations imposed on the Company under standard condition 44(5) of the Licence, and any such responsibility or liability is expressly disclaimed. The Regulatory Accounts contain certain forward-looking statements, which can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, business prospects, the availability of financing to the Company and anticipated cost savings are forward-looking statements.

By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of the Regulatory Accounts, and will not be updated during the year. Nothing in the Regulatory Accounts should be construed as a profit forecast.

The directors present their report, including a review of the business of Northern Electric Distribution Limited (the "Company") during the year, and the Regulatory Accounts for the year ended 31 March 2009 (the "Regulatory Year"), which includes the business review and audited financial statements for that year. The businesses of the affiliates of the Company that have carried out activities forming part of, or ancillary to, the distribution business of the Company have not been consolidated with the activities of the Company in the preparation of these accounts. The Regulatory Accounts, including pages 2 to 28 inclusive, which comprise the directors' report and the corporate governance statement, are separate from the statutory financial statements of the Company.

PRINCIPAL ACTIVITIES

The Company is part of the CE Electric UK Funding Company group of companies (the "CE Group") and its principal activity during the Regulatory Year was to distribute electricity to customers connected to its electricity distribution network.

The Company serves an area of approximately 14,400 sq km in the north east of England with a resident population of 3.2 million, receives electricity from the National Grid's transmission system and distributes it to the 1.6 million customers connected to its electricity distribution network of transformers, switchgear and overhead and underground cables, at voltages of up to 132kV. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. During the Regulatory Year, the Company distributed electricity to customers in its distribution services area and continued to improve the overall performance of its distribution network through its investment strategy being targeted at delivering improvements in an efficient and cost-effective manner.

In common with the CE Group, the Company operates a business model and strategy based on its six core principles, which are:

| <u>Principle</u> | <u>Strategy</u> | <u>Indicator</u> |
|-------------------------|--|---|
| Financial strength | Effective stewardship of the Company's financial resources and investing in assets and focusing on long-term opportunities, which contribute to the Company's future strength. | Profitability. Cash flow. Maintenance of investment grade credit ratings. |

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DIRECTORS' REPORT (CONTINUED)

PRINCIPAL ACTIVITIES (CONTINUED)

| | | |
|------------------------|--|--|
| Customer service | Delivering reliability, fair prices and exceptional service. | Improving network resilience and performance, measured by: Customer minutes lost; Customer interruptions; and Customer satisfaction. |
| Operational excellence | Setting high standards for the Company's operations and system investment, operation and maintenance. | Effective asset management. Managing commercial risk. Improving network resilience and performance. |
| Employee commitment | Equipping employees with the resources and skills they need to operate successfully and in a safe and rewarding environment. | Leading safety performer. Engaging employees. Effective leadership. |
| Environmental RESPECT | Using natural resources wisely and effectively protecting the environment, where it is impacted by the Company's operations. | Reducing environmental impact. Promoting and pursuing long term sustainability. |
| Regulatory integrity | Adhering to a policy of strict compliance with appropriate standards, policies and legislation. | Strong internal controls. Regulatory engagement. Industry influence. |

The Company continually puts plans in place to deliver its objectives against the strategy based on its core principles. The Company executes on those plans across a range of activities, measures its progress against those plans and introduces corrective action wherever required. Adherence to its strategy and core principles enabled the Company to deliver a high standard of performance against the challenges faced during the Regulatory Year.

BUSINESS REVIEW

Review of the Regulatory Year

The Company's progress during the Regulatory Year was pleasing, with the highlights being a strong underlying financial performance, improved customer service performance in the call centre and a significant improvement in the lead times for producing high volume quotations for connections to the distribution network. There were also general reductions in accident rates, oil leakages from fluid-filled cables and guaranteed standards of performance failures. These highlights were achieved while managing a sustained period of industrial action.

Issues identified as being central to delivery of the core principles in the future include further improvements in safety performance, network availability and reliability and the usefulness and accuracy of information provided to customers during network outages. In addition, the process of negotiating Distribution Price Control Review 5 ("DPCR5") will be a critical area of focus during 2009 as the outcome will set the Company's income from the charges for the use of its electricity distribution system through to March 2015.

Strategic objectives

As part of the CE Group, the Company's strategic objectives, based on its core principles, are to build a business, which

- continues to generate value over the long-term, in keeping with the nature of that business;

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Strategic objectives (continued)

- invests in and manages its electricity distribution network in an efficient and effective manner;
- provides its customers with an excellent standard of service;
- engages with its employees so that they feel rewarded and recognised as part of a team that sets and achieves increasingly high standards of performance; and
- is viewed as being a leader in terms of shaping the future direction of the electricity distribution network sector in the United Kingdom.

As part of its strategy, the Company is committed to putting safety first, respecting its customers, their time and property, doing a quality job, responding effectively in times of severe weather (when the Company is needed most) and caring for its local environment.

Principal risks and uncertainties

There are a number of potential risks and uncertainties, which could have a material impact on the Company and its strategy and may cause actual results to vary materially from those expected or historically experienced. The principal risks are outlined as follows:

Financial strength:

The main financial risks facing the Company are outlined in the Treasury section on pages 9 and 10 below.

As a holder of an electricity distribution licence, the Company is subject to regulation by the Gas and Electricity Markets Authority ("GEMA"), which acts through the Office of Gas and Electricity Markets ("Ofgem").

Most of the revenue of the electricity distribution licence holders is controlled by a distribution price control formula set out in the Licence. The price control formula does not constrain profits from year to year but is a control on revenue that operates independently of most of the electricity distribution licence holder's costs.

It has been the practice of Ofgem to review and reset the formula at five-year intervals, although the formula has been, and may be, reviewed at other times at the discretion of Ofgem. Details of such a review undertaken during the Regulatory Year are provided on page 8. The current five-year price control period became effective on 1 April 2005 and has set the Company's revenue through to 31 March 2010. A resetting of the formula requires the consent of the licence holder but licence modifications may be unilaterally imposed by Ofgem without such consent following review by the Competition Commission. During the term of the price control, changes in costs incurred will have a direct impact on the financial results of the Company.

During 2009, the Company is fully engaged with Ofgem in the DPCR5 process, which will culminate in Ofgem making its final proposals in respect of the price control formula that will take effect for the five-year period commencing 1 April 2010. That process involves submission of the Company's detailed business plans in February 2009 (with updates provided in June and July), triggering an assessment by Ofgem that will result in an initial set of proposals to be published in early August 2009. Dialogue between the Company and Ofgem will then take place throughout the second half of 2009 such that the final proposals are then expected prior to the end of 2009.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Principal risks and uncertainties (continued)

Other:

The principal risks facing the Company in respect of the other core principles include:

| <u>Risk</u> | <u>Issue</u> | <u>Mitigation</u> |
|--|--|---|
| Counter-party security | A counter-party with which the Company trades may go bankrupt causing loss of invested funds or amounts owing. | The treasury function has strict controls in respect of the counter-parties with which it deals, including the use of credit ratings and appropriate limits. Credit cover arrangements are in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism, if good debt control practices continue to be followed. |
| Potential flooding and other weather related events. | Recent weather patterns suggest a heightened risk of flooding of 'at risk areas' and the potential for increased occurrence of damage to the overhead network. | A robust major incident management plan is in place. The Company's critical property unit plan assesses those properties most at risk and a flood mitigation plan is in place, including the erection of permanent and temporary defences. |
| Supply chain interfaces | The various operational areas of the Company may overlap or have gaps in the supply chain. Current economic conditions are placing suppliers under pressure. | Roles and responsibilities of the interfacing departments are being better defined. Payment for goods and services provided is within agreed terms, after due scrutiny. |
| BT ESP analogue circuits | Potential withdrawal of service puts existing communication arrangements at risk. | Options include retaining the equivalent service, potentially at higher than current cost or utilising an alternative solution. |
| Network risk posed by cables through the Tyne Cable Tunnel | The 66kV fluid-filled cables in the tunnel are aging with increased risk of failure, leading to a requirement for the substantial use of generating units and potential guaranteed standards failures and incentive penalties. | The Company's Primary Engineering Projects team is developing a solution but has assessed the potential for simultaneously losing all circuits as being remote. |
| Motor accident management | Any significant road traffic accident involving a Company vehicle may create a liability, which the Company has to meet, and involve injury to employees and/or third parties. | The Safety Improvement Plan has a substantial focus on road risk and the reduction of preventable vehicle accidents. A dedicated road risk manager has been appointed. |

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Principal risks and uncertainties (continued)

Other (continued):

| | | |
|--|---|--|
| Electricity, Safety, Quality and Continuity Regulations 2002 | The regulations impose various statutory obligations, non-compliance with which could lead to incidents, prosecution and claims. | A full site inspection and risk assessment regime is in place designed to ensure compliance. |
| Shortage of supply and increased demand for copper | The global demand for copper has impacted the availability and cost of a number of core products and increased the risk of theft. | Improved and more efficient procurement processes have been introduced and security at all sites where copper products are stored has been reviewed and enhanced where required. |

A Compliance Assurance Programme Steering Group ("CAPSG") is in place, consisting of certain directors and senior managers of the CE Group in order to provide oversight at a strategic level and steering of the CE Group's performance in respect of governance and its key facets of compliance and risk management.

The Company operates a structured and disciplined approach to the management of risk, as part of the overall risk management approach of the CE Group. Those risks assessed to be significantly high are logged within a risk register that is reviewed regularly by the CAPSG and key indicators track the number of significant risks actively monitored by the CAPSG at any one time.

Risks are assessed with due regard to probability and impact and the risk environment is reviewed continually in order that new or emerging potential risks are identified. Risk mitigation and loss control plans are prepared in response to strategic risks in order that the directors can be assured that appropriate mitigating actions are in place and being implemented. These plans are monitored through to implementation and reviewed to determine whether the level of residual, mitigated risk is within an acceptable level of tolerance.

The CE Group's strategy is to follow an appropriate risk policy, which is intended to effectively manage exposures related to the achievement of business objectives. The CE Group identifies and assesses risks associated with the achievement of its strategic objectives, including those of an environmental and social nature. Any key actions needed to further enhance the control environment are identified, along with the person responsible for the management of the specific risk. A quarterly review of the key risks, controls and action plans is undertaken. The Governance and Risk Section oversees all aspects of risk and compliance, emphasising the CE Group's commitment to maintaining an appropriate risk and governance framework across the business.

The use of a well-defined risk management methodology allows a consistent and co-ordinated approach to risk reporting and mitigation.

A key element and requirement of the risk management process is that a written certificate is provided by the President and Chief Operating Officer of the CE Group confirming that the effectiveness of the system of internal controls has been reviewed during the year. A self-certification process is in place, in support of this review, whereby senior managers are required to confirm that the system of internal control in their area of the business is operating effectively.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Internal control

A rigorous internal control environment exists within the CE Group based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. MidAmerican Energy Holdings Company ("MidAmerican"), a parent company of the Company, requires a quarterly control risk self-assessment to be undertaken by all senior managers as part of its programme for compliance with the requirements of the Sarbanes-Oxley Act. During the Regulatory Year, an extensive programme to review the company-wide controls was completed. The review concluded that there were no significant weaknesses in the control environment and various opportunities identified by that review to enhance the existing control arrangements have been implemented.

The CE Group is committed to proper business conduct and, in common with the other affiliates of MidAmerican, has adopted a code of business ethics that emphasises the requirement for all staff to manage their activities to achieve the highest level of ethical conduct.

The CE Group has a "speaking up" policy in place for staff to raise any instances of unethical acts, malpractice or impropriety. An additional process is also available to all staff via an international anonymous help line operated by an independent company.

Human resource policies focus on skills, motivation and excellence and the promotion of high standards of probity among staff. In addition, the appropriate organisational structure has been developed to control business units and to delegate authority and accountability, having regard to acceptable levels of risk.

The Company has appropriate controls in place directed at ensuring compliance with the conditions in its Licence requiring any payments made to, or received from, affiliates or related undertakings in respect of goods and services provided or supplied to be on an arm's length basis and on normal commercial terms.

Other key features of the internal control system are:

- Comprehensive business planning and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- Regular review of key performance indicators to assess progress towards objectives;
- A range of policies, codes of practice and more detailed instructions that define the processes to be followed;
- A strong internal audit function to provide independent scrutiny of internal control systems and risk management procedures, including standards required by the Sarbanes-Oxley Act;
- On-going health and safety performance reviews carried out by in-house safety professionals in addition to the regime of routine health and safety risk assessment and management processes carried out within each of the operating units;
- Processes and procedures to operate under the Occupational Health and Safety Assessment Series ("OHSAS") standard OHSAS 18001, which is subject to external certification and regular assessment;
- An external obligations programme, which provides a robust approach to, and compliance with, financial, legal and regulatory obligations;

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Internal control (continued)

- Centralised treasury operations that operate within defined limits and are subject to regular reporting requirements and audit reviews; and
- Established procedures for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

Financial strength

During the Regulatory Year, the Company introduced improvements in its management of routine financial performance by identifying clearer lines of accountability, implementing tighter expenditure controls, improving management information and emphasising the culture of continuous financial improvement in all areas of operation.

In addition, representations were made to Ofgem, in accordance with the provisions set out in the electricity distribution licence, regarding certain categories of cost not fully taken into account when the current price control was set, effective from 1 April 2005, due to uncertainties at that time regarding the amount and materiality of those costs. After a due process of review Ofgem generally accepted those representations and agreed that the Company was able to recover approximately £18m, in addition to the otherwise agreed principles for calculating its allowed revenue, over the three regulatory years starting on 1 April 2009 and ending on 31 March 2012. The price control was adjusted accordingly.

The Company is keenly aware of the impact that the general economic climate is having, and may continue to have in the foreseeable future, on it and its customers. In that respect, procedures are in place to more closely monitor and manage the issues that may impact on the Company's business more significantly than others, including a reduction in overall demand for electricity leading to less units being distributed through the Company's network, lower activity in terms of new connections required to the network and the potential for higher receivables write-off as the economic downturn further affects the Company's customers.

Key aspects of financial performance for the Regulatory Year were as follows:

Revenue

Revenue at £211.8m was £7.1m lower than the prior year primarily reflecting a reduction in Use of System ("UoS") income in respect of use of the Company's electricity distribution network as a result of lower units distributed and lower tariffs.

Operating profit

Operating profit at £80.9m was £10.0m lower than the previous year, mainly due the reduction in UoS income and higher depreciation charges.

Finance costs

Finance costs at £24.5m were £1.0m higher than the prior year due to higher average borrowings during the Regulatory Year partly offset by a lower variable interest rate.

Taxation

The Company's taxation charge in 2008 and 2009 has been affected by changes in tax rates and legislation. Details are provided in Note 9 to the accounts.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Financial strength (continued)

Results and dividends

The Company made a profit after tax for the Regulatory Year of £34.6m. An interim dividend of £20.0m was paid during the Regulatory Year and the directors recommended that no final dividend be paid in respect of the statutory accounting year ended 31 December 2008.

No interim dividend was paid during the period 1 January 2009 to 31 March 2009.

Share capital and debt structures

There were no changes to the Company's share capital or debt structure during the Regulatory Year.

Dividend policy

The Company's dividend policy is that dividends will be paid only after having due regard to available distributable reserves, available liquid funds and the financial resources and facilities needed to enable the Company to carry on its business for at least the next year. In addition, the level of dividends is set to maintain sufficient equity in the Company so as not to jeopardise its investment grade credit rating.

Cash flow

The Company aims to collect from customers and pay suppliers within contracted terms. Any surplus cash is remitted to Yorkshire Electricity Group plc ("YEG"), a fellow company in the CE Group, and invested accordingly, generating a market rate of return for the Company.

Movements in cash flows were as follows:

- *Operating activities:* Cash flow from operating activities at £72.8m was £4.0m lower than the previous year, mainly due to lower cash profits (£9.2m) and adverse working capital movements (£2.0m), partly offset by lower net tax and interest paid (£7.2m).
- *Investing activities:* Net cash used in investing activities at £100.0m was broadly in line with the prior year and reflects the capital investment in the Regulatory Year, offset by customer contributions.
- *Financing activities:* The net cash generated by financing activities at £27.2m was broadly in line with the prior year and reflects the net increase in borrowings in the Regulatory Year.

Treasury

The Company's short-term financial objective is to ensure that it has access to sufficient liquidity to enable it to meet its obligations as they fall due and to provide adequately for contingencies. The long-term objective is to provide a stable and low cost of financing over time whilst observing approved risk parameters.

The main risks are liquidity and interest rate risk.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Financial strength (continued)

Treasury (continued)

Liquidity risk

The Company has access to short-term borrowing facilities provided by YEG, £50m in committed revolving credit facilities provided by Lloyds TSB Bank plc and Royal Bank of Scotland plc and an additional overdraft facility of £2m provided by Lloyds TSB Bank plc, which is renewed on an annual basis. The revolving credit facilities are due to expire in May 2010, at which point, the Company expects to raise further facilities as required. The directors do not consider there to be any doubt over the Company's ability to raise such finance given its investment grade issuer credit rating and the fundamental financial strength and nature of its business.

Interest rate risk

The Company is financed by long-term borrowings at fixed rates and has access to short-term borrowing facilities at floating rates of interest. As at 31 March 2009, 80% of the Company's borrowings were at fixed rates and the average maturity for these borrowings was 23 years.

Currency risk

No material currency risks are faced by the Company.

Trading risk

Throughout the Regulatory Year, the Company's policy was that no trading in financial instruments should be undertaken.

Financial derivatives

As at 31 March 2009 and during the Regulatory Year it was the Company's policy not to hold any derivative financial instruments.

Pensions

The Company is a participating employer in the Northern Electric Group of the Electricity Supply Pension Scheme (the "Scheme"), a defined benefit scheme. Full details of the Company's commitments to the Scheme and the associated deficit repair payments are provided in Note 24 to the accounts. The Company also participates in the Northern Electric Money Purchase Scheme, which is a defined contribution scheme.

Insurance

As part of its insurance and risk strategy, the CE Group has put in place a range of insurance policies covering it against risks, including damage to property and employer's, third party motor and public liability. The CE Group carries appropriate excesses on those policies and is effectively self-insured up to the level of those excesses. Consequently, the risk management and health and safety programmes in place are viewed as extremely important elements of the business, given the contribution they make to the elimination or reduction of exposure to such risks.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Customer service

During the Regulatory Year, the Company distributed electricity to customers in its distribution services area and continued to improve the overall performance of its distribution network through its investment strategy being targeted at delivering improvements in an efficient and cost-effective manner. The Company is focused on delivering a reliable and dependable supply of electricity and a high standard of service to its customers. In the first full year of operation since the launch of the "customer promises", a significant number of tangible improvements have been identified and delivered, as part of the overall goal to improve customer satisfaction with the service provided, including:

- improving under-performing parts of the distribution system by identifying "hot spots" and taking specific action to address the issues in those areas;
- undertaking a programme to reduce the number of instances by one third, in which the Company fails to meet an electricity guaranteed standard of performance;
- advancing the community care programme for the most vulnerable customers by ensuring that the needs of those customers are understood and responded to as effectively as possible, making available dedicated customer support vehicles and providing a 'language line' to facilitate conversations between customers and staff; and
- taking action to reduce the average length of time taken to restore supplies in fault situations.

The Company continued with its initiatives to reduce the time taken to restore supplies following faults on the network. Those initiatives include "Power in an Hour", which aims to restore the supplies of as many customers as possible within an hour of the start of an interruption, and the use of the latest mobile phone technology to locate and contact the nearest persons able to deal with faults.

The main achievements in the Regulatory Year were the overall reduction in failures against the guaranteed standards of performance, significant improvement in the quotation performance of the connections business and the naming of the customer relations centre as North East Contact Centre of the Year in its class. However, it is recognised that further effort is required to bring the Company's customer satisfaction scores to greater than 90% and the installation of a replacement telephone system that takes advantage of the latest developments in automatic messaging is expected to improve performance in this respect.

Ofgem has established an incentive scheme for quality of service, by which distribution network operators ("DNOs"), such as the Company, are provided with financial incentives based upon targets set by Ofgem for each of the DNOs with regard to their performance in the following areas:

- The number of interruptions to supply;
- The duration of interruptions to supply; and
- Customer satisfaction.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Customer service (continued)

Customer minutes lost ("CML") and customer interruptions ("CI") are the key performance indicators used by the Company to measure the quality of supply and system performance. CML measure the average number of supply minutes lost for every connected customer due to faults and planned outages that last for three minutes or longer. CI measure the average number of supply interruptions for every 100 connected customers due to faults and planned outages that last for three minutes or longer. DNOs' performance against guaranteed standards, set for activities such as restoring supplies after unplanned interruptions, provides a measure of the level of customer service. Performance against these measures forms part of the Company's regular reporting to Ofgem.

In respect of the key customer service performance indicators, the Company's performance for the Regulatory Year showed that it achieved the Ofgem CI target but missed the CML and customer satisfaction targets, as follows:

| | Actual | Target |
|------------------------|---------------------|-------------------|
| CML: | 76.3 (2008: 70.5) | 68.4 (2008: 69.5) |
| CI: | 64.2 (2008: 66.3) | 74.5 (2008: 74.5) |
| Customer satisfaction: | 89.2% (2008: 88.6%) | 90% (2008: 90%) |

Operational excellence

The Company's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the Regulatory Year, £145.3m was invested in the improvement of the distribution system, including the replacement of assets and continuing network improvements intended to increase the quality of the electricity supply provided to customers.

The investment strategy is designed to deliver improvements in an efficient and cost-effective manner by minimising the number of faults that occur, reducing the average number of customers affected by a fault and providing a quicker restoration service in the event of a fault. Such actions are expected to have a positive impact on future CI and CML performance. The focus during the Regulatory Year was on delivering the core operational programmes, in particular the installation of remote control units and improving the lead times for fault repair work-in-progress. The major projects undertaken as part of the investment strategy included:

- The completion of a project to establish a new 66/11kV primary substation at Scarborough;
- The completion of a project to establish a new 66/11kV primary substation at Breamish Street in Newcastle;
- The completion of a 132kV reinforcement project in the Richmond area and the establishment of a single transformer 132kV substation at Skeeby;
- Completion of the overhead line refurbishment works associated with phase two of the refurbishment of the Spennymoor to Skernside 66kV circuit;
- The continuation of a major 33kV reinforcement project in Newcastle designed to meet demand growth and provide further system security in the area;
- Replacement of 13 units of high voltage outdoor switchgear;
- Replacement of 33 high voltage distribution substations;

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Operational excellence (continued)

- Replacement of 10 units of high voltage indoor switchgear;
- Refurbishment or rebuilding of 50km of high voltage overhead line;
- Refurbishment or rebuilding of 8km of low voltage overhead line;
- The upgrade and reinforcement of 3km of overhead line to address the quality of supply performance issues relating to those circuits; and
- The installation and commissioning of 330 sites with remote control facilities.

In order to deliver its investment strategy, the Company used a mix of its own staff and contractors to undertake its activities.

2008 was the third year in succession to present significant weather-related problems for the distribution network, to which the Company's emergency response process was again effective, particularly in terms of the most severe flooding seen in the Morpeth area for almost 40 years.

In order to help it decide on the priorities for its investment plan, the Company consulted with a wide range of interested parties during the Regulatory Year about its proposals through the publication of a consultation document, which included information about the Company's activities and current priorities and posed a range of questions about its options for the future. The results of that consultation exercise will be considered as part of the discussions regarding the DPCR5 process, which the Company will be conducting with Ofgem throughout 2009.

Managing commercial risk in the context of the difficult economic and financial trading conditions was and will continue to be of key importance and has seen increased attention being paid by the Company in ensuring that the CE Group's policies for credit checking, payment terms, payment performance tracking and debt management are strictly adhered to.

The Company's main customers are the electricity suppliers who enter into Distribution Connection and Use of System Agreements ("DCUSAs") with the Company and who, under the terms of those agreements, pay UoS charges for the use of the Company's electricity distribution network. As the income received by the Company under the DCUSAs it has in place with the electricity suppliers represents over 85% of the Company's total income, the DCUSAs are considered to be contracts essential to the Company's business.

It is necessary to ensure that the Company maintains in place credit cover arrangements, in respect of the amounts payable by the electricity suppliers under the DCUSAs, which are in line with Ofgem's guidance. The principal electricity suppliers that use the Company's electricity distribution network are RWE Npower, British Gas, EDF Energy, E.on, Scottish and Southern Energy and Scottish Power.

Employee commitment

Health and safety

During the Regulatory Year, the focus on health and safety continued to be of paramount importance for the directors, as it is for all employees. Providing and maintaining a safe working environment is the first objective of the Company. There is a continuous drive for improvement in safety performance through the setting of challenging goals and the pursuit of a programme of on-site safety audits, which reflect the Company's fundamental objectives that none of its staff should go home injured and all employees should commit to behaving safely all of the time. The Company makes no compromise in respect of its health and safety obligations and centres its safety plans and systems on the principles found in companies with world class safety performance.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Employee commitment (continued)

Health and safety (continued)

The Company received its seventh consecutive Gold Award from the Royal Society for the Prevention of Accidents, for occupational health and safety performance and provision, to recognise the achievement of continued or improving standards of health and safety over a sustained period and continued to maintain its OHSAS 18001 certification.

The main key performance indicators used by the CE Group to monitor safety performance are measured on a calendar year basis and are as follows:

| | Year to 31 December 2008 | | Year to 31 December 2007 | |
|-------------------------------|--------------------------|--------|--------------------------|--------|
| | Target | Actual | Target | Actual |
| Lost time accidents | 0 | 2 | 0 | 3 |
| Medical treatment accidents | 3 | 1 | 1 | 4 |
| Operational incidents | 3 | 8 | 4 | 8 |
| Preventable vehicle accidents | 10 | 18 | 9 | 18 |

Safety performance against target was reasonable in certain areas during 2008 but continued to be somewhat disappointing in others and, following certain events at other platforms in the MidAmerican group, a wide-ranging audit of operational activity was undertaken, aimed at identifying any underlying procedural concerns in respect of operational performance. A number of initiatives arising from that exercise and the continuing evaluation of the lessons to be learned from all safety related incidents have been incorporated into the annual safety improvement plan for 2009, together with an enhanced number of site audits aimed at increasing the focus on operating a safe environment in both the workplace and on the road.

Management structure

The CE Group has a clearly defined leadership team, in which specific roles are identified, so allowing more effective management of the CE Group's business and response to any control weaknesses that may become apparent, with single units being in place for field operations, customer operations, asset management and performance analysis and innovation. The information technology, human resources, procurement and finance functions are centralised in order to provide those services across the CE Group.

Employees

The Company faced particular challenges during the Regulatory Year due to the significant industrial relations issues, with which it had to deal. Having come through that period with new agreements and understandings in place, the priority for 2009 and beyond will be to maintain constructive engagement with the Company's employees through the existing trade union relationships and management structures. The Company will also continue to build upon resource management processes to provide a sustainable environment in which employees are effectively utilised and company values are maintained.

The Company employed 967 staff as at 31 March 2009 at various locations throughout its distribution services area (2008: 964).

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Employee commitment (continued)

Disabled employees

The Company is an equal opportunities employer and is committed to the criteria underpinning the Employment Service disability symbol. It is the Company's policy to provide disabled people with equal opportunities for employment, training, career development and promotion, having regard to their aptitudes and abilities. Should any member of staff become disabled during their employment, that member of staff would be retrained and redeployed, wherever possible.

Employee consultation

The Company has a constitutional framework in place and has agreed that framework with trade union representatives. In addition, the Company communicates directly, and through the management structure, with personal contract holders and keeps them informed of and involved as appropriate in any developments that may impact on them now or in the future.

The Company is committed to maintaining and improving effective communication with employees, principally through regular staff briefs on current issues, meetings with staff and their representatives and the issue of newsletters and a quarterly employee magazine.

Environmental RESPECT

The CE Group's approach to environmental compliance is governed by its RESPECT policy of Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training, and supporting group policy, which includes the promotion of environmental awareness, best practice and legal compliance amongst its staff and contractors.

The CE Group has operated a scheme under the environmental management systems ("EMS") standard ISO 14001 since the late 1990s and is subject to regular six-monthly assessments by an external certification body in order to retain that status.

Lloyd's Register for Quality Assurance visited the CE Group in March 2009. That visit raised one new, minor non-conformance in respect of the testing of depot environmental operational controls. The tests were subsequently carried out and process improvements introduced. The minor non-conformance raised in September 2008, also in respect of operational controls, will be verified at the visit scheduled for September 2009. The minor finding regarding the oil testing programme to verify the polychlorinated biphenyls content of oil in certain categories of transformer assets will remain open until the conclusion of the programme. The report from the March 2009 visit stated that "based on the evidence presented, the assessment concluded that the company continues to demonstrate a sound approach to the implementation, maintenance and improvement of a mature EMS conforming to ISO 14001".

Improvements in support of the CE Group's environmental policy objectives during the Regulatory Year included:

- A programme to enhance secondary containment provision for primary transformer sites to prevent oil leakage;
- A programme to enhance emergency response provision for primary transformer sites to mitigate oil leakage;
- Replacement of oil-filled circuit breakers with vacuum and SF6 units at outdoor substations;
- Improved monitoring and response measures with regard to the management of fluid-filled underground cable networks;

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Environmental RESPECT (continued)

- Installation of additional engineering controls where required to improve pollution prevention in strategic sites; and
- Installation of underground cables using trenchless technology as opposed to open-cut excavations.

Other initiatives included:

- The evaluation of waste management provision and minimisation options together with systematic verification of the legal duty of care in connection with waste management activities;
- Monthly monitoring and management of fuel consumption by fleet vehicles;
- Environmental awareness training for staff and contractors; and
- Monthly monitoring of energy consumption at all premises.

Measurements used to monitor environmental performance include the following categories:

- An annual internal environmental management systems audit programme: (40 audits completed) (2008: 29);
- Internal environmental management systems non-conformances: (9 reported and addressed) (2008: 4);
- Continual improvement programmes: (10 underway and performing to target) (2008: 7 underway, with 6 performing to target and 1 temporarily delayed);
- Environmental incidents log: (44 investigated and remedial action taken, including 13 reported to the Environment Agency) (2008: 42 investigated and remedial action taken, including 11 reported to the Environment Agency);
- Cable fluid losses: (an average annual rate of 23.4 litres per kilometre) (2008: 26.2 litres per kilometre);
- Primary transformer oil losses: (zero litres) (2008: 57 litres);
- Secondary transformer oil losses: (2,283 litres) (2008: 2,224 litres);
- All other oil losses: (42 litres) (2008: 69 litres);
- SF6 switch-gear losses: (9.6 kg) (2008: zero kg). Both figures are estimates and the Company is currently implementing a revised recording mechanism, which it is expected will result in revisions to those figures; and
- Environmental customer communications: (217, mainly substation related, regarding graffiti, weeds and fly-tipping) (2008: 285).

The environmental key performance indicators are made available for scrutiny during the six-monthly external assessments and used by senior management to determine how the system is performing. They measure the delivery of system evaluation and continual improvement programmes, as well as detected non-conformances, reported incidents and the significance of environmental impacts and are subject to on-going monitoring as part of the CE Group's continual improvement programme.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Regulatory integrity

The Company manages its business to the highest behavioural standards and adheres to a policy of strict compliance with all relevant standards, legislation and regulatory conditions. The CAPSG continued to monitor and manage performance in risk-related and compliance areas and met on four occasions throughout the Regulatory Year.

The benefits associated with upgrading the Company's financial systems continued to be seen in terms of improvements in financial reporting and the controls in respect of the UoS process were subject to scrutiny by an internal audit, which did not identify any significant weaknesses in that process. In addition, the regulatory compliance process was embedded across the Company and includes the provision of quarterly reports to the board. Focus on the accuracy of regulatory returns has continued and positive comments were received from the external consultants who reviewed the systems for PAS 55 accreditation.

The regulatory framework across the energy industry in the UK is undergoing a wholesale review, which could result in fundamental changes to the way the industry is regulated in the future. A significant part of that process is Ofgem's "RPI-X@20" project, which is specifically considering the way in which energy networks are regulated. This review is running alongside the DPCR5 process and the Company has and will continue to take an active part in the debate, which ranges from the potential for new low-carbon technologies (insofar as they apply to electricity distribution networks), such as "smart" metering, and the increased use of micro and distributed generation, to the design of future regulatory price control review processes.

Other directors' report requirements

Corporate social responsibility

The Company values its relationship with its customers and their communities, recognising the importance of a secure power supply to the local communities and economy and aims to enhance its relationship through a wider involvement in the activities of and dialogue with the communities it serves.

As part of its customer service strategy, the Company engages directly with the communities it serves to create a dialogue on quality of supply issues, actions and investment planned to improve quality of supply, environmental and social implications of its operations and other opportunities to assist and engage in the life of the community. Where appropriate, this may include financial support for community projects. The Company has a targeted donations programme, focusing on its key priorities of support for youth, education and the environment, using both its own funds and income from trusts established with Community Foundations in Tyne and Wear, County Durham and Cleveland.

The CE Group is an active member of Business in the Community.

Sustainability

As a major player in the energy industry, the Company is well aware of the challenge of climate change and the efforts being made both nationally and internationally to combat it and has engaged in the national and regional debates and is facilitating the connection of distributed generation projects within its distribution services area. In addition, the Company recognises the importance, as a responsible company and employer, of taking action in relation to its own greenhouse gas emissions.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Other directors' report requirements (continued)

Sustainability (continued)

The CE Group has calculated the carbon footprint for 2007 and 2008, attributable to the electricity distribution businesses of the Company and its affiliate Yorkshire Electricity Distribution plc ("YEDL"), and will continue to do so, on a regular basis. For 2008, that total carbon footprint was 1,152,920 tonnes of CO2 equivalent, representing a 3.0% reduction on 2007. Excluding distribution system losses (the difference between electricity measured as having entered the distribution network and that measured leaving it), that carbon footprint was 11,793 tonnes of CO2 equivalent, representing a 1.8% reduction on 2007. The CE Group has set a target of reducing both figures by 20% by 2020.

Charitable and political donations

During the Regulatory Year, charitable donations of £38,499 were made (2008: £18,224), principally to local charities serving the communities in which the Company operates. No contributions were made to political organisations (2008: nil).

Research and development

The Company supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. The main areas of activity during the Regulatory Year were:

- Active participation in programmes of national significance in collaboration with other DNOs and academic institutions to make significant technological progress for utilisation by the industry as a whole;
- Continuing to support collaboration with other DNOs, both through industry associations and on a multilateral basis, on a range of incremental improvements to tools and equipment that, if successful, will further add to overall efficiency improvements;
- Continuing to support the development of a novel (super-conducting) fault current limiter, to reduce prospective short-circuit currents. The resultant lower stress on switchgear, if the project succeeds, will permit the connection of more rotating plant (including generation) with lower levels of reinforcement and/or replacement;
- Taking a key role in the set-up and successful start up of the Energy Innovation Centre to provide a portal for technologies and suppliers new to the DNO industry;
- The development of improved condition monitoring data and models to improve management of both new and already installed assets;
- Continuing to support a project at Durham University to assess electrical network risk with the objective of improving decision making on network reinforcement and operation;
- The development of options for automatic voltage control on the LV network; and
- The development of several different fault passage indicator systems to improve reaction time to network faults and minimise customer impact.

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Other directors' report requirements (continued)

Supplier payment policy

The Company complies with the Better Payment Practice Code for the prompt payment of suppliers in accordance with the normal terms of trade. It is CE Group policy with respect to its suppliers to settle the terms of payment with those suppliers when agreeing the terms of each transaction, to ensure that those suppliers are aware of the terms of payment and to pay in accordance with the CE Group's contractual and other legal obligations. The number of days purchases in trade creditors for the Company at 31 March 2009 was 18 (2008: 11).

Future Developments

The financial position of the Company, as at the end of the Regulatory Year, is shown in the balance sheet on page 32, there have been no significant events since the end of the Regulatory Year and the directors intend to develop the business in a manner that concentrates on its core skills of electricity distribution by continuing to operate its business with the goal of out-performing the allowances in the distribution price control, while efficiently investing in its electricity distribution system with the aim of improving the quality of supply provided to its customers.

Directors

The directors who served during the Regulatory Year and since the end of the Regulatory Year were as follows:

| | |
|------------|--|
| G E Abel | President, MidAmerican Energy Holdings Company |
| P E Connor | Senior Vice President & Chief Procurement Officer, MidAmerican Energy Holdings Company |
| R Dixon | Non-executive Director |
| J M France | Regulation Director, CE Electric UK |
| N M Gill | Field Operations Director |
| P A Jones | President and Chief Operating Officer, CE Electric UK |
| K Linge | Finance Director, CE Electric UK |

Details of the directors' emoluments are included in note 8 to the accounts.

Auditors

On 1 December 2008, Deloitte & Touche LLP changed its name to Deloitte LLP. An elective resolution is in place dispensing with the need to appoint auditors annually. Deloitte LLP has indicated its willingness to continue in office.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Other directors' report requirements (continued)

Going Concern

The Company's business activities, together with details regarding its future development, performance and position are set out in the business review in this report. In addition, the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities and its exposures to credit risk and liquidity risk are included in this report and the appropriate notes to the accounts.

When considering continuing to adopt the going concern basis in preparing the Regulatory Accounts, the directors have taken into account a number of factors, including the following:

- a) The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance their activities. In response to an information request issued by GEMA during the Regulatory Year, as part of its review of the short-term financial position of all electricity distribution licence holders, the Company certified that it has adequate financial facilities and/or resources to meet its obligations until 31 December 2009;
- b) The Company is profitable with strong underlying cash flows resulting in low gearing and has investment grade credit ratings; and
- c) The Company has considerable financial resources, in the form of short-term borrowings made available by YEG and committed revolving credit facilities from Lloyds TSB Bank plc and Royal Bank of Scotland plc. These credit facilities are due to expire in May 2010, at which point the Company expects to raise further finance as required. The directors do not consider there to be any doubt over the Company's ability to raise such finance, given the investment grade credit ratings held by the Company and due to the fact that the Company operates within a stable and traditionally low risk industry. As a consequence, the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

Consequently, after making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Regulatory Accounts.

Responsibility of the directors for the preparation of the Regulatory Accounts

The directors are responsible for preparing the Regulatory Accounts, including the directors' report, in accordance with standard condition 44(5) of the Licence. Consequently, the directors are required to prepare the Regulatory Accounts in accordance with International Financial Reporting Standards ("IFRS").

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards.

Directors are also required to:

- Properly select and apply accounting policies;

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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DIRECTORS' REPORT (CONTINUED)

Responsibility of the directors for the preparation of the Regulatory Accounts (continued)

- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Audit of the accounts

Each of the directors, who is a director of the Company as at the date of this report, confirms that:

- a) so far as he is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- b) he has taken all the steps he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S234ZA of the Companies Act 1985.



By order of the board
John Elliott
Company Secretary

17 July 2009

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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CORPORATE GOVERNANCE STATEMENT

The Financial Reporting Council issued a revised version of the Combined Code on Corporate Governance (the "Combined Code") in June 2006. The Listing Rules, essentially, require a company listed on the main market of the London Stock Exchange to provide, in its annual report and accounts, a statement of how the company has applied the main principles set out in the Combined Code or not complied with those provisions, together with the company's reasons for that non-compliance.

Although the Company does not have securities listed on the main market of the London Stock Exchange, this statement is provided pursuant to standard licence condition 44(5) of the Company's electricity distribution licence, which requires the Company's Regulatory Accounts to include a Corporate Governance Statement, which has the coverage and content of such a statement that a Quoted Company is required to prepare under the Combined Code.

The Company, therefore, provides the following statement by reference to the principles incorporated in the Combined Code.

A Directors

Principle A1: The Board:

The board of directors is responsible for the overall management of the Company and its system of internal controls. The directors have agreed a quarterly schedule of board meetings at which they review performance, strategy and operational and risk-related issues. Regular items on the agenda for consideration at board meetings are general business performance, internal control, key business activities and projects and the regulatory compliance process.

In addition, the President and Chief Operating Officer of the CE Electric UK Funding Company group (the "CE Group") participates in weekly performance review meetings with Mr Abel, the President of MidAmerican Energy Holdings Company ("MidAmerican"), and other senior managers of the MidAmerican group, including the Senior Vice President and Chief Financial Officer. At those weekly meetings, the views of Mr Abel and the MidAmerican senior management team regarding the key, current issues facing the Company are discussed. Mr Abel also receives weekly, monthly and quarterly written reports on the Company's performance from the CE Group's President and Chief Operating Officer. MidAmerican's Senior Vice President and Chief Financial Officer and General Counsel also hold similar weekly review meetings in respect of MidAmerican's financial and legal functions, at which the Company's Finance Director and General Counsel present their respective weekly reports.

The board meets quarterly and as required to consider relevant issues and met on nine occasions in total during the year ended 31 March 2009 (the "Regulatory Year"), with the individual directors' attendance being as follows:

| | | |
|------------|---|---|
| G E Abel | President, MidAmerican Energy Holdings Company | 0 |
| P E Connor | Senior Vice President and Chief Operating Officer, MidAmerican Energy Holdings Company | 1 |
| R Dixon | Non-executive Director | 7 |
| J M France | Regulation Director, CE Electric UK | 6 |
| N M Gill | Field Operations Director | 7 |
| P A Jones | President and Chief Operating Officer, CE Electric UK | 8 |
| K Linge | Finance Director, CE Electric UK | 7 |

Operational management of the Company's business (and that of its affiliate, Yorkshire Electricity Distribution plc) is delegated to a single senior management team, with specific functional responsibilities. That senior management team meets monthly with the senior management of the CE Group to monitor performance and address issues of policy across all areas of the business and holds weekly conference calls to report on and consider performance related issues for that week.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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CORPORATE GOVERNANCE STATEMENT (CONTINUED)

A Directors (continued)

Principle A1: The Board (continued):

The directors have overall responsibility for the internal control environment, which, within the CE Group, is based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. In addition, MidAmerican requires a quarterly control risk self-assessment to be undertaken by all senior managers as part of its programme for compliance with the requirements of the Sarbanes-Oxley Act. A review is undertaken of the company-wide controls in place on an annual basis and the review carried out in 2008, while not identifying any areas of significant weakness, resulted in the implementation of various recommended improvements. The key features of the CE Group's internal control system and the issues addressed by the Company and the CE Group during the Regulatory Year can be found on pages 7 and 8 of the business review of the year in the directors' report.

During the Regulatory Year, there were a number of committees in operation, acting under delegated terms of reference, which oversee the CE Group and, therefore, Company policy. As part of the approved terms of reference, those committees report regularly to the board on their activities. The committees in operation during the Regulatory Year were as follows:

Health and Safety Management Committee

The board of CE Electric UK Funding Company has established the CE Group Health and Safety Management Committee with delegated powers to manage the health and safety policy and performance of the CE Group. During the Regulatory Year, the committee comprised:

| | |
|---------------|---|
| P E Connor | Senior Vice President and Chief Procurement Officer, MidAmerican Energy Holdings Company; |
| J M France | Regulation Director, CE Electric UK; |
| N M Gill | Field Operations Director; |
| P A Jones | President and Chief Operating Officer, CE Electric UK; |
| K Linge | Finance Director, CE Electric UK; |
| A J MacLennan | Managing Director, Integrated Utility Services Limited; and |
| P McCormick | Director of Health, Safety and Environment, CE Electric UK; |

The committee meets on a regular basis in order to oversee implementation of health and safety policy, review and agree strategy for the management of health and safety issues, monitor health and safety performance across the CE Group, establish goals and targets, review the effectiveness of the health and safety policies and the health and safety management system and consider recommendations for changes in CE Group policy due to changes in appropriate legislation, codes of practice or guidance or due to recommendations arising from significant incidents.

Treasury Committee

The Treasury Committee oversees and implements the treasury policies outlined in the business review of the year in the directors' report and, during the Regulatory Year, comprised:

| | |
|--------------|---|
| G E Abel | President, MidAmerican Energy Holdings Company; |
| P Ainsley | Financial Controller, CE Electric UK; |
| D Brady | Treasurer, CE Electric UK; |
| P J Goodman | Senior Vice President and Chief Financial Officer, MidAmerican Energy Holdings Company; |
| P A Jones | President and Chief Operating Officer, CE Electric UK; |
| K Linge | Finance Director, CE Electric UK; |
| R D McHaddan | Assistant Treasurer, CE Electric UK; and |
| O Sutherland | Investor Reporting Manager. |

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CORPORATE GOVERNANCE STATEMENT (CONTINUED)

A Directors (continued)

Principle A1: The Board (continued):

Pensions Committee

The Pensions Committee oversees the CE Group's approach to the pension schemes to which it contributes and, during the Regulatory Year, comprised:

| | |
|--------------|--|
| P Ainsley | Financial Controller, CE Electric UK; |
| J M France | Regulation Director, CE Electric UK; |
| K Linge | Finance Director, CE Electric UK; |
| K Mawson | Head of Finance Development and Systems, CE Electric UK; |
| A Patterson | Director of Human Resources; CE Electric UK; |
| T Richardson | Pensions Manager, CE Electric UK; and |
| L Taylor | Director of Business Systems, CE Electric UK. |

Compliance Assurance Programme Steering Group ("CAPSG")

As mentioned in the directors' report, the CAPSG is the principal management forum in the CE Group with regard to corporate governance. Its purpose is to ensure that CE Group companies apply and maintain appropriate arrangements to deliver sound corporate governance and comply with the overall strategy, framework and supporting policies. The CAPSG monitors and reviews the strategic risk environment, ensuring the continued suitability, adequacy and effectiveness of risk management arrangements. During the Regulatory Year, the CAPSG comprised:

| | |
|-------------|---|
| J P Barnett | Director of Customer Operations; |
| R Dixon | Non-executive Director; |
| M Drye | Director of Asset Management; |
| J Elliott | Company Secretary, CE Electric UK; |
| J M France | Regulation Director, CE Electric UK; |
| N M Gill | Field Operations Director; |
| K Linge | Finance Director, CE Electric UK; and |
| L Taylor | Director of Business Systems, CE Electric UK. |

The risk management framework was monitored regularly during the Regulatory Year to ensure that all strategic risks, including those relating to environmental and social issues, were being addressed. Risk management policies and procedures were reviewed and updated to ensure a robust and clear approach was maintained. Mr Dixon attends meetings of the CAPSG to provide an independent view in respect of the matters discussed.

Asset risk continued to be a strong focus through the Asset Risk Management Executive Review Group and comprehensive plans continued to be in place to manage risks affecting all critical property assets and to strengthen the arrangements for crisis management and business continuity planning.

Further details of the CE Group's approach to corporate governance and the management of internal controls can be found in the business review of the year in the directors' report.

Principle A2: Chairman and Chief Executive

The Company does not have a formally appointed Chairman or Chief Executive. However, that division of responsibility is effectively achieved with the President and Chief Operating Officer of the CE Group chairing the board meetings, being responsible for the operation and management of the CE Group and reporting directly to the President of MidAmerican.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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CORPORATE GOVERNANCE STATEMENT (CONTINUED)

A Directors (continued)

Principle A3: Board balance and independence

The board comprises six executive directors who, collectively, bring a wide range of skills and experience to the board and a non-executive director who acts within agreed terms of reference. Consequently, the board believes that it possesses the skills and experience necessary to provide effective leadership, stewardship and control of the Company. There were no changes to the composition of the board during the Regulatory Year and the directors, as at the date of approval of the Regulatory Accounts, were as follows:

| | |
|------------|--|
| G E Abel | President, MidAmerican Energy Holdings Company |
| P E Connor | Senior Vice President & Chief Procurement Officer, MidAmerican Energy Holdings Company |
| R Dixon | Non-executive Director |
| J M France | Regulation Director, CE Electric UK |
| N M Gill | Field Operations Director |
| P A Jones | President and Chief Operating Officer, CE Electric UK |
| K Linge | Finance Director, CE Electric UK |

Mr Dixon is appointed as an independent non-executive director of the Company under the terms of certain of the CE Group's financing instruments and acts under agreed terms of reference.

Principle A4: Appointments to the Board

The CE Group does not have a nomination committee. Appointments to the board are made by MidAmerican, in conjunction with the President and Chief Operating Officer of the CE Group.

Principle A5: Information and professional development

Directors receive monthly reports outlining progress against the Company's goals and targets, enabling financial performance against budget and operational performance against a number of indicators to be reviewed, and also participate in weekly meetings, which consider the key issues of that week in some detail. The directors are able to utilise the advice and services of the Company Secretary, in respect of their duties and responsibilities as directors and any new legislation that may affect those duties and responsibilities. A briefing programme continued to run throughout the Regulatory Year for the directors in respect of the changes introduced by the phased implementation of the Companies Act 2006. The directors also have access to external legal advice, should they feel it necessary. Interim briefings are provided to the non-executive director, as appropriate. As there were no changes to the composition of the board during the Regulatory Year, a directors' induction programme was not required.

Principle A6: Performance evaluation

As part of their approved terms of reference, the committees report regularly on their activities, enabling the directors to evaluate the activities of those committees. However, the board does not have a process of evaluation of its own performance or of the performance of individual directors in their capacity as directors. The CE Group has a performance appraisal and development scheme in place, under which each senior manager of the CE Group is subject to a formal annual appraisal of performance against his individual and the CE Group's goals.

Principle A7: Re-election

The Company's articles of association do not require periodic retirement and re-election of directors.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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CORPORATE GOVERNANCE STATEMENT (CONTINUED)

B Remuneration

Principle B1: The level and make-up of remuneration

The CE Group does not have a remuneration committee. Annual remuneration awards for senior management of the CE Group are subject to the performance appraisal and development scheme process and consideration by the President of MidAmerican and the CE Group's President and Chief Operating Officer.

Principle B2: Procedure

As mentioned under Principle B1, the annual remuneration awards for senior management of the CE Group is subject to the performance appraisal and development scheme process and consideration by the President of MidAmerican and the CE Group's President and Chief Operating Officer. Other than Mr Abel and Mr Dixon, the directors of the Company are subject to the performance appraisal and development scheme process in their capacity as senior managers of the CE Group and not, specifically, in their capacity as board directors. No director is involved in deciding his own remuneration.

C Accountability and Audit

Principle C1: Financial Reporting

The board believes that the directors' report and business review of the year included in these Regulatory Accounts provides a balanced and understandable assessment of the Company's position and prospects. The directors have explained, at pages 20 and 21 in the directors' report, their responsibility for preparing the Regulatory Accounts, reported, at page 20 in the directors' report, that the Company is a going concern and included the independent accountant's report to the Gas and Electricity Markets Authority and the Company at page 29 of the Regulatory Accounts.

Principle C2: Internal control

The principal risks and uncertainties facing the Company and the key features of the CE Group's internal control system, together with details of the issues addressed by the Company and the CE Group during the Regulatory Year, can be found at pages 4 to 8 of the business review of the year in the directors' report.

Principle C3: Audit committee and auditors

The CE Group operates under the oversight of the MidAmerican Audit Committee, which is comprised of Mr. Marc D. Hamburg who, the MidAmerican board of directors has determined, qualifies as an "audit committee financial expert," as defined by the rules of the Securities and Exchange Commission, based on his education, experience and background. The MidAmerican Audit Committee is attended, from time to time, by the Senior Vice President and Chief Financial Officer and the Vice President and Chief Accounting Officer of MidAmerican, the Director of Internal Auditing of Berkshire Hathaway, Inc. and the Heads of Internal Audit of the various MidAmerican business platforms.

Given the MidAmerican group-wide audit committee arrangements, certain roles and responsibilities of the board of the Company are completed in conjunction with the MidAmerican Audit Committee. These are summarised as follows:

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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CORPORATE GOVERNANCE STATEMENT (CONTINUED)

C Accountability and Audit (continued)

Principle C3: Audit committee and auditors (continued)

The Board

Monitors the integrity of the financial statements of the Company and any formal announcements relating to the Company's financial performance and reviews significant financial reporting judgments contained therein;

Reviews the Company's internal financial controls and internal control and risk management systems; and

Is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the Company's assets and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

MidAmerican Audit Committee

Monitors and reviews the effectiveness of the CE Group's internal audit function;

Make recommendations to the board of the Company in relation to the appointment, re-appointment and removal of the external auditors and approves the remuneration and terms of engagement of the external auditor;

Develops and implements a policy on the engagement of the external auditors in respect of the supply of non-audit services, taking into account relevant guidance regarding the provision of non-audit services by the external audit firm; and

Reviews and monitors the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements.

The directors confirm that no fees were payable by the Company to Deloitte LLP in relation to non-audit services during the Regulatory Year.

On an annual basis, the CAPSG provides a report to the board, based on a paper submitted to the MidAmerican Audit Committee, of the work of the CE Group's Internal Audit section during the calendar year, together with a summary of the main audits planned to be carried out in the following year.

The internal control section on pages 7 and 8 of the directors' report contains details of the CE Group's "speaking up" policy.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

D Relations with shareholders

This section of the Combined Code is not applicable to the Company, as it is a wholly-owned subsidiary of a privately held group of companies and, therefore, has no institutional shareholders.

Compliance statement

Set out above and in the business review of the year in the directors' report are the areas in which the Company adopts and complies with the principles of the Combined Code. The Company has not complied with certain principles of the Combined Code, including the principles A2, A4, A6, A7, B1, B2, C3, D1 and D2. The directors confirm that such non-compliance was of a continuing nature throughout the Regulatory Year but consider the governance framework in place to be appropriate to the Company's circumstances, given that it includes regular reporting to and meetings with the President and senior management of MidAmerican, the presence of an independent non-executive director on the board and a strong internal control environment designed to meet the standards required by the Sarbanes-Oxley Act.

The intention of the Combined Code is that companies should be able to explain their governance policies in light of the principles contained in the Combined Code, including any special circumstances applying to them, which have led to a particular approach. The directors are of the opinion that, in the instances where the Company does not comply with certain provisions of the Combined Code, this approach is justifiable, given the ownership structure of the Company.

INDEPENDENT ACCOUNTANTS' REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY (THE "REGULATOR") AND NORTHERN ELECTRIC DISTRIBUTION LIMITED (THE "COMPANY")

We have audited the Regulatory Accounts of the Company for the year ended 31 March 2009 which comprise the income statement, the statement of recognised income and expense, the balance sheet, the cash flow statement and the related notes 1 to 27. These Regulatory Accounts have been prepared under the accounting policies therein.

This report is made, on terms that have been agreed, solely to the Company and the Regulator in order to meet the requirements of standard condition 44 of the electricity distribution licence, (the "Regulatory Licence"). Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report, or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared under the historical cost convention and in accordance with the Regulatory Licence and the accounting policies set out in the notes to the Regulatory Accounts.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not necessarily been prepared under the basis of International Financial Reporting Standards ("IFRS"). Financial information other than that prepared on the basis of IFRS does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The directors' responsibilities for preparing the Regulatory Accounts of the Company in accordance with the Regulatory Licence are set out in the statement of directors' responsibilities on pages 20 and 21.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK & Ireland) issued by the UK Auditing Practices Board, except as stated in the 'Basis of audit opinion', below and having regard to the guidance contained in Audit 05/03 *'Reporting to Regulators of Regulated Entities'*.

We report to you our opinion as to whether the Regulatory Accounts present fairly, in accordance with standard condition 44 of the Regulatory Licence and the accounting policies set out in note 2, the results and financial position of the Company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations that we require for our audit.

We read the other information presented with the Regulatory Accounts, being the Directors' Report and the Corporate Governance Statement, on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts.

**INDEPENDENT ACCOUNTANTS' REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY
(THE "REGULATOR") AND NORTHERN ELECTRIC DISTRIBUTION LIMITED (THE "COMPANY")
(CONTINUED)**

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the UK Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company for the year ended 31 December 2008, on which we reported on 31 March 2009, and which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our statutory audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our statutory audit work, for our statutory audit report, or for the opinions we have formed in respect of that statutory audit.

Opinion

In our opinion, the Regulatory Accounts present fairly in accordance with standard condition 44 of the Regulatory Licence and the accounting policies set out in note 2 the financial position of the Company as at 31 March 2009 and of its financial performance and cash flows for the year then ended, and have been properly prepared in accordance with standard condition 44 and the Company's accounting policies.



Deloitte LLP
Chartered Accountants and Registered Auditors
Newcastle upon Tyne

21 July 2009

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2009**

| | Notes | 2009 £m | 2008 £m |
|---|-------|---------------|---------------|
| Revenue | 3 | 211.8 | 218.9 |
| Cost of sales | | <u>(5.7)</u> | <u>(6.3)</u> |
| Gross profit | | 206.1 | 212.6 |
| Distribution costs | | (67.9) | (64.5) |
| Administrative expenses | | <u>(57.3)</u> | <u>(57.2)</u> |
| Operating profit | 6 | 80.9 | 90.9 |
| Profit on disposal of property, plant and equipment | | 0.1 | 0.3 |
| Investment income | 4 | 0.3 | 0.3 |
| Finance costs | 5 | <u>(24.5)</u> | <u>(23.5)</u> |
| Profit before tax | | 56.8 | 68.0 |
| Income tax expense | 9 | <u>(22.2)</u> | <u>(11.4)</u> |
| Profit from ordinary activities after tax | 22 | <u>34.6</u> | <u>56.6</u> |

All activities relate to continuing operations.

STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 MARCH 2009

There has been no other income or expense for the Company other than the profits reported above in the current or the prior year.

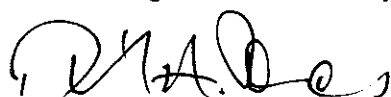
NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

BALANCE SHEET AS AT 31 MARCH 2009

| | Notes | 2009 £m | 2008 Restated Note 2 £m |
|---------------------------------|-------|------------------|----------------------------------|
| Non-current assets | | | |
| Property, plant and equipment | 11 | 1,339.1 | 1,233.6 |
| Intangibles | 12 | 5.5 | 6.3 |
| | | <u>1,344.6</u> | <u>1,239.9</u> |
| Current assets | | | |
| Inventories | 14 | 7.3 | 8.1 |
| Trade and other receivables | 15 | 36.5 | 38.7 |
| | | <u>43.8</u> | <u>46.8</u> |
| Total assets | | <u>1,388.4</u> | <u>1,286.7</u> |
| Current liabilities | | | |
| Trade and other payables | 16 | (42.6) | (42.1) |
| Current income tax liabilities | 16 | (7.3) | (9.2) |
| Borrowings | 17 | (96.6) | (49.4) |
| Deferred revenue | 19 | (12.7) | (10.8) |
| Provisions | 20 | (1.3) | (1.9) |
| | | <u>(160.5)</u> | <u>(113.4)</u> |
| Net current liabilities | | <u>(116.7)</u> | <u>(66.6)</u> |
| Non-current liabilities | | | |
| Borrowings | 17 | (347.5) | (347.5) |
| Deferred income tax liabilities | 18 | (134.7) | (125.0) |
| Deferred revenue | 19 | (389.5) | (359.6) |
| Provisions | 20 | (1.0) | (0.6) |
| | | <u>(872.7)</u> | <u>(832.7)</u> |
| Total liabilities | | <u>(1,033.2)</u> | <u>(946.1)</u> |
| Net assets | | <u>355.2</u> | <u>340.6</u> |
| Equity | | | |
| Share capital | 21 | 200.0 | 200.0 |
| Retained earnings | 22 | 155.2 | 140.6 |
| Total equity | 22 | <u>355.2</u> | <u>340.6</u> |

The financial statements were approved by the board of directors and authorised for issue on 17 July 2009 and were signed on its behalf by:



P A Jones
Director

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2009

| | Notes | 2009 £m | 2008 £m |
|---|-------|----------------|----------------|
| Net cash from operating activities | 23 | <u>72.8</u> | <u>76.8</u> |
| Investing activities | | | |
| Proceeds from disposal of property, plant and equipment | | 0.2 | 0.2 |
| Purchases of property, plant and equipment | | (140.3) | (148.7) |
| Purchases of intangible assets | | (0.8) | (1.0) |
| Receipt of customer contributions | | <u>40.9</u> | <u>44.5</u> |
| Net cash used in investing activities | | <u>(100.0)</u> | <u>(105.0)</u> |
| Financing activities | | | |
| Equity dividends paid | | (20.0) | (20.0) |
| Movement in borrowings | | 38.0 | - |
| Movement in loans from Group undertaking | | <u>9.2</u> | <u>48.2</u> |
| Net cash generated from financing activities | | <u>27.2</u> | <u>28.2</u> |
| Net movement in cash and cash equivalents | | - | - |
| Cash and cash equivalents at beginning of year | | <u>-</u> | <u>-</u> |
| Cash and cash equivalents at end of year | | <u>-</u> | <u>-</u> |

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009

1 GENERAL INFORMATION

Northern Electric Distribution Limited is a company incorporated in England and Wales under the Companies Act 1985. The address of the registered office is Lloyds Court, 78 Grey Street, Newcastle-upon-Tyne, NE1 6AF.

The nature of the Company's operations and its principal activities are set out in the business review, in the director's report and in Note 3.

2 ACCOUNTING POLICIES

Accounting convention and basis of preparation

The Regulatory Accounts have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Regulatory Accounts have also been prepared in accordance with IFRSs adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation and with those parts of the Act that are applicable to companies reporting under IFRS.

The accounting policies have been applied consistently throughout the year and the preceding year, with the exception of accrued interest as described below.

The Regulatory Accounts have been prepared under the historical cost convention, on a going concern basis, in accordance with standard condition 44 (Regulatory Accounts) of the Company's electricity distribution licence and the accounting policies set out below.

Standard condition 44(5) of the Company's electricity distribution licence requires the directors to prepare, on a consistent basis from accounting records in respect of each financial year, Regulatory Accounts comprising a directors' report, a corporate governance statement, a business review, an income statement, a statement of recognised income and expense, a balance sheet and a cash flow statement, together with notes thereto stating the accounting policies adopted. Regulatory Accounts and information shall, so far as reasonably practicable and unless otherwise approved by Ofgem, have the same content and format as the statutory accounts of the licensee prepared under sections 226 and 226A of the Companies Act 1985 and comply with all relevant accounting standards currently in force.

The preparation of Regulatory Accounts in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the Regulatory Accounts and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. For the Company the critical accounting policies relate to revenue, property, plant and equipment and provisions. Where such judgments are made they are indicated within the accounting policies below.

Going Concern

The Company's business activities, together with details regarding its future development, performance and position are set out in the business review in the directors' report. In addition, the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities and its exposures to credit risk and liquidity risk are included in the directors' report and the appropriate notes to the accounts.

When considering continuing to adopt the going concern basis in preparing the Regulatory Accounts, the directors have taken into account a number of factors, including the following:

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Going concern (continued)

- The Company is a stable electricity distribution business operating an essential public service and is regulated by the Gas and Electricity Markets Authority ("GEMA"). In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance their activities. In response to an information request issued by GEMA during the year, as part of its review of the short-term financial position of all electricity distribution licence holders, the Company certified that it has adequate financial facilities and/or resources to meet its obligations until 31 December 2009;
- The Company is profitable with strong underlying cash flows resulting in low gearing and has investment grade credit ratings; and
- The Company has considerable financial resources, in the form of short-term borrowings made available by Yorkshire Electricity Group plc ("YEG"), a fellow member of the CE Electric UK Funding Company group (the "CE Group") and committed revolving credit facilities from Lloyds TSB Bank plc and Royal Bank of Scotland plc. These credit facilities are due to expire in May 2010, at which point the Company expects to raise further finance as required. The directors do not consider there to be any doubt over the Company's ability to raise such finance, given the investment grade credit ratings held by the Company and due to the fact that the Company operates within a stable and traditionally low risk industry. As a consequence, the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

Consequently, after making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Regulatory Accounts.

Judgements in applying accounting policies and key sources of estimation uncertainty

Many of the amounts included in the financial statements involve the use of judgement and/or estimation. These judgements and estimates are based on management's best knowledge of the relevant facts and circumstances, having regard to previous experience, but actual results may differ from the amounts included in the financial statements. Information about such judgements and estimates is contained in the accounting policies and/or the notes to the financial statements and the key areas are summarised below.

Areas of judgement and estimation which have the most significant effect on the amounts recognised in the financial statements are:

- The estimation of useful economic lives for property, plant and equipment;
- The split of operating and capital expenditure and the allocation of overheads to capital projects; and
- Impairment reviews carried out to evaluate the carrying value of assets held at the balance sheet date.

Prior year restatement

A prior year restatement has been made in respect of accrued interest on borrowings. These balances have been reclassified from trade and other payables to short-term borrowings on the face of the balance sheet and in the related notes to the accounts in line with IAS 39 Financial Instruments: Recognition and Measurement. The effect of this adjustment is to increase borrowings in the prior year by £9.1m and to decrease trade and other payables by £9.1m. The adjustment has no impact on the prior year profit.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Adoption of new or revised standards

In the current year, one standard issued by the International Accounting Standards Board became effective; IAS 23; Borrowing Costs – Amendments to IAS 23. The amendments to IAS 23 have been adopted from its effective date of 1 January 2009. From this date, borrowing costs have been capitalised in line with the revised standard. The adoption of IAS 23 has had no material impact on these financial statements.

At the date of authorisation of these Regulatory Accounts there were standards and interpretations in issue but not yet effective, which have not yet been applied in these financial statements. The directors consider that the following may be relevant to the Company in future periods.

| | |
|----------|--|
| IAS 1 | Presentation of Financial Statements – Amendments to IAS 1 |
| IFRIC 12 | Service Concession Arrangements |
| IFRIC 18 | IAS 18 Revenue: Customer Contributions (Transfer of Assets from Customers) |
| IFRS 7 | Financial Instruments: Disclosures – Amendments to IFRS 7 |
| IFRS 8 | Operating Segments |

The directors anticipate that the adoption of the amendments to IAS 1, IFRIC 12, and IFRS 8 in future periods will have no material impact on the Regulatory Accounts of the Company. The amendments to IFRS 7 require enhanced disclosures about fair value measurement and liquidity risk. The directors are currently reviewing the potential impact of IFRIC 18 on the Regulatory Accounts of the Company in future periods.

The IASB project “2008 Annual Amendments to IFRSs” was published on 22 May 2008. This project will require presentational changes in the financial statements of the Company for annual periods beginning on or after 1 January 2009.

The directors anticipate the Company will adopt these standards and interpretations on their effective dates.

Revenue

Revenue is only recognised when the risks and rewards of ownership have been transferred to a third party. No revenue is recognised where there are significant uncertainties regarding the consideration to be received or the costs associated with the transaction.

Revenue represents charges for the use of the Company's distribution network, amortisation of customer contributions, recharge of costs incurred on behalf of related parties and the invoiced value of other goods sold and services provided, exclusive of value added tax.

Revenues from charges to end customers for the use of the Company's distribution network include estimates of the units distributed. The estimated usage is based on historic data, judgment and assumptions. Revenues are gradually adjusted to reflect actual usage in the period during which actual meter readings are obtained.

Any under or over-recovery of allowed distribution network revenues as prescribed by Ofgem is not provided for in the financial statements and will be recovered/repaid through future tariffs.

Customer contributions towards distribution system assets are included in deferred revenue. The Company's policy is to credit the customer contribution to revenue over 45 years on a straight-line basis, in line with the useful life of the distribution system assets.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Revenue (continued)

Dividend income from investments is recognised when the shareholders' right to receive payment has been established.

Research costs

Expenditure on research activities is written off to the income statement in the year in which it is incurred.

Operating profit

Operating profit is stated before profit on disposal of property, plant and equipment, investment income and finance costs.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or asset realised, based on tax rates and tax legislation enacted or substantively enacted at the balance sheet date.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment and depreciation

Property, plant and equipment is stated at cost. Cost includes the purchase price of the asset and any costs, including internal employee and other costs, directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The charge for depreciation is calculated to write off assets to their residual values over their estimated useful lives using the straight-line basis:

| | |
|--|-----------------------------------|
| Distribution system assets..... | 45 years |
| Metering equipment included in distribution system assets | up to 15 years |
| Information technology equipment included in distribution system assets..... | up to 10 years |
| Non-operational assets: | |
| Buildings – freehold..... | up to 60 years |
| Buildings – leasehold..... | lower of lease period or 60 years |
| Fixtures and equipment..... | up to 10 years |
| Software development costs | up to 10 years |

Freehold land is not depreciated.

Assets in the course of construction are carried at cost. Depreciation on these assets, on the same basis as other assets, commences when the assets are commissioned.

The estimated useful economic lives of property, plant and equipment are based on management's judgment and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of the Company's investment in property, plant and equipment, variations between actual and estimated useful lives could impact operating results both positively and negatively.

The Company is required to evaluate the carrying values of property, plant and equipment for impairment whenever circumstances indicate, in management's judgment, that the carrying value of such assets may not be recoverable. An impairment review requires management to make judgments concerning the cash flows, growth rates and discount rates for the cash-generating units under review.

Software development costs

Costs in respect of major developments are capitalised and amortised over the expected life of the software. Capitalised software costs that are not an integral part of the related hardware are included in intangible assets on the balance sheet and amortised over the expected life of the software of up to 10 years.

Investments

Fixed asset investments are stated at cost less provision for impairment in value.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Inventories

Inventories are stated at the lower of cost and net realisable value as follows.

Raw materials and consumables are valued at purchase cost determined on an average price basis.

Work in progress is valued at the cost of direct materials and labour plus attributable overheads based on the normal level of activity less progress payments.

Net realisable value is based on estimated selling price less further costs expected to be incurred to completion and disposal.

Provisions

Provisions are recognised when the Company has a present obligation as a result of a past event and it is probable that the Company will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. Reasonable estimates involve judgments made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute and prior experience.

Where the effect is significant, provisions in respect of material future liabilities are stated at their net present value and arrived at by discounting the anticipated future costs, at the market rate at the balance sheet date.

Leases

Leases are classified as finance leases wherever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease rentals are charged to the income statement in equal annual amounts over the lease term.

Trade receivables

Trade receivables are measured at initial recognition at fair value. Appropriate allowances for estimated irrecoverable amounts are recognised in the income statement when there is objective evidence that the asset is impaired.

Trade payables

Trade payables are not interest bearing and are stated at their nominal value.

Borrowings

Borrowings are classified as other financial liabilities at amortised cost. They are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement for redemption and direct issue costs, are accounted for on an accruals basis in the income statement using the effective interest rate method. They are added to the carrying amount of the instruments to the extent that they are not settled in the period in which they arise.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when the Company becomes a party to the contractual provisions on the instrument.

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 30 days, as well as observable changes in national or local economic conditions that correlate with default on receivables.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the income statement.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangement entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Pensions

The Company contributes to the Northern Electric Group of the Electricity Supply Pension Scheme (the "Northern Electric Group of the ESPS"), which is a defined benefit plan that shares risk between various entities under common control. There is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual group entities and accordingly the Company accounts for the scheme as if it were a defined contribution scheme. Contributions to the scheme are charged to the income statement or capitalised as appropriate. The capital cost of ex-gratia and supplementary pensions are normally charged to the income statement in the period in which they are granted.

The Company also participates in a defined contribution scheme. Contributions payable to the scheme are charged to the income statement in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

3 REVENUE

Revenue, profit before tax and net assets are attributable to electricity distribution. Revenue is all in respect of sales to United Kingdom customers.

Revenue represents charges made to customers for use of the distribution system, recharge of costs incurred on behalf of related parties, amortisation of customer contributions and other services and is included net of value added tax.

4 INVESTMENT INCOME

| | 2009 £m | 2008 £m |
|---|------------|------------|
| Dividends received | 0.1 | - |
| Interest receivable from Group undertakings | 0.2 | 0.3 |
| | <u>0.3</u> | <u>0.3</u> |

5 FINANCE COSTS

| | 2009 £m | 2008 £m |
|---|-------------|-------------|
| Interest payable on loans from Group undertakings | 24.2 | 23.5 |
| Interest payable on other loans | 0.3 | - |
| | <u>24.5</u> | <u>23.5</u> |

6 OPERATING PROFIT

| | 2009 £m | 2008 £m |
|---|--------------|--------------|
| This is stated after charging/(crediting): | | |
| Staff costs (Note 7) | 39.6 | 38.8 |
| Research costs | 0.5 | 0.4 |
| Depreciation of property, plant and equipment | 41.1 | 38.9 |
| Amortisation of deferred revenue | (10.8) | (9.8) |
| Amortisation of intangibles | 1.6 | 1.7 |
| Impairment loss on trade and other receivables | 0.3 | 0.2 |
| | <u>0.3</u> | <u>0.2</u> |
| Analysis of auditors' remuneration is as follows: | | |
| | 2009 £000 | 2008 £000 |
| Fees payable to the Company's auditors for the audit of the Company's annual statutory accounts | 75 | 62 |
| Other services supplied pursuant to legislation | 36 | 34 |

There were no fees payable in relation to other non-audit services in 2009 or 2008. Other services supplied pursuant to legislation relate to regulatory reporting in line with Ofgem requirements.

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****7 STAFF COSTS**

| | 2009 £m | 2008 £m |
|---|------------|------------|
| Salaries | 35.2 | 34.3 |
| Social security costs | 3.0 | 3.2 |
| Defined benefit pension costs | 28.2 | 26.9 |
| Defined contribution pension costs | 0.1 | 0.1 |
| | <hr/> | <hr/> |
| | 66.5 | 64.5 |
| Less charged to property, plant and equipment | (26.9) | (25.7) |
| | <hr/> | <hr/> |
| | 39.6 | 38.8 |

The 2008 split of total costs between salaries and other has been revised with no impact on prior year results.

The majority of the Company's employees are members of the Northern Electric Group of the ESPS, details of which are given in Note 24.

The average monthly number of employees during the year was:

| | 2009 No. | 2008 No. |
|----------------|-------------|-------------|
| Technical | 253 | 238 |
| Industrial | 448 | 455 |
| Administration | 201 | 209 |
| Other | 64 | 63 |
| | <hr/> | <hr/> |
| | 966 | 965 |

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

8 DIRECTORS' AND KEY PERSONNEL REMUNERATION

DIRECTORS' REMUNERATION

| | 2009 £ | 2008 £ |
|---|----------------|----------------|
| <u>Highest Paid</u> | | |
| Short-term employee benefits | 114,219 | 81,570 |
| Post employment benefits | 10,016 | 47,171 |
| Other long-term benefits | 101,707 | 111,466 |
| | <u>225,942</u> | <u>240,207</u> |
| <u>Total</u> | | |
| Short-term employee benefits | 416,732 | 357,662 |
| Post employment benefits | 107,076 | 150,511 |
| Other long-term benefits | 325,208 | 354,535 |
| | <u>849,016</u> | <u>862,708</u> |
| Directors who are members of the defined benefit scheme | <u>6</u> | <u>6</u> |
| Accrued pension benefit relating to highest paid director | <u>-</u> | <u>47,710</u> |

KEY PERSONNEL REMUNERATION

| | 2009 £ | 2008 £ |
|------------------------------|----------------|----------------|
| Short-term employee benefits | 287,577 | 257,320 |
| Post retirement benefits | 71,431 | 61,337 |
| Other long-term benefits | 88,588 | 100,214 |
| | <u>447,596</u> | <u>418,871</u> |

Other key personnel includes a number of senior functional managers who, whilst not board directors, have authority and responsibility for planning, directing and controlling the activities of the Company.

The directors and key personnel are remunerated for their services to the CE Group, of which the Company is a subsidiary. The figures above represent the share of the costs borne by the Company.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

9 INCOME TAX EXPENSE

| | 2009 | | 2008 | |
|---|-------|-------------|-------|-------------|
| | £m | £m | £m | £m |
| Tax expense comprises: | | | | |
| Current tax: | | | | |
| Corporation tax charge for the year | 4.1 | | 14.3 | |
| Payments for use of group losses | 9.4 | | 6.8 | |
| Over provision for prior years | (1.0) | | - | |
| Total current tax charge | | 12.5 | | 21.1 |
| Deferred tax: | | | | |
| Deferred tax expense/(income) relating to the origination and reversal of temporary differences | 3.2 | | (0.7) | |
| Effect of change in tax legislation | 6.5 | | - | |
| Effect of change in tax rates | - | | (9.0) | |
| Total deferred tax | | 9.7 | | (9.7) |
| Tax on profit before tax | | <u>22.2</u> | | <u>11.4</u> |
| The total tax charge can be reconciled to the profit before tax as follows: | | | | |
| Profit on ordinary activities before tax | | <u>56.8</u> | | <u>68.0</u> |
| Tax on profit before tax at standard rate of corporation tax in United Kingdom of 28% (2008: 30%) | | 15.9 | | 20.4 |
| Effect of change in tax legislation | | 6.5 | | - |
| Effect of change in tax rates | | - | | (9.0) |
| Over provision for prior years | | (0.2) | | - |
| Tax on profit before tax | | <u>22.2</u> | | <u>11.4</u> |

There is an increase in the deferred tax liability provided in the year due to the cessation of capital allowances on qualifying industrial buildings from 2011, as a result of changes in legislation introduced by the Finance Act 2008.

10 DIVIDENDS

| | 2009 | 2008 | 2009 | 2008 |
|---------------|-----------------|-----------------|-------------|-------------|
| | Pence per share | Pence per share | £m | £m |
| Dividend paid | <u>10.0</u> | <u>10.0</u> | <u>20.0</u> | <u>20.0</u> |

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

11 PROPERTY, PLANT AND EQUIPMENT

| | Distribution system £m | Fixtures and equipment £m | Total £m |
|--|------------------------------|---------------------------------|-------------|
| COST | | | |
| At 1 April 2007 | 1,253.7 | 14.7 | 1,268.4 |
| Additions | 133.9 | 1.0 | 134.9 |
| Disposals | (1.7) | (0.3) | (2.0) |
| At 31 March 2008 | 1,385.9 | 15.4 | 1,401.3 |
| Additions | 145.3 | 1.3 | 146.6 |
| Disposals | (4.1) | (0.3) | (4.4) |
| At 31 March 2009 | 1,527.1 | 16.4 | 1,543.5 |
| ACCUMULATED DEPRECIATION | | | |
| At 1 April 2007 | 119.4 | 11.4 | 130.8 |
| Charge for the year | 37.1 | 1.8 | 38.9 |
| Disposals | (1.7) | (0.3) | (2.0) |
| At 31 March 2008 | 154.8 | 12.9 | 167.7 |
| Charge for the year | 39.5 | 1.6 | 41.1 |
| Disposals | (4.1) | (0.3) | (4.4) |
| At 31 March 2009 | 190.2 | 14.2 | 204.4 |
| Net book value at 31 March 2009 | 1,336.9 | 2.2 | 1,339.1 |
| Net book value at 31 March 2008 | 1,231.1 | 2.5 | 1,233.6 |
| Assets in the course of construction included above: | | | |
| At 1 April 2007 | 96.8 | - | 96.8 |
| Additions | 133.9 | 1.0 | 134.9 |
| Available for use | (165.9) | (1.0) | (166.9) |
| At 31 March 2008 | 64.8 | - | 64.8 |
| Additions | 145.3 | - | 145.3 |
| Available for use | (135.2) | - | (135.2) |
| At 31 March 2009 | 74.9 | - | 74.9 |

The Company has entered into contractual commitments in relation to the purchase of property, plant and equipment of £9.2m (2008: £23.7m).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****12 INTANGIBLES**

| | Software Development Costs £m |
|---------------------------------|--|
| COST | |
| At 1 April 2007 | 16.0 |
| Additions | 1.0 |
| | <hr/> |
| At 31 March 2008 | 17.0 |
| Additions | 0.8 |
| | <hr/> |
| At 31 March 2009 | 17.8 |
| | <hr/> |
| AMORTISATION | |
| At 1 April 2007 | 9.0 |
| Charge for the year | 1.7 |
| | <hr/> |
| At 31 March 2008 | 10.7 |
| Charge for the year | 1.6 |
| | <hr/> |
| At 31 March 2009 | 12.3 |
| | <hr/> |
| Net book value at 31 March 2009 | 5.5 |
| | <hr/> |
| Net book value at 31 March 2008 | 6.3 |
| | <hr/> |

13 INVESTMENTS

Details of the principal investments of the Company at 31 March 2009 are listed below:

| Name of Company | Country of Registration | Holding of Ordinary Shares | Proportion | Nature of Business |
|----------------------------------|----------------------------|-------------------------------|------------|--|
| Electralink Limited | England and Wales | 619 at 10p | 6.7% | Data transfer network operator |
| Gemserv Limited | England and Wales | 1 at £1 | 1.7% | Meter point registration |
| MRA Service Company Limited | England and Wales | 1 at £1 | 1.0% | Governance of the electricity industry's Master Registration Agreement |
| DCUSA Limited | England and Wales | 1 at £1 | 5.6% | Management and governance of the Distribution Connection and Use of System Agreement |
| Northern Electric Finance plc | England and Wales | 50,000 at £1 | 100% | Finance company |

The above investments are unlisted. The cost and net book value of the investments are Electralink Limited £62 (2008: £62), Gemserv Limited £1 (2008: £1), MRA Service Company Limited £1 (2008: £nil), DCUSA Limited £1 (2008: £nil) and Northern Electric Finance plc £50,000 (2008: £50,000).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****14 INVENTORIES**

| | 2009 £m | 2008 £m |
|-------------------------------|------------|------------|
| Raw materials and consumables | 7.0 | 7.7 |
| Work in progress | 0.3 | 0.4 |
| | <u>7.3</u> | <u>8.1</u> |

15 OTHER FINANCIAL ASSETS**Trade and other receivables**

| | 2009 £m | 2008 £m |
|--|-------------|-------------|
| Distribution use of system receivables | 29.1 | 32.4 |
| Amounts receivable from sale of goods and services | 5.8 | 4.8 |
| Prepayments and accrued income | 1.4 | 1.2 |
| Other receivables | 0.2 | 0.3 |
| | <u>36.5</u> | <u>38.7</u> |

The directors consider that the carrying amount of trade and other receivables approximates their fair value calculated by discounting the future cash flows at the market rate at the balance sheet date. The maximum risk exposure to the Company is the book value of these receivables less any provisions for impairment.

Distribution use of system receivables

The Company's distribution customers are concentrated in a small number of electricity supply businesses with RWE NPower plc accounting for approximately 35% of distribution revenues in 2009 (2008: 39%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account. Included within other payables (Note 16) are customer deposits of £1.5m as at 31 March 2009 (2008: £1.6m). Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or be able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. The Company has made a provision of £0.3m (2008: £0.1m) for bad debts in relation to these receivables at the balance sheet date.

Amounts receivable for sale of goods and services

Sales of goods and services comprise all income streams which are not classified as Use of System ("UoS") income. Examples of non-UoS income streams would be customer contributions in relation to distribution system assets and recovery of amounts for damage caused by third parties to the distribution system.

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****15 OTHER FINANCIAL ASSETS (CONTINUED)****Amounts receivable for sale of goods and services (continued)**

The average credit period on sales of goods and services is 30 days. Interest is not generally charged on the trade receivables paid after the due date. An allowance for doubtful debts is made for debts past their due date based on estimated irrecoverable amounts from the sale of goods and services, determined by reference to past default experience.

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.3m (2008: £0.7m) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.3m (2008: £0.3m) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 516 days (2008: 665 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.9m (2007: £0.4m) which are past due at the reporting date and for which the Company has not provided as there has not been a significant change in credit quality and the amounts are still considered recoverable. The Company does not hold any collateral over these balances. The average age of these receivables is 108 days (2008: 101).

Ageing of past due but not impaired receivables

| | 2009 £m | 2008 £m |
|--------------|------------|------------|
| 30-60 days | 0.1 | 0.1 |
| 60-120 days | 0.5 | 0.2 |
| 120-210 days | 0.3 | 0.1 |
| Total | <u>0.9</u> | <u>0.4</u> |

Movement in the allowance for doubtful debts

| | £m |
|--|------------|
| At 1 April 2008 | 0.3 |
| Amounts utilised/written off in the year | - |
| Amounts recognised in the income statement | <u>0.3</u> |
| At 31 March 2009 | <u>0.6</u> |

In determining the recoverability of the trade and other receivables, the Company considers any change in the credit quality of the trade and other receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk, other than in relation to UoS receivables, is limited due to the customer base being large and unrelated. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are specific trade receivables with a balance of £0.3m (2008: £0.4m), which have been placed in administration. The impairment represents the difference between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

16 OTHER FINANCIAL LIABILITIES

Trade and other payables

| | 2009 | 2008 Restated Note 2 |
|---------------------------------------|-------------|----------------------------|
| | £m | £m |
| Payments received on account | 16.5 | 17.5 |
| Trade payables | 4.0 | 4.4 |
| Amounts owed to Group undertakings | 0.3 | 0.3 |
| Other taxes and social security costs | 2.3 | 2.9 |
| Accruals | 15.4 | 13.7 |
| Other payables | 4.1 | 3.3 |
| | <u>42.6</u> | <u>42.1</u> |

Current income tax liabilities

| | 2009 £m | 2008 £m |
|-----------------|------------|------------|
| Corporation Tax | <u>7.3</u> | <u>9.2</u> |

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the balance sheet date. Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Invoices are paid at the end of the month following the date of the invoice. The Company has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities included in Notes 16 and 17. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest possible date on which the Company can be required to pay. The tables include both interest and principal cash flows.

| | Less than 3 months £m | 3 months To 1 year £m | 1 to 5 years £m | 5+ Years £m | Total £m |
|----------------------------------|-----------------------------|-----------------------------|-----------------------|-------------------|--------------|
| 2009: | | | | | |
| Non-interest bearing | 26.1 | - | - | - | 26.1 |
| Variable interest rate liability | 87.5 | - | - | - | 87.5 |
| Fixed interest rate liability | <u>2.6</u> | <u>19.9</u> | <u>89.9</u> | <u>710.6</u> | <u>823.0</u> |
| | <u>116.2</u> | <u>19.9</u> | <u>89.9</u> | <u>710.6</u> | <u>936.6</u> |
| 2008: | | | | | |
| Non-interest bearing | 30.9 | 8.2 | 9.1 | - | 48.2 |
| Variable interest rate liability | 40.3 | - | - | - | 40.3 |
| Fixed interest rate liability | <u>2.6</u> | <u>19.8</u> | <u>89.6</u> | <u>732.8</u> | <u>844.8</u> |
| | <u>73.8</u> | <u>28.0</u> | <u>98.7</u> | <u>732.8</u> | <u>933.3</u> |

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

17 BORROWINGS

| | Book value | | Fair value | |
|---|--------------|----------------------------|--------------|----------------------------|
| | 2009 | 2008 Restated Note 2 | 2009 | 2008 Restated Note 2 |
| | £m | £m | £m | £m |
| Loans | 38.0 | - | 38.0 | - |
| Amounts owed to Group undertakings | 406.1 | 396.9 | 388.5 | 401.1 |
| | <u>444.1</u> | <u>396.9</u> | <u>426.5</u> | <u>401.1</u> |
| The borrowings are repayable as follows: | | | | |
| On demand or within one year | 96.6 | 49.4 | 96.6 | 49.4 |
| After five years | 347.5 | 347.5 | 329.9 | 351.7 |
| | <u>444.1</u> | <u>396.9</u> | <u>426.5</u> | <u>401.1</u> |
| Analysis of borrowings: | | | | |
| Short-term loan | 38.0 | - | 38.0 | - |
| Inter-company short-term loan | 49.5 | 40.3 | 49.5 | 40.3 |
| Northern Electric Finance plc 2020 (8.875%) | 104.0 | 104.0 | 126.9 | 128.6 |
| Northern Electric Finance plc 2035 £50m (5.125%) | 49.8 | 49.8 | 42.1 | 45.8 |
| Yorkshire Electricity Group plc 2037 (5.9%) | 101.5 | 101.5 | 89.9 | 98.5 |
| Northern Electric Finance plc 2037 (5.125%) | 101.3 | 101.3 | 80.1 | 87.9 |
| | <u>444.1</u> | <u>396.9</u> | <u>426.5</u> | <u>401.1</u> |

The directors' estimates of the fair value of the Company's borrowings are calculated by discounting their future cash flows at the market rate at the balance sheet date.

Interest on the inter-company working capital loan is charged at a floating rate of interest at LIBOR plus 0.25%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £1.0m per year. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

The loans are non-secured and are denominated in sterling.

The covenants associated with the 2035 bonds include restrictions on the issuance of new indebtedness and the making of distributions dependent on the scale of the ratio of Senior Total Net Debt to Regulatory Asset Value ("RAV"). The definition of Senior Total Net Debt excludes any subordinated debt and any debt incurred on a non-recourse basis. In addition, it excludes interest payable, any fair value and accounting adjustments and unamortised issue costs.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

17 BORROWINGS (CONTINUED)

The Company's Senior Total Net Debt as at 31 March 2009 totalled £437.5m. Using the RAV value as at March 2009, as outlined by Ofgem in its Final Proposals for Distribution Prices published in November 2004 and up rating for the effects of movements in the value of the Retail Price Index, gives an approximation for the RAV value as at March 2009 of £823.9m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 53%.

At 31 March 2009, the Company had available £14.0m (2008: £52.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

18 DEFERRED TAX

| | Accelerated Tax Depreciation £m | Other £m | Total £m |
|---|--|-------------|-------------|
| At 1 April 2006 | 135.2 | (0.5) | 134.7 |
| (Credit)/charge to the income statement | (9.8) | 0.1 | (9.7) |
| At 31 March 2008 | 125.4 | (0.4) | 125.0 |
| Charge to the income statement | 9.7 | - | 9.7 |
| At 31 March 2009 | 135.1 | (0.4) | 134.7 |

Other comprises provisions and employee expenses deductible for tax on a paid basis and claims for hold over relief.

19 DEFERRED REVENUE

| | £m | |
|-------------------------------------|------------|------------|
| At 1 April 2007 | 342.9 | |
| Additions | 37.3 | |
| Amortisation | (9.8) | |
| At 31 March 2008 | 370.4 | |
| Additions | 42.6 | |
| Amortisation | (10.8) | |
| At 31 March 2009 | 402.2 | |
| | 2009 £m | 2008 £m |
| Included in current liabilities | 12.7 | 10.8 |
| Included in non-current liabilities | 389.5 | 359.6 |
| | 402.2 | 370.4 |

Deferred revenue represents contributions from customers made in advance towards distribution system assets. This income is released to the income statement over 45 years on a straight line basis, in line with the useful economic life of the distribution system assets.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

20 PROVISIONS

| | Claims £m | Other £m | Total £m |
|-------------------------------------|--------------|-------------|-------------|
| At 1 April 2008 | 1.9 | 0.6 | 2.5 |
| Utilised/paid in the year | (1.2) | - | (1.2) |
| Charged to the income statement | 0.6 | 0.4 | 1.0 |
| At 31 March 2009 | <u>1.3</u> | <u>1.0</u> | <u>2.3</u> |
| | | 2009 £m | 2008 £m |
| Included in current liabilities | | 1.3 | 1.9 |
| Included in non-current liabilities | | 1.0 | 0.6 |
| | | <u>2.3</u> | <u>2.5</u> |

Claims: Provision has been made to cover costs arising from actual claims, which are not externally insured. Settlement is expected substantially within 12 months.

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated biphenyls (PCBs) and for an amount to cover claims made under section 74 of the New Road and Street Works Act 1991. Provision has also been made for the costs of an environmental clean up operation on a leased site and the cost to the Company of excess mileage charges.

21 SHARE CAPITAL

| | 2009 No./£ | 2008 No./£ |
|------------------------------------|--------------------|--------------------|
| Ordinary shares of £1 each | | |
| Authorised | 300,000,000 | 300,000,000 |
| Allotted, called up and fully paid | <u>200,000,100</u> | <u>200,000,100</u> |

The Company has one class of ordinary shares which carry no right to fixed income.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

22 MOVEMENT ON RESERVES AND RECONCILIATION OF MOVEMENTS IN TOTAL EQUITY

| | Share Capital £m | Retained Reserves £m | Total Equity £m |
|---------------------|------------------------|----------------------------|--------------------|
| At 1 April 2007 | 200.0 | 104.0 | 304.0 |
| Profit for the year | - | 56.6 | 56.6 |
| Dividends paid | - | (20.0) | (20.0) |
| At 31 March 2008 | 200.0 | 140.6 | 340.6 |
| Profit for the year | - | 34.6 | 34.6 |
| Dividends paid | - | (20.0) | (20.0) |
| At 31 March 2009 | <u>200.0</u> | <u>155.2</u> | <u>355.2</u> |

23 NET CASH FROM OPERATING ACTIVITIES

| | 2009 £m | 2008 £m |
|--|-------------|-------------|
| Operating profit | 80.9 | 90.9 |
| Depreciation and amortisation | 42.7 | 40.6 |
| Amortisation of deferred revenue | (10.8) | (9.8) |
| (Decrease)/increase in provisions | (0.2) | 0.1 |
| Operating cash flows before movements in working capital | 112.6 | 121.8 |
| Decrease/(increase) in inventories | 0.8 | (1.4) |
| Decrease/(increase) in receivables | 2.6 | (3.8) |
| (Decrease)/increase in payables | (4.6) | 6.0 |
| Cash generated by operations | 111.4 | 122.6 |
| Income taxes paid | (5.0) | (12.6) |
| Group relief paid | (9.4) | (10.3) |
| Interest received | 0.2 | 0.3 |
| Interest paid | (24.5) | (23.2) |
| Dividends received | 0.1 | - |
| Net cash from operating activities | <u>72.8</u> | <u>76.8</u> |

NORTHERN ELECTRIC DISTRIBUTION LIMITED

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NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

24 PENSION COMMITMENTS

The Company has two retirement benefit schemes.

The Northern Electric Group of the ESPS is a defined benefit scheme for directors and employees, which provides pension and other related benefits based on final pensionable pay. The assets of the Northern Electric Group of the ESPS, which was closed to staff commencing employment on or after 23 July 1997, are held in a separate trustee-administered fund. The Northern Electric Money Purchase Scheme ("NEMPS") was made available to new employees from that date.

The Northern Electric Group of the ESPS and NEMPS are operated by Northern Electric plc on behalf of the participating companies within the CE Group.

The last full actuarial valuation of Northern Electric Group of the ESPS was carried out by the Group Trustees' Actuarial advisors, Hewitt Associates, as at 31 March 2007. The projected unit method was used for the valuation. The principal actuarial assumptions were that pre retirement investment returns would exceed salary increases by 1.8% per annum (inclusive of merit awards) and post retirement returns would exceed future pension increases by 1.8% per annum.

The total market value of the assets of Northern Electric Group of the ESPS at the date of the actuarial valuation was £926.7m.

For the Northern Electric Group of the ESPS, the actuarial valuation showed that the value of the assets represented 90.7% of the actuarial value of the accrued benefits. This represents a shortfall of assets compared to the value of accrued benefits of £95.1m. The accrued benefits include all benefits for pensioners and other former members as well as benefits based on service completed to date for active members, and allows for an estimate of future salary increases.

The CE Group reached agreement during March 2008 with the Group Trustees to repair this deficit. The agreement comprises monthly cash payments of £2.4m (£28.4m per annum) backdated to commence in April 2007. Of these annual payments £21.9m will be paid by the Company. These payments aim to remove the shortfall of £95.1m by December 2010 subject to actuarial assumptions adopted for the triennial valuation as at 31 March 2007 being borne out in practice. The next triennial valuation will take place as at 31 March 2010, as part of which the Scheme deficit will be re-assessed.

The Northern Electric Group of the ESPS is a defined benefit plan that shares the risk between various entities under common control. There is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual group entities and accordingly the Company accounts for the scheme as if it were a defined contribution scheme.

The contribution rates to the Northern Electric Group of the ESPS, in addition to the deficit repair contributions mentioned above for 2009, were 44.7% (60.7% to March 2008) for certain senior management and 26.3% (20.6% to March 2008) for other employees. These rates will remain in place until at least 31 March 2010.

NEMPS is also accounted for as a defined contribution scheme.

The Company's defined contribution pension cost for the year ended 31 March 2009 was £28.3m (2008: £27.0m).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****24 PENSION COMMITMENTS (CONTINUED)**

Disclosures in relation to the Northern Electric Group of the ESPS are:

Principal assumptions:

| | 2009 | 2008 |
|-------------------------------|----------------|----------------|
| | Projected unit | Projected unit |
| Valuation method | | |
| Discount rate | 6.70% | 6.90% |
| Inflation rate | 3.15% | 3.50% |
| Increase to pensions | 3.15% | 3.50% |
| Increase to deferred benefits | 3.15% | 3.50% |
| Salary increases | 3.40% | 3.15% |

The mortality assumptions are based on the recent actual mortality experience of members within the Northern Electric Group of the ESPS and the assumptions allow for future mortality improvements. The assumption is that a member currently aged 60 will live for a further 26 years, if he is male, and for a further 27 years if she is female. Life expectancy at age 60 for non-pensioners (currently aged 45) is assumed to be 28 years, if they are male, and 28 years, if they are female.

For closed schemes, such as the Northern Electric Group of the ESPS, under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

Changes in present value of the defined benefit obligation are as follows:

| | 2009 £m | 2008 £m |
|------------------------------------|--------------|--------------|
| Opening defined benefit obligation | 819.7 | 903.5 |
| Current service cost | 7.4 | 11.4 |
| Interest cost | 55.5 | 48.1 |
| Contributions from employees | 3.0 | 3.3 |
| Actuarial gains | (13.6) | (107.3) |
| Benefits paid | (41.6) | (39.3) |
| Closing defined benefit obligation | <u>830.4</u> | <u>819.7</u> |

Changes in the fair value of the plan assets are as follows:

| | 2009 £m | 2008 £m |
|-----------------------------------|--------------|--------------|
| Opening fair value of plan assets | 912.5 | 923.0 |
| Expected returns | 62.4 | 64.6 |
| Actuarial losses | (223.6) | (80.4) |
| Contributions by employer | 42.4 | 41.3 |
| Contribution from employees | 3.0 | 3.3 |
| Benefits paid | (41.6) | (39.3) |
| Closing fair value of plan assets | <u>755.1</u> | <u>912.5</u> |

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)****24 PENSION COMMITMENTS (CONTINUED)**

The fair value of the plan assets at the balance sheet date is analysed below:

| | Long term rates of return expected at | | Value | |
|-----------------------------------|--|-----------|--------------|--------------|
| | 2009 % | 2008 % | 2009 £m | 2008 £m |
| Equities | 8.9 | 8.7 | 301.4 | 350.9 |
| Gilts | 5.3 | 4.5 | 373.5 | 442.5 |
| Cash | 4.5 | 5.0 | 0.7 | 24.5 |
| Property | 7.9 | 7.7 | 79.5 | 94.6 |
| Total fair value of scheme assets | | | <u>755.1</u> | <u>912.5</u> |

The CE Group employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long term rates of return on each asset class are set out within these disclosures. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the Northern Electric Group of the ESPS.

The CE Group expects to contribute approximately £44.1m to its defined benefit plan in the year ending 31 March 2010, including £28.4m for pension deficit repair.

25 OPERATING LEASE ARRANGEMENTS

| | 2009 £m | 2008 £m |
|--|------------|------------|
| Minimum lease payments under operating leases recognised in the year | <u>6.8</u> | <u>5.5</u> |

At the balance sheet date, the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

| | 2009 £m | 2008 £m |
|---------------------------------------|-------------|-------------|
| Within one year | 4.3 | 4.1 |
| In the second to fifth year inclusive | 13.5 | 13.5 |
| After five years | <u>18.6</u> | <u>20.8</u> |
| | <u>36.4</u> | <u>38.4</u> |

Leases consist of rent payable in respect of property and vehicle leases both primarily from related parties.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

26 RELATED PARTY TRANSACTIONS

The Company has advanced loans to companies in the CE Group. The total interest included in investment income in the income statement for the year ended 31 March 2009 was £0.2m (2008: £0.3m).

The Company has received loans from companies in the CE Group. The total interest included in finance costs in the income statement for the year ended 31 March 2009 was £24.2m (2008: £23.5m). Included within borrowings is £406.1m as at 31 March 2009 (2008: £397.0m) in respect of these loans.

Interest on loans from CE Group companies is charged at a commercial rate of interest.

The Company also entered into transactions, in the ordinary course of business, with other CE Group companies. Transactions entered into and trading balances outstanding were as follows:

| Related Party | Sales to Related Party £m | Purchases from Related Party £m | Amounts Owed to Related Party (Note 16) £m |
|---|---------------------------------|--|--|
| 2009: | | | |
| CE Insurance Services Limited | - | 0.6 | - |
| Integrated Utility Services Limited | 0.1 | 0.1 | - |
| Integrated Utility Services Limited (registered in Eire) | - | 0.4 | - |
| Northern Electric plc | 0.2 | 5.5 | - |
| Northern Electric Properties Limited | - | 1.1 | - |
| Yorkshire Electricity Distribution plc | 10.1 | 6.2 | - |
| Vehicle Lease and Service Limited | - | 3.4 | 0.3 |
| 2008: | | | |
| CE Insurance Services Limited | - | 0.6 | - |
| Integrated Utility Services Limited | 0.2 | 0.2 | - |
| Integrated Utility Services Limited (registered in Eire) | - | 1.2 | - |
| Northern Electric plc | 0.2 | 6.2 | - |
| Northern Electric Properties Limited | - | 0.9 | - |
| Yorkshire Electricity Distribution plc | 9.8 | 5.5 | - |
| Vehicle Lease and Service Limited | - | 3.0 | 0.3 |

Sales and purchases from related parties were made at commercial prices.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of amounts owed by related parties.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 MARCH 2009 (CONTINUED)

27 ULTIMATE HOLDING COMPANY AND CONTROLLING PARTY

The immediate parent undertaking of Northern Electric Distribution Limited is Northern Electric plc. The ultimate controlling party and ultimate parent undertaking of Northern Electric plc is Berkshire Hathaway, Inc., a company incorporated in the United States of America.

Copies of the group accounts of Berkshire Hathaway, Inc. (the parent undertaking of the largest group preparing group accounts) which include Northern Electric Distribution Limited and the group accounts of Northern Electric plc, the smallest parent undertaking to prepare group accounts in the UK can both be obtained from the Company Secretary, CE Electric UK Funding Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.