

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**  
**REGULATORY ACCOUNTS**  
**FOR THE YEAR ENDED**  
**31 MARCH 2011**

# **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2011**

## **CONTENTS**

Directors' Report	1
Business Review	2
Review of the Regulatory Year	2
Strategic Objectives	3
Principal Risks and Uncertainties	3
Internal Control	5
Financial Strength	6
Customer Service	9
Operational Excellence	11
Employee Commitment	13
Environmental Respect	14
Regulatory Integrity	16
Other Directors Report Requirements	18
Responsibility Statement of the Directors in respect of the Regulatory Accounts	20
Corporate Governance Statement	21
Independent Auditors' Report to the Members of Northern Electric Distribution Limited	28
Income Statement	30
Statement of Comprehensive Income	30
Statement of Changes in Equity	30
Statement of Financial Position	31
Cash Flow Statement	32
Notes to the Accounts	33

# 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 the Regulatory Accounts for the year ended 31 March 2011 (the "Regulatory Year") for Northern Electric Distribution Limited (the "Company"), which include the directors' report, business review, corporate governance statement 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 are separate and, therefore, may differ from the statutory financial statements of the Company, which have been drawn up and presented in accordance with the Companies Act 2006.

### **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 year was to distribute electricity to customers connected to its electricity distribution network.

The Company serves an area of approximately 6,000 square miles in the north east of England with a resident population of 3.2 million, which extends from North Northumberland south to York and west to the Pennines. The Company's distribution system receives electricity from the National Grid's transmission system and distributes it, at voltages of up to 132kV, to approximately 1.6 million customers connected to its network of transformers, switchgear and overhead and underground cables. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. The main classes of asset, which make up the Company's distribution network, include:

<b><u>Asset class</u></b>	<b><u>Approximate number</u></b>
Total circuit length (underground and overhead)	25,000 miles
Ground-mounted distribution substations	10,300
Pole-mounted distribution substations	15,900
Other substations	250
LV services (overhead)	153,000
LV services (underground)	1.4 million

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **PRINCIPAL ACTIVITIES (CONTINUED)**

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

<b><u>Principle</u></b>	<b><u>Strategy</u></b>	<b><u>Indicator</u></b>
Financial strength	Effective stewardship of the Company's financial resources, investing in assets and focusing on long-term opportunities, which contribute to the Company's future strength.	Profitability, cash flow and maintenance of investment grade credit ratings.
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 and 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 performance, engaging employees and effective leadership.
Environmental respect	Using natural resources wisely and protecting the environment, where it is impacted by the Company's operations.	Reducing environmental impact and 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 and industry influence.

The Company continues to put plans in place to deliver its objectives against the strategy based on the Core Principles, executes on those plans across a range of activities, measures its progress and introduces corrective action wherever required. Although there was only limited improvement in the general economic environment, by adhering to the Core Principles, the Company was able to deliver a satisfactory financial performance for the Regulatory Year by adhering to the Core Principles.

### **BUSINESS REVIEW**

#### **Review of the Regulatory Year**

The performance of the Company during the Regulatory Year was satisfactory, with the Company making a promising start to the Distribution Price Control Review 5 ("DPCR5") period, which took effect on 1 April 2010 for a five-year period and followed its agreement to the required modifications to its electricity distribution licence. A change to the tariff charging methodology and increases in tariffs themselves during the Regulatory Year resulted in an increase in revenue compared to the prior year.

Based on the DPCR5 final proposals, together with a rebalancing of distribution charges between customer groups, the charges made by the Company in relation to the distribution of electricity to domestic and non-domestic customers were amended with effect from 1 April 2010. Those charges varied between the different types of customer.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **BUSINESS REVIEW (CONTINUED)**

##### **Review of the Regulatory Year (continued)**

There is a focus in DPCR5 on rewarding Distribution Network Operators ("DNOs") for delivering high standards of customer service and it provides the opportunity for outperforming Ofgem's baseline expenditure and performance targets. In addition, Ofgem has set out the "outputs" it expects the Company to achieve and, as an incentive to provide better customer service, introduced new statutory guaranteed standards of performance in respect of connections to the distribution network, more challenging targets for network reliability and a new measure of customer satisfaction with the service provided.

During the year, the CE Group was successful in winning funding under the Low Carbon Networks Fund arrangements for its Customer-Led Network Revolution project, received an award under the electricity distribution customer service reward scheme, implemented the new guaranteed standards of performance in the network connections area of its business and achieved a significant reduction in the number of failures recorded against the various guaranteed standards of performance.

The Company measures its health and safety performance on a calendar year basis and, for the year ended 31 December 2010, missed its internal targets in respect of lost time accidents and operational incidents. However, the number of preventable vehicle accidents experienced was better than target and also reduced in comparison to the year ended 31 December 2009.

##### **Strategic objectives**

The Company's strategic objectives remain based on the Core Principles and are to build a business, which:

- continues to generate value over the long-term;
- 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 continues to be committed to putting safety first, respecting its customers, their time and property, doing a quality job, responding effectively in times of severe weather and caring for its local environment.

#### **PRINCIPAL RISKS AND UNCERTAINTIES**

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

##### **Financial risk**

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 Ofgem.

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

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **BUSINESS REVIEW (CONTINUED)**

##### **Principal risks and uncertainties (continued)**

###### **Financial strength (continued)**

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. The current five-year price control period became effective on 1 April 2010 and has set the Company's revenues through to 31 March 2015. During the term of the price control, changes in costs incurred will have a direct impact on the Company's financial results. A resetting of the formula currently requires the consent of the electricity distribution licensees or, if that consent is withheld, the endorsement of the Competition Commission. However, the regime by which changes to licence conditions may be made is likely to change. Regulations have been laid before Parliament that will, if approved by both Houses of Parliament, amend the existing law under which licence modifications are made. Under the new arrangements GEMA will be empowered to make modifications to licences without the consent of licensees but licensees and certain other materially affected third parties will be given a substantive right of appeal to the Competition Commission. The remit of the Competition Commission in considering such an appeal is defined in the regulations.

The Company operates under a price control that determines the maximum permitted revenue for each regulatory year. Where the Company recovers more, or less, than this maximum the difference is carried forward, with interest, into the entitlement for the following year. In respect of the regulatory year to 31 March 2010, the Company was forecast to exceed the maximum permitted under the price control mainly as a result of late changes in the volumes of sales reported by the electricity suppliers that had an impact on the Company's entitlement under the electrical losses incentive of its price control formula. The Company entered into a dialogue with Ofgem in respect of this issue and proposed certain adjustments to the relevant data for the regulatory year to 31 March 2010, which Ofgem confirmed were necessary to restore the Company's allowed revenue position to an appropriate level. This issue is discussed further on page 16.

The other financial risks facing the Company are outlined in the Treasury section on page 8 of this report.

###### **Operational risk**

There are a number of risks to the Company's operational performance in respect of the other Core Principles, which include:

- Counter-party security, with credit cover arrangements being in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism;
- Severe weather incidents, which impact on the distribution network's performance and are addressed through a robust major incident management plan;
- The demand for copper, a key component in the construction of distribution network assets, which has resulted in inflated prices and an increased risk of unauthorised access to the Company's sites for the purpose of theft;
- Public safety and network security issues, particularly relating to the theft of copper; and
- The potential for the failure of major circuits, which would put a significant number of customers at risk of losing supply.

###### **Risk management**

The CE Group operates a structured and disciplined approach to the management of risk, as part of the overall risk management approach. 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. Those risks assessed to be significantly high are logged within a risk register that the Governance and Risk Management Group ("GRMG") reviews regularly and key indicators track the number of significant risks, which are actively monitored by the GRMG at any one time.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Principal risks and uncertainties (continued)**

##### **Risk management (continued)**

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 are 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 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 regular review of the key risks, controls and action plans is undertaken.

Risk management continues to be a central theme of senior management priority setting as well as an explicit business process that helps to stimulate the senior leadership's consciousness of lower probability, high consequence threats to business success or continuity. This approach is reinforced by the approach taken by the wider MidAmerican Energy Holdings Company ("MidAmerican") group, whose activities have continued to include a structured benchmarking of risk management activities across the business units, including the sharing of significant lessons learned associated with risk management.

The risk management programme includes regular review of crisis management and disaster recovery plans, which are periodically tested. During the Regulatory Year, activities included a review of the CE Group's major incident plan for operational systems, participation in exercises with local authorities to review the planned response to major events and a disaster recovery test simulating the loss of a non-operational office and support systems.

A key element and requirement of the risk management process is that a written certificate is provided by the President and Chief Executive 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.

##### **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, 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. A review is undertaken of the company-wide controls in place on an annual basis and, while no significant areas of weakness have been identified, any recommended improvements are implemented.

The CE Group is committed to proper business conduct and, in common with 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.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Principal risks and uncertainties (continued)**

##### **Internal control (continued)**

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 the 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 compliance with financial, legal and regulatory obligations;
- 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 continued to implement tighter expenditure controls through the wide-ranging cost mitigation exercise, enhanced the reporting of management information and embedded the culture of continuous financial improvement in all areas of its operations.

The Company remains very aware of the impact that the general economic climate has had and may continue to have for the foreseeable future on it and its customers. In that respect, procedures are in place to closely monitor and manage the issues that may impact on the Company's business more significantly than others, including lower activity in terms of new connections required to the network and the potential for higher debt write-off as the economic downturn further affects the Company's customers.

Although it benefits from the stability provided by DPCR5 in terms of its income until 31 March 2015, the Company recognises that it needs to show that it is delivering reliable services at a fair price to its customers, while operating in an efficient and effective manner.

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

##### **Revenue**

The Company's revenue at £268.3m was £37.3m higher than the prior year mainly due to higher tariffs implemented in April 2010 following the fifth Distribution Price Control Review ("DPCR5") settlement.



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Financial strength (continued)**

##### **Operating profit**

The Company's operating profit at £131.3.0m was £36.5m higher than the previous year reflecting the increase in revenues during the Regulatory Year.

##### **Finance costs and investment income**

Finance costs net of investment income at £26.0m were £2.8m higher than the prior year due to refinancing activities.

##### **Taxation**

The effective tax rate in the current year is 18.8%. Details are provided in Note 9 to the accounts.

##### **Results and dividends**

The Company made a profit after tax for the Regulatory Year of £85.8m. The directors recommended that no final dividend be paid in respect of the statutory accounting year ended 31 December 2010. An interim dividend of £20m was paid during the statutory accounting year ended 31 December 2010.

No interim dividend was paid during the period 1 January 2011 to 31 March 2011.

##### **Share capital and debt structures**

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

On 2 July 2010 the Company entered into an agreement with the European Investment Bank ("EIB"), under which EIB provided the Company with a credit facility of £119m. The financial obligations of the Company under this contract are guaranteed by CE Electric UK Funding Company. Between 31 January 2011 and 28 February 2011, the Company drew down the entire credit facility of £119m at an average fixed rate of 4.228%.

##### **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 issuer credit rating.

##### **Cash flow**

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

Movements in cash flows for the Regulatory Year were as follows:

Operating activities: Cash flow from operating activities at £120.4m was £28.8m higher than the previous year reflecting higher profitability in the Regulatory Year.

Investing activities: Net cash used in investing activities at £84.1m was £7.2m lower than the previous year, reflecting lower net capital expenditure compared to the prior year.

Financing activities: The net cash used in financing activities at £8.2m represents a £7.9m adverse variance compared to the previous year, mainly due to the repayment of loans which were outstanding at 31 March 2010.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Financial strength (continued)**

##### **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.

##### **Liquidity risk**

The Company has access to £75m under a three year committed revolving credit facility provided by Lloyds TSB Bank plc, The Royal Bank of Scotland plc and Abbey National Treasury Services plc. This facility replaced the £50m five year committed revolving credit facility provided by Lloyds TSB Bank plc and The Royal Bank of Scotland plc, which expired on 31 March 2010. The £75m three year committed revolving credit facility expires on 31 March 2013 and the Company expects to raise further facilities as required, at that time.

In addition, the Company has access to further short-term borrowing facilities provided by YEG and a £4m overdraft facility provided by Lloyds TSB Bank plc, which is renewable annually.

The directors do not consider there to be any doubt over the Company's ability to raise appropriate levels of finance in the future, 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 2011, 100% of the Company's borrowings were at fixed rates and the average maturity for these borrowings was 18 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 2011 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 23 to the accounts.

During the Regulatory Year, Northern Electric plc, the Company's immediate parent company and the Principal Employer of the Scheme, was engaged with the Group Trustees in the triennial actuarial valuation process, as at 31 March 2010, in order to determine the funding position of the Scheme and the associated deficit repair arrangements. The actuarial valuation concluded that there was a shortfall of assets in the Scheme compared to the value of accrued benefits of £276m.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Financial strength (continued)**

##### **Pensions (continued)**

Agreement was reached during June 2011 with the Group Trustees to repair this deficit over the 15 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2010 being borne out in practice. The agreement includes cash payments of £29.9m per annum, made on a monthly basis, for the first five years of the recovery plan followed by an agreed profile of payments to be made over the remaining ten years of the recovery plan.

Ofgem recognises that pensions, particularly with respect to the current deficit positions of various schemes, represent a significant cost to the DNOs and as part of the DPCR5 process undertook a review of the pension principles it established in 2003. In its DPCR5 final proposals, Ofgem confirmed that DNOs would be allowed to recover the full value of the deficits attributable to a licensee's distribution business in existence as at 31 March 2010 (after an adjustment to reflect the residual of unfunded early retirement deficiency costs as at 31 March 2010), via its regulated revenues. However, given the regulated nature of the DNOs' businesses, Ofgem took the view that there is not the same risk or urgency as in other sectors of the economy to ensure that those deficits are repaired as soon as possible and therefore set a notional repair period of 15 years for the purpose of assessing the DNOs' allowed revenues in respect of pension costs over the DPCR5 period.

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 in place a range of insurance policies, including policies which cover risks associated with damage to property, employer's and third party motor liability 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.

##### **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 the distribution network through an investment strategy 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. During the Regulatory Year the Company made a major commitment to improving customer service, introducing a programme centred on the development of the customer experience and looking at improving performance in its contact centre services, web services, stakeholder engagement and customer service competencies and complaints handling processes. A significant number of improvements have already been identified and delivered as part of the overall goal to improve customer satisfaction with the service provided.

Those improvements included:

- building on the introduction of the interactive voice response system in the call centre. The system takes advantage of the latest developments in automatic messaging and enables the provision of an improved service, including text and voice-message updates, to customers during loss of supply incidents, which includes text and voice-message updates;
- improving the accuracy of the times estimated for the restoration of supply during network faults that are communicated to customers;

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Customer service (continued)**

- continuing to improve under-performing parts of the distribution network by identifying "hot spots" and taking specific action to address the issues in those areas;
- maintaining the priority services register so that the Company is aware of people with disabilities or special needs, who may be affected by interruptions to the electricity supply, and can take appropriate action to assist those people in such circumstances;
- undertaking a programme to reduce the number of instances in which the Company fails to meet an electricity guaranteed standard of performance; and
- improving customer service by resolving in excess of 95% of enquiries at the initial point of contact.

The Company achieved a customer satisfaction score of 86.6% for the Regulatory Year and intends to build on the telephony system mentioned above in order to more effectively integrate its other customer facing processes to improve the service provided. Continued development of the Company's customer service improvement plan will include increasing focus on excellence in customer service in order to achieve a customer satisfaction score of greater than 90%.

The Company formally implemented the new electricity connections guaranteed standards of performance in October 2010 following a successful audit, which confirmed compliance with Ofgem's requirements. Performance was positive throughout the opening quarter following the implementation of those new guaranteed standards, with the Company achieving a success rate of 99.82%. This positive performance continued into the final quarter of the Regulatory Year, with the success rate being 99.81% for the period January to March 2011.

Following the completion of the successful audit, the Company submitted a regulated margin notice to Ofgem, in accordance with the provisions of Charge Restriction Condition 12 of the electricity distribution licence, of its intention to charge a regulated margin on relevant connections activities. As a result, a regulated margin of 4% has been charged on the relevant connections activities since October 2010.

Ofgem has established an incentive scheme for quality of service, by which the DNOs are provided with financial incentives based upon targets set by Ofgem with regard to their performance in the following areas:

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

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 goal is to achieve performance that is below the target number in respect of CML and CI and more than the target number in respect of customer satisfaction. The Company's reported performance for the Regulatory Year, against the targets determined by Ofgem, was as follows:

## NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

### DIRECTORS' REPORT (CONTINUED)

#### Customer service (continued)

	Year to 31 March 2011		Year to 31 March 2010	
	Actual	Target	Actual	Target
<b>CML:</b>	<b>71.1</b>	<b>71.3</b>	68.8	67.4
<b>CI:</b>	<b>65.2</b>	<b>68.3</b>	62.3	74.5
<b>Customer satisfaction:</b>	<b>86.6%</b>	<b>90.0%</b>	91.2%	90.0%

Performance in the Regulatory Year was better than Ofgem's target for both CML and CI. Customer satisfaction was below target and was affected by the introduction into the target, in April 2010, of an element relating to the unsuccessful call rate. Measured without the unsuccessful call element and on a like-for-like basis with the prior year, customer satisfaction performance would have been 90%.

The Company is continuing to develop its telephony system to address the unsuccessful call rates and anticipates that the improvement actions mentioned above, together with the various improvement actions in respect of the network's resilience, will continue to support improvements in customer service performance.

At the time the targets for the regulatory year to 31 March 2010 were set, no account was taken of the customer service impact arising from additional vegetation management obligations, which were not allowed for in the distribution price control four ("DPCR4") settlement. The customer service targets were not adjusted to take account of the effects of the representations made by the Company and accepted by Ofgem. Instead, the benefits arising from that decision were reflected in a favourable adjustment to the Company's base allowed revenue. That position continued until 31 March 2010 and the implementation of DPCR5 with effect from 1 April 2010.

#### 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, £124.8m was invested in the improvement of the distribution network, including the replacement of assets and continuing network improvements intended to increase the quality of the electricity supply provided to customers.

#### Operational activity

The Company's investment strategy is designed to deliver improvements in an efficient and cost-effective manner in order to improve the network's resilience 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.

The Company's Field Operations structure is designed to provide the best possible foundation for optimum operational performance and is based on six individual business units for the operation of the network. Those business units are Network Operations, which provides the day-to-day and reactive management of the network, Service Delivery, which has responsibility for the control and management of the direct labour force, Network Repairs, which focuses on core repair activities, Connections Delivery, which undertakes customer-driven work, Programme Delivery, which includes primary engineering projects and technical services, and Operational Services, which includes supply chain management, training and health and safety services.

The Company's priorities during the Regulatory Year included a reduction in the average level of fault repair work in progress, the introduction of improvements in field response and supply restoration times and in the management of intermittent faults, the implementation of enhanced controls for outage risk management and a more robust approach to the control of operations on the low voltage network.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Operational excellence (continued)**

##### **Operational activity (continued)**

The major projects undertaken in support of those targets and as part of the investment strategy included:

- Continuation of the 132kV switchgear replacement project at Tynemouth in North Tyneside and of a new 33/20kV substation to provide improved voltage regulation in the Wensleydale area of North Yorkshire and completion of a new 20kV capacitor switch station in the North Northumberland area;
- Refurbishment of 2.7km of 66kV overhead line and the refurbishment or rebuilding of 37km of high voltage overhead line and 14km of low voltage overhead line;
- Replacement of 100 units of high voltage outdoor switchgear, 31 high voltage distribution substations and 183 units of high voltage indoor switchgear;
- The upgrade and reinforcement of 8 sites to address the quality of supply performance issues relating to those circuits; and
- The installation and commissioning of 265 new remote control sites.

In order to deliver its investment strategy, the Company used a mix of its own staff and contractors, including Integrated Utility Services Limited, a company registered in the Republic of Ireland and part of the CE Group, to undertake its activities.

#### **Commercial risk**

Managing commercial risk in the context of the difficult economic and financial trading conditions, which continued throughout the Regulatory Year, was, and will continue to be, of key importance to the Company's operations. In that respect the Company focused on ensuring that its policies for credit checking, payment terms, payment performance tracking and debt management were strictly adhered to.

The Company's relationship with its main customers is governed by a distribution connection and use of system agreement ("DCUSA"), which is in place with each of those customers. Those customers are the electricity suppliers who, under the terms of the DCUSA, pay charges for the use of the distribution network, in respect of which it is necessary to ensure that the credit cover arrangements in line with Ofgem's guidance remain in place. The principal electricity suppliers that use the Company's network are RWE Npower, British Gas, EDF Energy, E.ON, Scottish and Southern Energy and Scottish Power.

The Company operates its business utilising a mix of direct labour and contracted resource and has a range of contracts in place with various service providers for delivery of its work programmes, which are subject to regular market testing and tendering exercises. Those services include vegetation management, overhead line inspection and construction, substation construction and maintenance, cable engineering services, vehicle leasing and servicing, tower painting and information technology services. The Company also has an extensive suite of contracts in place for the procurement of all of the goods and equipment it requires to deliver its capital expenditure programme and to run its business, including for varying types of transformers, switchgear and cables.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **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.

In 2011 the Company received a President's Award from the Royal Society for the Prevention of Accidents for achieving ten consecutive Gold Awards, which have been presented in recognition of achievements in 2010 and continued or improving standards of health and safety over a sustained period. The Company continued to maintain its occupational health and safety management system and retained its OHSAS 18001 certification.

In respect of the main key performance indicators used by the Company to monitor safety performance, the goal is to achieve performance that is below the target number. Those key performance indicators are as follows:

	<b>Year to December 2010</b>		<b>Year to December 2009</b>	
	<b>Target</b>	<b>Actual</b>	<b>Target</b>	<b>Actual</b>
Lost time accidents	<b>0</b>	<b>4</b>	0	1
Restricted duty accidents	<b>1</b>	<b>1</b>	1	1
Medical treatment accidents	<b>3</b>	<b>2</b>	3	2
Operational incidents	<b>3</b>	<b>6</b>	3	4
Preventable vehicle accidents	<b>10</b>	<b>5</b>	10	13

The Company measures its safety performance in calendar years and, although performance continued to exceed the industry average, it fell short of the CE Group's goals in certain areas during 2010. The Company continues to implement a safety improvement plan that targets delivery of continuous improvement. As part of that plan, the Company introduced a number of safety initiatives in order to prevent slips, trips and falls, which proved successful during the severe wintry weather conditions experienced at the end of 2010. These initiatives included the use of "Spikey Plus" ice cleats for use over other safety footwear and the increased availability of grit salt for use on site works.

Performance in respect of preventable vehicle accidents was better than the target for 2010 and in comparison to 2009. A key factor in that improvement was the progress made in respect of the CE Group's road risk management plan, which involved a significant number of staff undertaking the Institute of Advanced Motorists online driver assessment and training module followed by an on-road refresher training session if required. In 2010 the road risk plan was named Van Fleet Initiative of the Year by industry experts in a competition run by industry magazine Fleet News.

##### **Management structure**

The Company has a clearly defined leadership team in which specific roles are identified so allowing effective management of the Company'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 health, safety and environment. The business systems, human resources, procurement and finance functions are centralised in order to provide those services across the CE Group.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Employee commitment (continued)**

##### **Employees**

The challenging external economic environment continued throughout the Regulatory Year and the Company continued to implement its programme of cost mitigation, which included the control of headcount.

The Company has placed, and will continue to place, significant emphasis on the importance and application of high standards of management and performance in pursuit of the Core Principles and ensures that a level of consistency is adopted in doing so. In respect of employee relations, the Company and the trades unions continue to work towards building a constructive relationship.

Given the demographics of the Company's workforce, the increasing investment in the distribution network and in order to encourage investment in a sustainable workforce, Ofgem provided an allowance in its DPCR5 final proposals in order to fund the plans for workforce renewal across the DPCR5 period. Ofgem has stated that the allowance is on a "use it or lose it" basis and the Company will need to demonstrate that it has used that allowance appropriately and efficiently to recruit and train new staff or for other means of renewing its workforce and report annually on its progress in that respect. The CE Group recruited 45 members of staff in 2010 and has a target to recruit an additional 75 in 2011 under its workforce renewal programme. Overall, plans are in place to have recruited a total of 275 graduate trainees, technical trainees and craft apprentices by the end of 2015.

The Company employed 963 staff at the end of March 2011. (2010: 974).

##### **Disabled employees**

The CE Group is committed to equality at work and as such is committed to the criteria underpinning the Employment Service disability symbol. It is the CE Group's policy to provide all protected groups including disabled people with equality at work in respect of employment, training, career development and promotion, having regard to their aptitudes and abilities. Should any member of staff become disabled during their employment, the Company would work to retrain and/or redeploy that member of staff wherever possible.

##### **Employee consultation**

The CE Group has a constitutional framework in place and has agreed that framework with trade union representatives. In addition, the CE Group 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 CE Group 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 an employee publication. During the Regulatory Year, the President and Chief Executive Officer of the CE Group delivered regular broadcast briefings using telephone conference call facilities in order to provide employees with updates such as on the performance of the CE Group, financial, organisational and safety issues and customer service performance.

##### **Environmental respect**

The CE Group's approach to environmental compliance is governed by its environmental policy and the MidAmerican Energy Holdings Company ("MidAmerican") policy of Environmental RESPECT (Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training). These policies and their subordinate operational control procedures and systems address compliance with legal and other key environmental requirements, pollution prevention and continual improvement and also promote environmental awareness and best practice amongst the Company's staff and contractors.



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Environmental respect (continued)**

The Company has operated a United Kingdom Accreditation Service scheme for environmental management since the late 1990s, certified to the environmental management systems standard ISO 14001:2004 it is subject to regular six-monthly assessment visits by an accredited external certification body in order to retain that status. The most recent visit was a full scheme assessment for three yearly certificate renewal purposes and was carried out by Lloyd's Register Quality Assurance in February 2011. The assessment report drew management attention to some minor non-conformances to be addressed by agreed proposed actions. The report also noted good processes for identifying environmental aspects and legal requirements and taking them into account in the system. There were no major non-conformances noted and continued certification was recommended and subsequently confirmed.

Having met its key improvement target in the reduction of cable fluid leakages for the two previous years, the Company did not achieve its target for the year ended 31 December 2010. However, the position in the first quarter of 2011 showed significant improvement, despite the adverse effect on the fluid-filled cable systems of the extremely low temperatures in late 2010 and early 2011. Although falling short of expectations, performance in the Regulatory Year continued to provide a crucial contribution to the control of the CE Group's environmental impact to ground and the associated risk to the business. Future improvements are supported by the Company's continued asset investment plan.

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

- Replacing selected fluid-filled cable sections with non-fluid polymeric equivalents;
- Replacing oil-filled circuit breakers with vacuum and sulphur hexafluoride gas filled units at outdoor substations to reduce the potential for oil leakage;
- Installing underground cables using trenchless technology as opposed to open-cut excavations;
- A depot energy efficiency improvement programme; and
- Environmental awareness training for new personnel and contractors, complemented by periodic refresher training for all staff.

Environmental impact on protected structures, features, areas, wildlife and habitat is a central consideration when planning improvements to the Company's electricity distribution network. This includes protecting bird life by placing bird-diverters on power lines in reserves or in locations where rare species of bird are known to live or breed and in response to information from incident trends and the proximity of wetlands and flight paths.

#### **Sustainability**

The Company takes its responsibilities towards reducing the impact of global warming seriously, both in its capacity as a major participant in the UK energy industry and in terms of its own carbon footprint. Through its involvement in industry groups and its interactions with government and regulators, it is contributing to the target of transforming the UK electricity industry into a low carbon emitter. The Company also works with customers to assist in solving issues raised by the introduction of low-carbon generation and products and their implications for the planning and operation of the electricity network.

System losses contribute to the UK's carbon footprint and the Company's programmes include trialling technological innovations that help to reduce those losses, such as the superconducting fault current limiter project. It is also involved in studies with Durham University to examine behavioural influences on energy demand patterns. In recognition of the fact that the advent of the electric vehicle has the potential to radically alter how and when electricity is used, the Company is working closely with key partners in the North East who are installing a significant number of charging points for electric vehicles across the region and is monitoring their impact on energy demand patterns. The findings will also influence the Company's future network investment.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Sustainability (continued)**

The CE Group measures and publishes its own carbon footprint and has set a target of reducing that footprint by 5% in both 2010 and 2011. Actions taken in 2010 to assist in meeting this target included fitting speed limiters to its vehicle fleet, the training of staff in the use of the building energy management systems installed at its major office sites and extending the recycling of office waste to a total of five sites. In addition, the Company has, in line with Ofgem's requirements, contributed to the sustainability agenda through public reporting on the carbon footprint of its business.

In partnership with British Gas, Durham University and EA Technology, the CE Group submitted a successful bid to Ofgem's Low Carbon Networks Fund for its project, Customer-Led Network Revolution. The project was the largest project supported by Ofgem in the first year of the fund and the CE Group will incur expenditure of £31m over the three year life of the project. Of that expenditure, 90% is funded by electricity customers in Great Britain and successful delivery of the project over the three years agreed with Ofgem will enable the CE Group to recover the additional 10% from customers and potentially qualify for a further discretionary award. The project seeks to facilitate speedier and more economical take-up by customers of low-carbon technologies such as solar photovoltaics, heat pumps and electric vehicles. The project will investigate customer behaviour in the use of low-carbon technology, whether this can be influenced by financial incentives and the extent to which customer response, when used in conjunction with innovative network technology, can reduce network costs.

The Company is also enabling customers in fuel poverty to reduce their energy bills and carbon emissions by working with leading suppliers of renewable energy technologies to minimise the impact of these technologies on the network, ultimately reducing the production cost for customers. The Company has already produced a customer-friendly guide to sustainable energy production.

#### **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 GRMG monitored and managed performance in risk-related and compliance areas and met on four occasions during the Regulatory Year.

As has been the case for some years, breaches by a DNO of its licence conditions could lead to financial penalties, which Ofgem has stated "will have a proportionate impact on shareholder returns". In order to assure compliance with its licence and other regulatory obligations, the Company operates a regulatory compliance affirmation process, under which ownership of the approximately 1,781 regulatory obligations contained within the compliance database is currently assigned to 55 responsible managers. Those responsible managers are required, on a quarterly basis, to review compliance with the relevant obligations that have been assigned to them for certification and report on any perceived risks to the compliance process, which are then addressed. The Regulation Manager reports to the board of directors on the outcome of each quarter's exercise.

A revenue-related issue arose in that the adjustment of settlements data by certain suppliers had the effect of distorting the apparent performance of the Company under the losses incentive scheme for the regulatory year ended 31 March 2010. The Company devoted a significant effort to investigating the complexities of the settlement system data flows and presented its findings to Ofgem, which agreed to the restatement of losses information for the regulatory year ended 31 March 2010 on a revised basis proposed by the Company. Ofgem's agreement to this restatement covered only the data flows relating to the regulatory year ended 31 March 2010 and resulted in an under-recovery being generated in respect of the Company's maximum permitted revenue for that year of £2.2m to be recognised as revenue over the 2011/12 regulatory period, as opposed to the previously anticipated over-recovery.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Regulatory integrity (continued)**

Although this restatement is a favourable outcome and a significant step towards resolving the overall commercial impact of supplier activity on allowed revenues associated with the losses incentive, the issue remains subject to the closing out the DPCR4 losses rolling retention mechanism. In addition, the impact of the DPCR4 period performance on the DPCR5 final losses targets remains uncertain and is still to be resolved. Discussions with Ofgem in respect of those issues are continuing as at the date of approval of these Regulatory Accounts and the directors anticipate that those discussions will be concluded early in 2012.

Implementation of the DPCR5 settlement from April 2010 included the introduction, from October 2010, of a significant number of new guaranteed standards relating to the Company's connection activities and unmetered repairs activities. The Company successfully met a licence requirement to pass an independent audit of its readiness and ability to implement these new standards and comply with the associated new financial reporting requirements.

The outcome of the wholesale review of the regulatory framework across the energy industry in the UK that was heralded by the launch of Ofgem's "RPI-X@20" project in 2008, with the aim of determining how best to meet the challenges and opportunities of delivering the networks required for a sustainable, low-carbon energy sector, was announced in October 2010. The Company took an active part in the associated consultations and debates.

Under the resulting new RIIO (revenue = incentives + innovation + outputs) model for regulation, price controls will be set for eight years (rather than five as at present), with provision for a mid-period review of the outputs that network companies are required to deliver. There will be increased involvement and influence for other stakeholders. A particular potential issue, to which the new regime may give rise, lies in the cash-flow impacts of a proposed shift in the treatment of regulatory depreciation to reflect economic asset lives, especially at a time when significant investment is likely to be needed. The RIIO model will first be applied in the transmission and gas distribution price control reviews that are currently underway and are due to be implemented in April 2013.

#### **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 the economy. The Company aims to enhance this relationship through wider involvement in the activities of, and dialogue with, the communities it serves.

The Company engages directly with the communities it serves to create a dialogue on quality of supply issues, the actions and investment planned to improve the quality of supply, the environmental and social implications of its operations and other opportunities to assist and engage in the life of the local communities. The Company seeks to engage disadvantaged groups in projects that bring about benefits for participants and communities by actively promoting participation and the development of transferable skills. This is underpinned by a small donation programme focused on the Company's key priorities for support for youth, education and the environment.

The Company recognises the importance of its service to customers and the economy and is committed to forging strong links with partners to improve its emergency response. The Company has strengthened its relationship with the Environment Agency and local authorities so that it can respond quickly when river levels rise. Once the Environment Agency issues a flood warning, the Company's database now identifies substations that are at risk so that staff can be deployed immediately to erect perimeter flood defences at major substation sites and portable defence barriers at lower-risk sites. The CE Group now employs a full-time Civil Contingency Co-ordinator who liaises with the Resilience Forums of those local authorities in the Company's distribution services area to ensure that its emergency response continues to improve.

Safety is a theme that unites every aspect of the Company's operations and it participates alongside other key organisations in Crucial Crew, which is a schools-based safety initiative that teaches children to recognise and avoid situations that put them in danger, such as climbing electricity pylons and fishing near power lines. The campaign is supported through an interactive website and mobile phone game.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Regulatory integrity (continued)**

##### **Corporate social responsibility (continued)**

In September 2010, the CE Group received an award under the Corporate Social Responsibility category of Ofgem's Customer Service Reward scheme for its work to assist customers installing air source heat pumps.

#### **Other directors' report requirements**

##### **Charitable and political donations**

During the Regulatory Year, charitable donations of £22,302 were made (2010: £58,625), principally to local charities serving the communities in which the Company operates. No contributions were made to political organisations (2010: 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, on which the Company invested £0.5m (Note 6 to the accounts), were:

- 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;
- Development of a successful competitive bid to the newly established Low Carbon Networks Fund, second tier. This project, which is being delivered in collaboration with several key UK technology providers, will trial novel technologies and approaches to the installation and use of low carbon technologies likely to be seen on the network in the near future and to explore the impact of such technologies on network planning, design and operation;
- Building on the successful, and still ongoing, field trials of newly developed superconducting fault limiters. A new project funded through the Low Carbon Networks Fund first tier has been instigated to implement this new technology at higher voltages and thus provide further technology options as alternatives to traditional engineering solutions for network constraints;
- Continuing to develop a suite of asset indices for improved asset management alongside a new integrated database and expert system to allow better decision making and improved exploitation of information gathered in previous projects;
- Having completed a project at Durham University to assess electrical network risk with the objective of improving decision making for network reinforcement and operation, the Company has successfully obtained further funding through the Knowledge Transfer Partnership programme to embed the learning developed within the organisation to ensure maximum business impact for the investment already made; and
- A new project, investigating demand side management impacts on network risk, which will also support the low carbon network activities is now underway.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (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 Company 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 Company's contractual and other legal obligations. The number of days purchases in trade creditors for the Company at 31 March 2011 was 40 (2010: 32).

##### **Future Developments**

The financial position of the Company, as at the Regulatory Year end, is shown in the statement of financial position on page 31.

The directors intend to intend to continue to develop the Company's business in a manner that concentrates on its core skills of electricity distribution by continuing to operate that business with the goal of out-performing the allowances in the distribution price control, while efficiently investing in the electricity distribution network with the aim of improving the quality of supply and service provided to its customers.

##### **Directors**

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

R Dixon	Non-Executive Director
T E Fielden	Finance Director, CE Electric UK
J M France	Regulation Director, CE Electric UK
N M Gill	Field Operations Director, CE Electric UK
P A Jones	President and Chief Executive Officer, CE Electric UK

During and as at the end of the Regulatory Year, none of the directors was interested in any contract which was significant in relation to the business of the Company.

##### **Auditors**

An elective resolution is in place dispensing with the need to appoint auditors annually. Deloitte LLP has indicated its willingness to continue in office.

##### **Going Concern**

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

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Other directors' report requirements (continued)**

##### **Going Concern (continued)**

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

- 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 the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Company is profitable with strong underlying cash flows and holds investment grade credit ratings; and
- The Company is financed by long-term borrowings with an average maturity of 18 years and has access to borrowing facilities provided by Lloyds TSB Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc.

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 annual report and 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"). These Regulatory Accounts have been prepared on a consistent basis with those for the regulatory year ended 31 March 2010.

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;
- 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.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Other directors' report requirements (continued)**

##### **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 S418 of the Companies Act 2006.

#### **Corporate Governance Statement**

Although the Company does not have equities 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.

##### **Compliance statement**

Set out below and in the review of the Regulatory 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, A3, 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 circumstances of the Company, given that the framework is agreed with MidAmerican and includes regular reporting to and meetings with the Chairman and senior management of MidAmerican, the presence of an independent non-executive director at board meetings of the Company 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 that the Company is a wholly-owned subsidiary of MidAmerican and, as mentioned above, the governance framework in place throughout the CE Group is agreed with MidAmerican.

#### **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.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Corporate Governance Statement (continued)**

##### **A Directors (continued)**

###### **Principle A1: The Board (continued):**

In addition, the President and Chief Executive Officer of the CE Group participates in weekly performance review meetings with the Chairman of 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 the Chairman of MidAmerican and the senior management team regarding the key, current issues facing the Company are discussed.

The Chairman of MidAmerican also receives weekly, monthly and quarterly reports on the Company's performance from the CE Group's President and Chief Executive 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 eight occasions in total during the Regulatory Year, with the attendance of those directors, who were directors as at 31 March 2011, being as follows:

R Dixon	Non-Executive Director	8
T E Fielden	Finance Director	8
J M France	Regulation Director	7
N M Gill	Field Operations Director	7
P A Jones	President and Chief Executive Officer	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. Further details of the management structure of the CE Group are provided in the directors' report.

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, while no significant areas of weakness have been identified, any recommended improvements are implemented. 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 in the review of business in the report of the directors.

A schedule of key delegations of authority has been approved by the board, which delegates authority for decision-making to senior and other managers in respect of issues such as capital expenditure, procurement, contractual, human resource and payment matters and for the conduct of claims and litigation. That schedule reserves decision-making to the directors above certain financial limits.

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



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Corporate Governance Statement (continued)**

##### **A Directors (continued)**

##### **Principle A1: The Board (continued):**

##### **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. Membership of the committee comprises:

T E Fielden	Finance Director
J M France	Regulation Director
N M Gill	Field Operations Director
P A Jones	President and Chief Executive Officer
A J Maclellan	Managing Director, Integrated Utility Services Limited
G M Earl	Head of Health, Safety and Environment

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, which are outlined in the directors' report, and comprises:

G E Abel	Chairman, MidAmerican
P Ainsley	Financial Controller
D Brady	Treasurer
T E Fielden	Finance Director
P J Goodman	Senior Vice President and Chief Financial Officer, MidAmerican
P A Jones	President and Chief Executive Officer
R D McHaddan	Assistant Treasurer
O Sutherland	Investor Reporting Manager

##### **Pensions Committee**

The Pensions Committee oversees the CE Group's approach to the pension schemes to which it contributes and comprises:

P Ainsley	Financial Controller
T E Fielden	Finance Director
J M France	Regulation Director
K Mawson	Head of Finance Development and Systems
A Patterson	Director of Human Resources
N Dawson	Pensions Manager
L Taylor	Director of Business Systems
L Tweedie	Head of Service Delivery

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Corporate Governance Statement (continued)**

##### **A Directors (continued)**

##### **Principle A1: The Board (continued):**

##### **Governance and Risk Management Group**

During the Regulatory Year the GRMG was 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 GRMG monitors and reviews the strategic risk environment, ensuring the continued suitability, adequacy and effectiveness of risk management arrangements and reports to the CE Group's Audit Committee. The GRMG comprises:

J P Barnett	Director of Customer Operations
R Dixon	Non-Executive Director
M Drye	Director of Asset Management
J Elliott	Company Secretary
T E Fielden	Finance Director
J M France	Regulation Director
N M Gill	Field Operations Director
A Patterson	Director of Human Resources
L Taylor	Director of Business System

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 attended meetings of the GRMG 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 directors' report.

As explained in Principles A4 and B1, the Company does not have a remuneration committee or a nomination committee.

##### **Principle A2: Chairman and Chief Executive**

During the Regulatory Year, the Company did not have a formally appointed Chairman or Chief Executive. However, in August 2011, the President and Chief Operating Officer of the CE Group was appointed as the President and Chief Executive Officer of the CE Group. In common with each of MidAmerican's business platforms, the President and Chief Executive Officer of the CE Group is responsible for the operation and management of the CE Group and reports directly to the Chairman of MidAmerican.

##### **Principle A3: Board balance and independence**

The board comprises four executive directors and Mr Dixon, a non-executive director, who, collectively, bring a range of skills and experience to the board. Although Mr Dixon is the sole non-executive director, so the board does not include a balanced number of executive and non-executive directors, the board believes that it possesses the skills and experience necessary to provide effective leadership, stewardship and control of the Company.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Corporate Governance Statement (continued)**

##### **A Directors (continued)**

###### **Principle A3: Board balance and independence (continued)**

The directors of the Company, as at the date of approval of the Regulatory Accounts, were as follows:

R Dixon	Non-Executive Director
T E Fielden	Finance Director
J M France	Regulation Director
N M Gill	Field Operations Director
P A Jones	President and Chief Executive Officer

###### **Principle A4: Appointment to the Board**

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

###### **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 are also able to 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. 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.

###### **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. MidAmerican 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 MidAmerican's goals.

###### **Principle A7: Re-election**

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

##### **B Remuneration**

###### **Principle B1: The level and make-up of remuneration**

The Company 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 Chairman of MidAmerican and the President and Chief Executive Officer. As the Company has no equity securities listed on the London Stock Exchange, it is not required to make directors' remuneration disclosures, other than those required for private companies.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **DIRECTORS' REPORT (CONTINUED)**

#### **Corporate Governance Statement (continued)**

#### **B Remuneration (continued)**

##### **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 Chairman of MidAmerican and the President and Chief Executive Officer. Mr Fielden, Dr France, Mr Gill and Dr Jones 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 review of the year provide a balanced and understandable assessment of the Company's position and prospects. The directors explain, at page 20, their responsibility for preparing the Regulatory Accounts, have reported, at page 20 in the directors' report, that the Company is a going concern and included the independent auditor's report to the Company at page 28 of the Regulatory Accounts.

##### **Principle C2: Internal Control**

The principal risks and uncertainties facing the Company and the key features of the internal control system, together with details of the issues addressed by the Company during the year, can be found at pages 3 to 6 of the directors' report.

##### **Principle C3: Audit committee and auditors**

The board of CE Electric UK Funding Company has established an audit committee for the CE Group, under delegated terms of reference, which include monitoring of the financial reporting process, the effectiveness of the internal control, internal audit and risk management systems, the statutory audit of the accounts, the independence of and the provision of additional services by the auditor.

The Audit Committee receives annual reports from the GRMG and from the CE Group's Head of Internal Audit on the work of the Internal Audit Section during the year and the audit plan for the following year. Combined Code provision C.3.1 states that the board should establish an audit committee of at least three independent non-executive directors and should satisfy itself that at least one member has recent and relevant financial experience. Mr Dixon was the Company's sole independent non-executive director during the Regulatory Year and the Audit Committee comprises:

R Dixon	Non-Executive Director
T E Fielden	Finance Director

The directors confirm that a small amount of fees were payable by the Company to Deloitte LLP in relation to non-audit services during the year. Details are given in note 6 to these Regulatory Accounts.

The internal control section on page 5 of the directors' report contains details of the Company's "speaking up" policy.

#### **D Relations with shareholders**

##### **Principle D1: Dialogue with Institutional 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.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**DIRECTORS' REPORT (CONTINUED)**

**Corporate Governance Statement (continued)**

**D Relations with shareholders (continued)**

**Principle D2: Constructive use of the AGM**

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.

By order of the board

A handwritten signature in black ink, appearing to read 'J Elliott', written over a horizontal line.

John Elliott  
Company Secretary

6 September 2011

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **INDEPENDENT AUDITORS' 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 2011 on pages 30 to 56 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Cash Flow Statement and the related notes numbered 1 to 26. These Regulatory Accounts have been prepared under the accounting policies set out 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 ("Statutory Accounts") and have not necessarily been prepared under the basis of International Financial Reporting Standards as endorsed by the European Union ("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 2006.

#### **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 in accordance with Condition 44 of the Regulatory Licence are set out in the statement of directors' responsibilities on page 20.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK & Ireland) issued by the 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 on pages 33 to 38, 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 business review, the directors' report, the corporate governance statement, and the statement of directors' responsibilities 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.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

#### **Basis of opinion**

We conducted our audit in accordance with International Standards on Auditing (UK & 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 United Kingdom Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the Statutory Accounts of the Company on which we reported on 23 March 2011, 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 Chapter 3 of Part 16 of the Companies Act 2006. 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.

#### **Audit opinion**

In our opinion

- the Regulatory Accounts of the Company present fairly in accordance with Standard Condition 44 of the Regulatory Licence and the accounting policies set out on pages 33 to 39 the financial position of the Company as at 31 March 2011 and of its financial performance and cashflows for the year then ended; and
- have been properly prepared in accordance with Standard Condition 44 and the Company's accounting policies.

*Deloitte LLP*

#### **Deloitte LLP**

Chartered Accountants and Registered Auditors  
Newcastle upon Tyne

13 September 2011

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2011**

	Notes	2011 £m	2010 £m
Revenue	3	268.3	231.0
Cost of sales		<u>(7.4)</u>	<u>(6.2)</u>
<b>Gross profit</b>		260.9	224.8
Distribution costs		(74.5)	(71.5)
Administrative expenses		<u>(55.1)</u>	<u>(58.5)</u>
<b>Operating profit</b>	6	131.3	94.8
Profit on disposal of property, plant and equipment		0.2	0.2
Investment income	4	0.1	-
Finance costs	5	<u>(26.0)</u>	<u>(23.2)</u>
<b>Profit before tax</b>		105.6	71.8
Income tax expense	9	<u>(19.8)</u>	<u>(20.0)</u>
<b>Profit for the financial year</b>		<u>85.8</u>	<u>51.8</u>

All activities relate to continuing operations.

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2011**

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

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2011**

	Share Capital £m	Retained Reserves £m	Total Equity £m
At 1 April 2009	200.0	155.2	355.2
Comprehensive income for the year	-	51.8	51.8
Dividends paid	<u>-</u>	<u>(20.0)</u>	<u>(20.0)</u>
At 1 April 2010	200.0	187.0	387.0
Comprehensive income for the year	-	85.8	85.8
Dividends paid	<u>-</u>	<u>(20.0)</u>	<u>(20.0)</u>
At 31 March 2011	<u>200.0</u>	<u>252.8</u>	<u>452.8</u>



**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2011**

	Notes	2011 £m	2010 £m
<b>Non-current assets</b>			
Property, plant and equipment	11	1,493.3	1,414.1
Intangibles	12	3.7	4.4
		<u>1,497.0</u>	<u>1,418.5</u>
<b>Current assets</b>			
Inventories	14	7.4	6.3
Cash and cash equivalents		28.1	-
Trade and other receivables	15	41.7	38.2
		<u>77.2</u>	<u>44.5</u>
<b>Total assets</b>		<u>1,574.2</u>	<u>1,463.0</u>
<b>Current liabilities</b>			
Trade and other payables	16	(62.6)	(46.9)
Current income tax liabilities	16	(18.6)	(10.6)
Borrowings	17	(10.0)	(116.3)
Deferred revenue	19	(13.7)	(12.6)
Provisions	20	(1.3)	(1.1)
		<u>(106.2)</u>	<u>(187.5)</u>
<b>Net current liabilities</b>		<u>(29.0)</u>	<u>(143.0)</u>
<b>Non-current liabilities</b>			
Borrowings	17	(466.5)	(347.6)
Deferred income tax liabilities	18	(127.2)	(137.7)
Deferred revenue	19	(420.4)	(402.2)
Provisions	20	(1.1)	(1.0)
		<u>(1,015.2)</u>	<u>(888.5)</u>
<b>Total liabilities</b>		<u>(1,121.4)</u>	<u>(1,076.0)</u>
<b>Net assets</b>		<u>452.8</u>	<u>387.0</u>
<b>Equity</b>			
Share capital	21	200.0	200.0
Retained earnings		252.8	187.0
<b>Total equity</b>		<u>452.8</u>	<u>387.0</u>

The financial statements were approved by the board of directors and authorised for issue on 6 September 2011 and were signed on its behalf by:



T E Fielden  
Director

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2011**

	Notes	2011 £m	2010 £m
<b>Net cash from operating activities</b>	22	<u>120.4</u>	<u>91.6</u>
<b>Investing activities</b>			
Purchase of property, plant and equipment		(123.7)	(124.2)
Purchase of intangible assets		(0.8)	(0.4)
Proceeds from disposals of property, plant and equipment		0.2	0.2
Receipt of customer contributions		<u>40.2</u>	<u>33.1</u>
<b>Net cash used in investing activities</b>		<u>(84.1)</u>	<u>(91.3)</u>
<b>Financing activities</b>			
Equity dividends paid		(20.0)	(20.0)
Repayment of borrowings		(25.0)	(13.0)
New borrowings		119.0	-
Movement in loans from Group undertaking		<u>(82.2)</u>	<u>32.7</u>
<b>Net cash used in financing activities</b>		<u>(8.2)</u>	<u>(0.3)</u>
<b>Net increase in cash and cash equivalents</b>		28.1	-
<b>Cash and cash equivalents at beginning of year</b>		<u>-</u>	<u>-</u>
<b>Cash and cash equivalents at end of year</b>		<u>28.1</u>	<u>-</u>

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **NOTES TO THE ACCOUNTS - 31 MARCH 2011**

#### **1 GENERAL INFORMATION**

Northern Electric Distribution Limited is a company originally 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 financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The financial statements 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 Companies Act 2006 (the "Act") that are applicable to companies reporting under IFRS.

The accounts have been prepared under the historical cost convention. The Company has relied upon Section 400 of the Act and has presented the accounts for the Company as an individual undertaking only and not as a Group undertaking.

##### **Going Concern**

The directors have, at the time of approving the financial statements, 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 financial statements. Further detail is contained within the Directors Report on page 19.

##### **Judgments in applying accounting policies and key sources of estimation uncertainty**

Many of the amounts included in the financial statements involve the use of judgment and/or estimation. These judgments 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 judgments 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 judgment 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.

##### **Critical accounting policies**

The critical accounting policies adopted by the directors relate to property, plant and equipment, taxation, pensions and revenue and are described below. The accounting policies have been applied consistently throughout the year and the preceding year.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

#### **2 ACCOUNTING POLICIES (CONTINUED)**

##### **Adoption of new or revised standards**

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these financial statements.

##### Standards affecting presentation and disclosure

IFRS 8              Operating Segments – Amendments to IFRS 8

The amendments to IFRS 8 clarify the requirements with respect to the measurement of assets for each reportable business segment. This change has not led to any change in the disclosures contained within these financial statements. Further detail can be found in note 3 to the accounts.

##### Standards affecting the reported results and the financial position

IAS 17              Leases – Amendments to IAS 17  
IFRIC 18            Transfer of Assets from Customers

The amendments to IAS 17 relate to the categorisation of leased land as an operating or a finance lease. These amendments have not had a material impact on these financial statements.

IFRIC 18 is an interpretation which applies to utility companies that have received assets or funds to build assets on behalf of their customers. The interpretation aims to ensure that these assets are reflected in the balance sheet of those companies. The adoption of IFRIC 18 has not had a material impact on these financial statements.

##### **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.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

#### **2 ACCOUNTING POLICIES (CONTINUED)**

##### **Revenue (continued)**

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.

Dividend income from investments is recognised when the shareholders' rights to receive payment have 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 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 2011 (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
Distribution generation.....	15 years
Metering equipment included in distribution system assets .....	up to 6 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, although historically, few changes to estimated useful lives have been required.

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 2011 (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 2011 (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 uncollectable, 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"). The Northern Electric Group of the ESPS 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 Northern Electric Group of the ESPS as if it were a defined contribution scheme. Contributions to the Northern Electric Group of the ESPS are charged to the income statement or capitalised as appropriate. The capital costs 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 defined contribution 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.

#### **3 REVENUE**

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief Executive Officer of the CE Electric UK Funding Company group of companies (the "CE Group") to allocate resources to these segments and to assess their performance.



# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

### 3 REVENUE (CONTINUED)

In practice, the President and Chief Executive Officer allocates resources and assesses performance based upon the aggregate results of the Company and Yorkshire Electricity Distribution plc, another distribution network operator in the CE Group, suggesting that no segmental reporting is required.

Revenue is all in respect of sales to United Kingdom customers.

A requirement has been introduced into the Company's distribution licence to publish certain segmental information in the Regulatory Accounts, as follows:

	Distribution 2010/11 £m	Distributed Generation 2010/11 £m	Excluded Services 2010/11 £m	Metering 2010/11 £m	De Minimis 2010/11 £m	Total 2010/11 £m
<b>INCOME STATEMENT</b>						
Sales	246.0	(0.8)	2.0	4.8	16.3	268.3
Cost of sales	(6.0)	-	(0.9)	-	(0.5)	(7.4)
Gross profit	<u>240.0</u>	<u>(0.8)</u>	<u>1.1</u>	<u>4.8</u>	<u>15.8</u>	<u>260.9</u>
Distribution costs	(69.7)	(0.9)	(0.2)	(3.7)	-	(74.5)
Administration costs	(39.1)	-	(0.5)	(0.1)	(15.4)	(55.1)
Operating profit	<u>131.2</u>	<u>(1.7)</u>	<u>0.4</u>	<u>1.0</u>	<u>0.4</u>	<u>131.3</u>
<b>OTHER INFORMATION</b>						
Capital tangible additions	112.5	9.6	3.8	1.1	-	127.0
Capital intangible additions	<u>0.7</u>	<u>0.1</u>	<u>0.1</u>	<u>-</u>	<u>-</u>	<u>0.9</u>

As this licence condition applies only for the regulatory year 2010/11 onwards, no comparative figures have been provided within this note to the Regulatory Accounts.

### 4 INVESTMENT INCOME

	2011 £m	2010 £m
Interest receivable from Group undertakings	0.1	-
	<u>0.1</u>	<u>-</u>

### 5 FINANCE COSTS

	2011 £m	2010 £m
Interest payable on loans from Group undertakings	24.4	23.0
Interest payable on other loans	<u>1.6</u>	<u>0.2</u>
	<u>26.0</u>	<u>23.2</u>

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

**6 OPERATING PROFIT**

	2011 £m	2010 £m
This is stated after charging/(crediting):		
Staff costs (Note 7)	35.8	37.3
Research costs	0.5	0.4
Depreciation of property, plant and equipment	47.9	44.6
Amortisation of deferred revenue	(12.6)	(12.0)
Amortisation of intangibles	1.6	1.5
Impairment loss on trade and other receivables	0.1	0.1
	<hr/>	<hr/>
Analysis of auditors' remuneration is as follows:	2011 £000	2010 £000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	60	60
Other services supplied pursuant to legislation	49	45
Other assurance services	5	-
	<hr/>	<hr/>

Other services supplied pursuant to legislation relate to regulatory reporting in line with Ofgem's requirements.

**7 STAFF COSTS**

	2011 £m	2010 £m
Salaries	37.3	36.6
Social security costs	3.2	3.2
Defined benefit pension costs	27.3	28.4
Defined contribution pension costs	0.1	0.1
	<hr/>	<hr/>
	67.9	68.3
Less charged to property, plant and equipment	(32.1)	(31.0)
	<hr/>	<hr/>
	35.8	37.3
	<hr/>	<hr/>

The majority of the Company's employees are members of the Northern Electric Group of the ESPS, details of which are given in Note 23.

The average monthly number of employees during the year was:

	2011 No.	2010 No.
Technical	233	237
Industrial	465	467
Administration	201	197
Other	65	62
	<hr/>	<hr/>
	964	963
	<hr/>	<hr/>

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

**8 DIRECTORS' & KEY PERSONNEL REMUNERATION**

DIRECTORS' REMUNERATION	2011 £	2010 £
<u>Highest Paid</u>		
Short-term employee benefits	139,889	132,325
Post employment benefits	10,977	9,409
Other long-term benefits	145,860	59,454
	<u>296,726</u>	<u>201,188</u>
<u>Total</u>		
Short-term employee benefits	381,240	386,121
Post employment benefits	74,359	95,939
Other long-term benefits	274,985	153,903
	<u>730,584</u>	<u>635,963</u>
Directors who are members of the defined benefit scheme	<u>3</u>	<u>3</u>
Accrued pension benefit relating to highest paid director	<u>-</u>	<u>-</u>
 OTHER KEY PERSONNEL REMUNERATION	 2011 £	 2010 £
<u>Total</u>		
Short-term employee benefits	289,131	277,420
Post employment benefits	61,332	74,318
Other long-term benefits	102,350	24,906
	<u>452,813</u>	<u>376,644</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 2011 (CONTINUED)**

**9 INCOME TAX EXPENSE**

	2011	2010
	£m	£m
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	10.5	9.2
Payments for use of group losses	17.6	8.8
Under/(over) provision for prior years	2.2	(1.0)
Total current tax charge	30.3	17.0
Deferred tax:		
Deferred tax (income)/expense relating to the origination and reversal of temporary differences	(0.7)	3.0
Effect of changes in legislation	(9.8)	-
Total deferred tax (credit)/charge	(10.5)	3.0
Tax on profit before tax	19.8	20.0
The total charge can be reconciled to the accounting profit as follows:		
Profit before tax	105.6	71.8
Tax on profit before tax at standard rate of corporation tax in United Kingdom of 28%	29.6	20.1
Effect of changes in tax rate	(9.8)	-
Over provision for prior years	-	(0.1)
Tax on profit before tax	19.8	20.0

The Finance Act 2010 included a provision that the standard rate of corporation tax in the United Kingdom would reduce from 28% to 27% from 1 April 2011. This was superceded when the Government announced in the Budget Report, on 23 March 2011, that the main rate of corporation tax would instead be reduced from 28% to 26% from 1 April 2011. This reduction was substantively enacted on 29 March 2011 and, accordingly, this rate has been applied when calculating the deferred tax liability at 31 March 2011.

The Finance Act 2011 also includes a further reduction in the corporation tax rate to 25% with effect from 1 April 2012 and this element was substantively enacted on 5 July 2011. The Government has also announced that it intends to further reduce the main rate of corporation tax by 1% per annum to 23% by 1 April 2014. As these rate reductions were not substantively enacted by the balance sheet date they are not reflected in the financial statements.

**10 DIVIDENDS**

	2011	2010	2011	2010
	Pence per share	Pence per share	£m	£m
Dividend paid	10.0	10.0	20.0	20.0

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

**11 PROPERTY, PLANT AND EQUIPMENT**

	Distribution system £m	Fixtures and Equipment £m	Total £m
<b>COST</b>			
At 1 April 2009	1,527.1	16.4	1,543.5
Additions	117.7	1.9	119.6
Disposals	(4.8)	(0.2)	(5.0)
At 1 April 2010	1,640.0	18.1	1,658.1
Additions	124.5	2.6	127.1
Disposals	(4.2)	(1.3)	(5.5)
At 31 March 2011	<u>1,760.3</u>	<u>19.4</u>	<u>1,779.7</u>
<b>ACCUMULATED DEPRECIATION</b>			
At 1 April 2009	190.2	14.2	204.4
Charge for the year	43.1	1.5	44.6
Disposals	(4.8)	(0.2)	(5.0)
At 1 April 2010	228.5	15.5	244.0
Charge for the year	46.4	1.5	47.9
Disposals	(4.2)	(1.3)	(5.5)
At 31 March 2011	<u>270.7</u>	<u>15.7</u>	<u>286.4</u>
Net book value at 31 March 2011	<u>1,489.6</u>	<u>3.7</u>	<u>1,493.3</u>
Net book value at 31 March 2010	<u>1,411.5</u>	<u>2.6</u>	<u>1,414.1</u>
Assets in the course of construction included above:			
At 1 April 2009	74.9	-	74.9
Additions	117.7	-	117.7
Available for use	(144.5)	-	(144.5)
At 1 April 2010	48.1	-	48.1
Additions	124.5	-	124.5
Available for use	(108.6)	-	(108.6)
At 31 March 2011	<u>64.0</u>	<u>-</u>	<u>64.0</u>

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £13.2m (2010: £16.0m).

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

### 12 INTANGIBLES

	Software Development Costs £m
<b>COST</b>	
At 1 April 2009	17.8
Additions	0.4
	<hr/>
At 1 April 2010	18.2
Additions	0.9
	<hr/>
At 31 March 2011	<hr/> <b>19.1</b>
<b>AMORTISATION</b>	
At 1 April 2009	12.3
Charge for the year	1.5
	<hr/>
At 1 April 2010	13.8
Charge for the year	1.6
	<hr/>
At 31 March 2011	<hr/> <b>15.4</b>
Net book value at 31 March 2011	<hr/> <b>3.7</b>
Net book value at 31 March 2010	<hr/> <b>4.4</b>

### 13 INVESTMENTS

Details of the principal investments of the Company at 31 March 2011 are listed below:

Name of Company	Country of Registration		Holding of Ordinary Shares	Proportion	Nature of Business
Electralink Limited	England Wales	and	619 at 10p	6.7%	Data transfer network operator
MRA Service Company Limited	England Wales	and	1 at £1	1.0%	Governance of the electricity industry's Master Registration Agreement
DCUSA Limited	England Wales	and	1 at £1	2.0%	Management and governance of the Distribution Connection and Use of System Agreement
Northern Electric Finance plc	England Wales	and	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 (2010: £62), MRA Service Company Limited £1 (2010: £1), DCUSA Limited £1 (2010: £1) and Northern Electric Finance plc £50,000 (2010: £50,000).

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****14 INVENTORIES**

	2011 £m	2010 £m
Raw materials and consumables	7.2	6.1
Work in progress	0.2	0.2
	<u>7.4</u>	<u>6.3</u>

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

	2011 £m	2010 £m
Distribution use of system receivables	38.0	32.3
Amounts receivable from sale of goods and services	1.5	1.5
Prepayments and accrued income	2.1	1.0
Other receivables	0.1	3.4
	<u>41.7</u>	<u>38.2</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 exposure to risk to the Company is the book value of these receivables less any provisions for impairment.

**Distribution use of system receivables**

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 30% of distribution revenues in 2011 (2010: 32%). 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 are customer deposits of £1.5m as at March 2011 (2010: £1.5m).

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 is 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. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £0.3m, which have been placed into administration and have therefore been provided in full at the year end (2010: £0.2m)

**Amounts receivable from sale of goods and services**

Sales of goods and services comprise all income streams which are not classified as UoS income. Examples of non-UoS income streams would be service alterations/disconnections and recovery of amounts for damage caused by third parties to the distribution system.

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.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****15 OTHER FINANCIAL ASSETS (CONTINUED)****Amounts receivable from sale of goods and services (continued)**

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.7m (2010: £0.7m) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.4m (2010: £0.1m) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 302 days (2010: 342 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.3m (2010: £0.3m). These amounts are past due at the reporting date and the Company has not provided for any amounts as not being recoverable because 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 69 days (2010: 67 days).

Ageing of past due but not impaired receivables

	2011 £m	2010 £m
30-60 days	0.2	0.2
60-120 days	-	0.1
120-210 days	0.1	-
Total	<u>0.3</u>	<u>0.3</u>

**Movement in the allowance for doubtful debts**

	£m
At 1 April 2010	0.3
Amounts recognised in income statement	<u>0.1</u>
At 31 March 2011	<u>0.4</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 (2010: £0.2m), 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 2011 (CONTINUED)**

**15 OTHER FINANCIAL ASSETS (CONTINUED)**

**Categories of financial assets**

	2011 £m	2010 £m
Loans and receivables at amortised cost	67.7	37.2
Total financial assets	67.7	37.2
Non current assets	1,497.0	1,418.5
Inventories	7.4	6.3
Prepayments and accrued income	2.1	1.0
Total non-financial assets	1,506.5	1,425.8
Total Assets	1,574.2	1,463.0

**16 OTHER FINANCIAL LIABILITIES**

**Trade and other payables**

	2011 £m	2010 £m
Payments received on account	30.8	22.7
Trade payables	5.0	4.2
Amounts owed to Group undertakings	0.3	0.3
Other taxes and social security costs	8.3	5.2
Accruals	13.4	13.2
Other payables	4.8	1.3
	62.6	46.9

**Current income tax liabilities**

	2011 £m	2010 £m
Corporation Tax	12.1	8.8
Group Relief	6.6	1.8
	18.7	10.6

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.

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

### 16 OTHER FINANCIAL LIABILITIES (CONTINUED)

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities included in Note 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
2011:					
Non-interest bearing	34.3	-	-	-	34.3
Variable interest rate liability	-	-	-	-	-
Fixed interest rate liability	2.6	24.9	110.0	799.9	937.4
	<u>36.9</u>	<u>24.9</u>	<u>110.0</u>	<u>799.9</u>	<u>971.7</u>
2010:					
Non-interest bearing	24.2	-	-	-	24.2
Variable interest rate liability	107.2	-	-	-	107.2
Fixed interest rate liability	2.6	19.9	89.9	688.1	800.5
	<u>134.0</u>	<u>19.9</u>	<u>89.9</u>	<u>688.1</u>	<u>931.9</u>

### Categories of financial liabilities

	2011 £m	2010 £m
Loans and payables at amortised cost	<u>486.6</u>	<u>469.7</u>
Total financial liabilities	<u>486.6</u>	<u>469.7</u>
Payments received on account	30.8	22.7
Income tax liabilities	145.8	148.3
Other taxes and social security	8.3	5.2
Accruals	13.4	13.2
Deferred Revenue	434.1	414.8
Provisions	<u>2.4</u>	<u>2.1</u>
Total non-financial liabilities	<u>634.8</u>	<u>606.3</u>
Total liabilities	<u>1,121.4</u>	<u>1,076.0</u>

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

### 17 BORROWINGS

The Directors consideration of liquidity, interest rate and foreign currency risk is described in detail in the Directors Report on pages 9 and 10.

	Book value		Fair value	
	2011	2010	2011	2010
	£m	£m	£m	£m
Loans	119.6	25.0	120.6	25.0
Amounts owed to Group undertakings	356.9	438.9	383.8	456.1
	<u>476.5</u>	<u>463.9</u>	<u>504.4</u>	<u>481.1</u>
The borrowings are repayable as follows:				
On demand or within one year	10.0	116.3	10.0	116.3
After five years	466.5	347.6	494.4	364.8
	<u>476.5</u>	<u>463.9</u>	<u>504.4</u>	<u>481.1</u>
Analysis of borrowings:				
Short term loan	-	25.0	-	25.0
Inter-company short term loan	-	82.2	-	82.2
Northern Electric Finance plc 2020 – 8.875%	104.1	104.0	133.7	129.2
Northern Electric Finance plc 2035 - £50m 5.125%	50.0	49.9	49.2	48.2
Yorkshire Electricity Group plc 2037 – 5.9%	101.5	101.5	105.9	103.7
Northern Electric Finance plc 2037 – 5.125%	101.3	101.3	95.0	92.8
European Investment Bank 2018 – 4.065%*	40.2	-	10.0	-
European Investment Bank 2019 – 4.241%*	40.2	-	10.0	-
European Investment Bank 2020 – 4.386%*	39.2	-	10.0	-
	<u>476.5</u>	<u>463.9</u>	<u>504.4</u>	<u>481.1</u>

The fair value of the external borrowings is determined with reference to quoted market prices. The directors' estimates of the fair value of internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments.

Interest on the inter-company short-term loan is charged at base rate and on short-term loans 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 £0.2m per year. This is considered to be an acceptable level of risk. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

\* The borrowings from the European Investment Bank were drawn down in twelve tranches, repayable in 2018, 2019 and 2020. The interest rates shown above are average rates for those repayment dates. The spread of interest rates are as follows:

2018: 3.901% - 4.283%  
 2019: 4.077% - 4.455%  
 2020: 4.227% - 4.586%

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****17 BORROWINGS (CONTINUED)**

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

The covenants associated with the 2035 bonds issued by Northern Electric Finance plc, a wholly-owned subsidiary of the Company, 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 adjustments and unamortised issue costs.

The Company's Senior Total Net Debt as at 31 March 2011 totalled £439.4m. Using the RAV value as at March 2011, as outlined by Ofgem in its Final Proposals for Distribution Prices published in December 2009, 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 31 March 2011 of £963.5m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 45.6%.

At 31 March 2011, the Company had available £79.0m (2010: £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 2009	135.1	(0.4)	134.7
Charge to income statement	2.9	0.1	3.0
At 1 April 2010	138.0	(0.3)	137.7
(Credit)/charge to income statement	(10.6)	0.1	(10.5)
At 31 March 2011	127.4	(0.2)	127.2

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 2009	402.2
Additions	24.6
Amortisation	(12.0)
At 1 April 2010	414.8
Additions	31.9
Amortisation	(12.6)
At 31 March 2011	434.1

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

### 19 DEFERRED REVENUE (CONTINUED)

	2011 £m	2010 £m
Included in current liabilities	13.7	12.6
Included in non-current liabilities	420.4	402.2
	<u>434.1</u>	<u>414.8</u>

Deferred revenue represents contributions from customers made in advance towards distribution system assets. This income is released to the income statement over 15 - 45 years on a straight line basis, in line with the useful economic life of the distribution system assets.

### 20 PROVISIONS

	Claims £m	Other £m	Total £m
At 1 April 2009	1.3	1.0	2.3
Utilised/paid in the year	(0.9)	0.1	(0.8)
Charged to the income statement	<u>0.6</u>	<u>-</u>	<u>0.6</u>
At 1 April 2010	1.0	1.1	2.1
Utilised/paid in the year	(0.9)	(0.2)	(1.1)
Charged to income statement	<u>1.4</u>	<u>-</u>	<u>1.4</u>
At 31 March 2011	<u>1.5</u>	<u>0.9</u>	<u>2.4</u>
		2011 £m	2010 £m
Included in current liabilities		1.3	1.1
Included in non-current liabilities		<u>1.1</u>	<u>1.0</u>
		<u>2.4</u>	<u>2.1</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. Costs are expected to be incurred over the next 20 years.

### 21 SHARE CAPITAL

	2011 No./£	2010 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 carries no right to fixed income.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****22 NET CASH FROM OPERATING ACTIVITIES**

	2011 £m	2010 £m
Operating profit	131.3	94.8
Depreciation and amortisation	49.4	46.1
Amortisation of deferred revenue	(12.6)	(12.0)
Increase/(decrease) in provisions	0.3	(0.2)
Operating cash flows before movements in working capital	168.4	128.7
(Increase)/decrease in inventories	(1.1)	1.0
Increase in receivables	(6.4)	(2.6)
Increase in payables	6.8	2.2
Cash generated by operations	167.7	129.3
Group relief paid	(12.8)	(7.0)
Corporation tax paid	(9.5)	(6.7)
Interest received	0.1	-
Interest paid	(25.1)	(24.0)
Net cash from operating activities	120.4	91.6

**23 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 was made available to new employees from that date.

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

The last full actuarial valuation of the Northern Electric Group of the ESPS was carried out by the Group Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2010. 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 and post-retirement returns would exceed future pension increases by 2.8% per annum.

The total market value of the assets of the Northern Electric Group of the ESPS, at the date of the actuarial valuation, was £983m and the actuarial valuation showed that the value of the assets represented 78% of the amount needed to pay Group benefits i.e. the value of the technical provisions. This represents a shortfall of assets compared to the value of accrued benefits of £276m. 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.

## NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

### NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)

#### 23 PENSION COMMITMENTS (CONTINUED)

The CE Group reached agreement during June 2011 with the Group Trustees to repair this deficit over the fifteen year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2010 being borne out in practice. The agreement includes cash payments of £29.9m per annum made on a monthly basis for the first five years of the recovery plan, and increased for indexation followed by an agreed profile of payments to be made over the remaining ten years of the recovery plan. Of these annual payments, £20.7m will be paid by the Company. The deficit repair payments are made in addition to the normal employer contributions.

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, were 41.9% for certain senior management and 23.5% for other employees up to 30 June 2011 and 47.0% and 29.4% respectively from 1 July 2011. These rates will remain in place until such a time as a new schedule of contributions is agreed between the trustees of the Northern Electric Group of the ESPS and the Company as part of the next triennial valuation process.

The money purchase pension scheme is also accounted for as a defined contribution scheme.

The Company pension cost for the year ended 31 March 2011 was £27.4m (2010: £28.5m).

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

Principal assumptions:

	2011 Projected unit	2010 Projected unit
Valuation method		
Discount rate	5.50%	5.60%
Inflation rate	3.20%	3.30%
Increase to pensions	3.20%	3.30%
Increase to deferred benefits	3.20%	3.30%
Salary increases	3.20%	3.00%*

\* assumed for the first 5 years then 3.30% p.a. thereafter

The mortality assumptions used in the triennial actuarial valuation as at 31 March 2011 were based on the recent actual mortality experience of members within the CE Group and also allow for future mortality improvements. The assumption is that a member currently aged 60 will live for a further 27.9 years, if he is male, and for a further 28.0 years, if she is female. For a member who retires in 2026 at age 60 the assumptions are that they will live on average for a further 29.5 years after retirement if they are male and for a further 29.7 years after retirement 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.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)**

**23 PENSION COMMITMENTS (CONTINUED)**

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

	2011 £m	2010 £m
Opening defined benefit obligation	1,023.2	830.4
Current service cost	9.8	7.4
Interest cost	56.4	54.5
Contributions from employees	3.0	3.0
Actuarial gains	48.4	171.8
Benefits paid	(43.8)	(43.9)
Closing defined benefit obligation	<u>1,097.0</u>	<u>1,023.2</u>

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

	2011 £m	2010 £m
Opening fair value of plan assets	981.8	755.1
Expected returns	63.2	51.5
Actuarial gains	4.6	172.0
Contributions by employer	36.4	44.1
Contribution from employees	3.0	3.0
Benefits paid	(43.8)	(43.9)
Closing fair value of plan assets	<u>1,045.2</u>	<u>981.8</u>

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

	Long term rates of return expected at		Value	
	2011 %	2010 %	2011 £m	2010 £m
Equities	8.5	8.5	338.8	364.5
Gilts	4.8	5.1	604.3	531.0
Cash	4.4	4.5	6.0	0.3
Property	8.2	8.5	96.1	86.0
Total fair value of scheme assets			<u>1,045.2</u>	<u>981.8</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 £48.6m to its defined benefit plan in 2011, including £31.3m of pension deficit repair costs.



**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****24 OPERATING LEASE ARRANGEMENTS**

	2011 £m	2010 £m
Minimum lease payments under operating leases recognised in the year	<u>4.6</u>	<u>6.5</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:

	2011 £m	2010 £m
Within one year	4.1	4.4
In the second to fifth year inclusive	14.2	13.4
After five years	<u>13.1</u>	<u>15.2</u>
	<u>31.4</u>	<u>33.0</u>

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

**25 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 2011 was nil (2010: nil).

The Company has received loans from other companies in the CE Group. The total interest included in finance costs in the income statement for the year ended 31 March 2011 was £24.4m (2010: £23.0m). Included within borrowings is £356.9m as at 31 March 2011 (2010: £438.9m).

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 MARCH 2011 (CONTINUED)****25 RELATED PARTY TRANSACTIONS (CONTINUED)**

The Company entered into transactions, in the ordinary course of business, with affiliated companies. Transactions entered into and trading balances outstanding at the year end were as follows:

Related Party	Sales to Related Party  £m	Purchases from Related Party  £m	Amounts Owed to Related Party (Note 16) £m
2011:			
CE Insurance Services Limited	-	0.5	-
Integrated Utility Services Limited	0.4	0.1	-
Integrated Utility Services Limited (registered in Eire)	-	0.5	-
Northern Electric plc	0.2	4.9	-
Northern Electric Properties Limited	-	0.7	-
Yorkshire Electricity Distribution plc	14.7	8.9	-
Vehicle Lease and Service Limited	-	3.1	0.3
2010:			
CE Insurance Services Limited	-	0.5	-
Integrated Utility Services Limited	0.4	0.3	-
Integrated Utility Services Limited (registered in Eire)	-	0.5	-
Northern Electric plc	0.1	5.4	-
Northern Electric Properties Limited	-	0.7	-
Yorkshire Electricity Distribution plc	13.8	8.4	-
Vehicle Lease and Service Limited	-	3.1	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

**26 IMMEDIATE PARENT UNDERTAKING 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.