

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**REGULATORY ACCOUNTS**

**FOR THE YEAR ENDED**

**31 MARCH 2014**

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

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for the Year Ended 31 March 2014**

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## NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

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

### 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.

### STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014

The directors present the Regulatory Accounts for the year ended 31 March 2014 (the "Regulatory Year") of Northern Powergrid (Northeast) Limited (the "Company"), which include the strategic report, directors' report, 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 for the year ended 31 December 2013, which were drawn up and presented in accordance with the Companies Act 2006.

### BUSINESS MODEL

The Company is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group") and, as a distribution network operator ("DNO"), distributes electricity to approximately 1.6 million customers connected to its electricity distribution network within its distribution services area in the northeast of England, which extends from North Northumberland, south to York and west to the Pennines. The Company's distribution network of transformers, switchgear and overhead and underground cables receives electricity from generators connected to it and from the National Grid's transmission system and distributes that electricity at voltages of up to 132kV. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State.

The main classes of asset, which make up the Company's distribution network, include:

<u>Asset class</u>	<u>Approximate number</u>
Total circuit length (underground and overhead)	40,787 kilometres
Ground-mounted distribution substations	10,703
Pole-mounted distribution substations	16,122
Major substations	251
LV services (overhead)	152,000
LV services (underground)	1.4 million

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **BUSINESS MODEL (CONTINUED)**

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

<b>Principle</b>	<b>Strategy</b>	<b>Indicator</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, dependability, 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, system investment and maintenance.	Effective asset management, managing commercial risk and improving network resilience and performance.
Employee commitment	Equipping employees with the resources and support they need to operate successfully and in a safe and rewarding work 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 applicable laws, regulations, standards and policies.	Strong internal controls, regulatory engagement and industry influence.

#### **Strategic objectives**

The Company's strategic objectives are based on the Core Principles, remain consistent 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 shaping the future direction of the electricity distribution 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 to major incidents on the network in times of severe weather and caring for its local environment.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **REVIEW OF THE REGULATORY YEAR**

The Company delivered a satisfactory financial performance for the Regulatory Year, which benefited from a further change to the rate of taxation and continued effective cost control. However, that performance fell slightly short of plan due to a rebate of £15.5 million, which the Company made to the electricity suppliers as part of the Government-led initiative to assist domestic customers with their energy bills and will be recovered by the Company in future years.

Ofgem finalised its price control policies early in 2013 in respect of the next regulatory period, which will run from 1 April 2015 to 31 March 2023 and is known as ED1. One of the main priorities for the Company in the Regulatory Year, therefore, was the preparation of its well-justified business plan, which was submitted for Ofgem's consideration on 28 June 2013. Ofgem announced on 22 November 2013 that it had decided that the Company's plan was not to proceed on the "fast track" and, while recognising that the Company had submitted a strong plan, had certain reservations about the future cost efficiency and asset replacement elements. Although the Company was disappointed by that decision, most if not all of the commitments made in its plan will stand and, in order to deliver on those commitments, work has already begun to change the way the Company operates. Following Ofgem's decision, the Company revisited its plan and provided Ofgem with a revised version including further justification of the associated costs on 17 March 2014. Ofgem is expected to issue its draft determination by the end of July 2014. A final decision is expected by December 2014 and, on conclusion of the process, the Company's revenues will be set for the period from 2015 to 2023.

Continuing with its policy to invest efficiently in its electricity distribution network, the Company delivered its largest ever capital expenditure programme in the year to 31 December 2013 such that, during the Regulatory Year, the Company invested £207.8 million in the network, exceeded its investment in the regulatory year to 31 March 2013 and remains well-placed in respect of the outputs it intends to deliver by the end of the current Distribution Price Control period to 31 March 2015 ("DPCR5").

In the first quarter of 2014, the Department of Energy and Climate Change and Ofgem began reviews of the performance of the DNOs affected by the severe weather experienced over the Christmas 2013 period so that future responses to such incidents can be improved and, therefore, the inconvenience to the affected customers can be minimised as far as possible. Although the Company's network was not adversely affected by the severe weather over the Christmas 2013 period, it did experience disruption as a result of the tidal surges along the Northeast coast in early December 2013. The Company is actively involved in both reviews and is supporting the industry exercise to create a single, national telephone number, which customers can use to contact their DNO if their power supply is affected as a result of such an incident. The Company also recognises the need to improve the ways in which it communicates with its customers via both traditional methods and social media and is playing a central role in taking forward changes to the industry arrangements necessary for the DNOs to have access to better customer contact information that can be used to provide more proactive information during times of severe weather.

The Company continued to design and deliver initiatives to improve the quality of service provided to its customers and, while recognising that improvements still have to be made in order to meet its targets, maintained the upward trend in its customer service performance.

The Company introduced an online application process in April 2013, which allows customers to apply for certain types of new connection quickly, easily and conveniently. Work also began on developing an online self-quotation service for high volume connections customers which, when launched, will deliver a significant reduction in the overall time to serve those customers. When taken with other services such as 'ask our expert', an indicative pricing tool and a small scale embedded generation single connection notification process, the Company was the first DNO to offer customers such a wide variety of connection services online. The Company again beat Ofgem's targets for the quality of the electricity supply provided to its customers and continued to focus on reducing the average times taken to restore supplies following a power cut.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **REVIEW OF THE REGULATORY YEAR (CONTINUED)**

As delivery of the capital expenditure programme, the provision of excellent customer service and ensuring a reliable electricity supply are some of the most significant outputs the Company is required to deliver during DPCR5, the directors are confident that the performance delivered in the Regulatory Year maintains the strong basis for a successful conclusion to DPCR5 developed over the preceding four regulatory years.

Environmental performance continued to be strong with the Company's response time to environmentally-related network events improving such that fewer incidents were reportable to the Environment Agency in the year to 31 December 2013 than in the previous year. Less oil was lost to the ground than in 2012 despite the on-going issue of interference with the Company's assets by third parties intent on metal theft. Given the impact on the environment of such events, the Company included a commitment to reducing losses from fluid-filled cables in its well-justified business plan by replacing a significant number of those assets on a phased and prioritised basis over ED1 and increasing the use of perfluorocarbon tracers to improve the efficiency of oil leak identification. That strong environmental performance continued in the first quarter of 2014 and benefitted from stable network performance such that the Northern Powergrid Group experienced only two incidents that were reportable to the Environment Agency.

The long-term trend in the Company's overall safety performance continued to compare well with that of the industry but the internal target for the year to 31 December 2013 was missed in respect of lost time accidents. Preventable vehicle accident performance met target and was better than that recorded in 2012. However, the same number of lost time accidents occurred in 2013 as in the previous year. One of those lost time accidents was an electrical contact incident, which had the potential to be more serious than the ultimate outcome. In addition, an employee of a contractor to the Company tragically died while working on the network. That incident was subject to an investigation by the Health and Safety Executive, which concluded with the Health and Safety Executive not taking any further action against the Company.

#### **CORE PRINCIPLES**

##### **Financial strength**

During the Regulatory Year, the Company continued to maintain good control in respect of both its capital and operating costs by effectively managing the various financial risks that could have had an adverse impact on its business.

The Company benefits from the stability provided by the arrangements agreed in respect of DPCR5 in terms of its income until 31 March 2015 and 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 £315.0 million was £5.8 million higher than the prior year mainly due to additional allowances arising from the settlement in respect of DPCR5, partly offset by the rebate to the electricity suppliers noted on page 3.

##### **Operating profit and position at the Regulatory Year end**

Although the Company's revenue was higher than in the regulatory year to 31 March 2013, operating profit at £141.8 million was £6.9 million lower than the previous regulatory year, mainly due to the rebate to the electricity suppliers and increases in some operating costs such as depreciation and salaries. The statement of financial position on page 35 shows that, as at 31 March 2014, the Company had total equity of £658.8 million. The directors consider the Company to have a strong balance sheet which, when coupled with the preference of its parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy"), for leaving equity in the business, creates a stable base for continued strong performance into ED1.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

###### **Finance costs and investments**

Finance costs net of investment income at £25.9 million were £1.1 million lower than the regulatory year to 31 March 2013 reflecting changes in the profile of borrowings during the Regulatory Year.

###### **Taxation**

The effective tax rate in the current year is 7%. The effective tax rate before adjusting for the impact of the changes in tax rates introduced by the Finance Act 2013 would be 20%. Details are provided in Note 9 to the Regulatory Accounts.

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

The Company made a profit after tax for the Regulatory Year of £107.3 million (2013: £103.5 million). An interim dividend of £30.0 million was paid during the Regulatory Year (2013: £30.0 million) and the directors recommended that no final dividend be paid in respect of the statutory accounting year to 31 December 2013.

###### **Share capital and debt structure**

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

###### **Dividend policy**

The Company's dividend policy is that dividends may only be paid 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 Northern Powergrid Group, and invested accordingly, generating a market rate of return for the Company.

Movements in cash flows were as follows:

Operating activities: Cash flow from operating activities at £131.7 million was £12.2 million higher than the previous regulatory year primarily due to favourable working capital movements.

Investing activities: Investing activities: Net cash used in investing activities at £178.6 million was £25.2 million higher than the previous regulatory year, reflecting higher net capital expenditure.

Financing activities: The net cash from financing activities at £46.9 million represents a £70.0 million favourable variance compared to the previous regulatory year, reflecting net movements in borrowings in the year.

###### **Liquidity risk**

The Company has access to £75 million under a five year committed revolving credit facility provided by Lloyds Bank plc, The Royal Bank of Scotland plc and Abbey National Treasury Services plc, which expires on 20 August 2017. 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 to a £19 million overdraft facility provided by Lloyds Bank plc, which is reviewed 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.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

###### **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 2014, 100% of the Company's long-term borrowings were at fixed rates and the average maturity for these borrowings was 15 years.

###### **Currency risk**

No material currency risks are faced by the Company.

###### **Pensions**

The Company is a participating employer in the Northern Powergrid 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 Regulatory Accounts.

The Company also participates in the Northern Powergrid Pension Scheme, which is a defined contribution scheme.

###### **Insurance**

As part of its insurance and risk strategy, the Northern Powergrid 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 Northern Powergrid 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 remains focused on delivering a reliable and dependable supply of electricity and a high standard of service to its customers.

The Company aims to enhance its relationship with various stakeholders through direct engagement on the actions and investment planned to improve the performance of the network and on the environmental and social implications of its operations. Consequently, as part of the process of drafting its well-justified business plan for submission to Ofgem for consideration in respect of ED1, the Company consulted with a wide range of stakeholders regarding its services. That consultation included formal presentations to large groups, web-based communications and some high quality input from three expert panels, which looked at social issues, low carbon networks and customer service.

Taking account of the views of its stakeholders that were received as part of the consultation process, the Company took forward its programme to modernise and redesign the customer-facing elements of its business in support of the goal of improving customer satisfaction with the service provided. The various initiatives in that programme included:

- The transformation of the connections business so that it is led by and tailored to meet the requirements of customers in different market segments;
- Extending the means by which the Company undertakes its stakeholder engagement, which will involve building on the experience gained from the process of drafting the well-justified business plan and by increasing joint initiatives with other utility companies;



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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

- Encouraging uptake of the Company's online community to facilitate discussion among stakeholders regarding the Company's services and use of the dedicated web area where stakeholders can provide feedback to influence the Company's policies and priorities and be in continuing contact with the Company;
- Further developing customer relationship management information technology, social media and website services to provide more accurate information to customers, particularly in respect of estimated times for the restoration of supply during power cuts and to engage more effectively with and receive feedback from customers;
- Developing and implementing self-service quotation facilities for customers seeking low voltage connections in order to extend the Company's online transactional capabilities;
- Improving the reliability of under-performing parts of the distribution network by continuing to identify "hot spots" of particularly poor network performance and taking specific action to address the issues in those areas;
- Refreshing and promoting the priority services register so enabling the Company to be aware of vulnerable customers who may be affected by power cuts so that it can take appropriate action to assist those people in such circumstances, engaging the support of the British Red Cross where appropriate;
- Operating customer service vehicles wherever they can assist with the welfare of customers and provide support during power cuts; and
- Continuing a programme to provide employees from across the Northern Powergrid Group with enhanced customer service awareness training and the tools and skills needed to handle power cut calls during periods of peak call demand.

The performance of the DNOs against guaranteed standards, which are set for activities such as restoring supplies after power cuts, provides a measure of the level of customer service. Performance against these measures forms part of the Company's regular reporting to Ofgem.

Ofgem's incentive scheme for quality of service, by which the DNOs are provided with financial incentives, is based upon targets set by Ofgem with regard to each DNO's performance in terms of the number of power cuts, the duration of those power cuts 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 measures the average number of supply minutes lost for every connected customer due to both planned and unplanned power cuts that last for three minutes or longer. CI measures the average number of supply interruptions for every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer.

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

In respect of these key customer service performance indicators, the goal is to achieve performance that is below Ofgem's target number in respect of CML and CI. Although formal directions are awaited from Ofgem regarding the impact of certain incidents, as at the date of these Regulatory Accounts, the Company's reported performance for the Regulatory Year is as follows:

	Year to 31 March 2014		Year to 31 March 2013	
	Actual	Target	Actual	Target
CML	64.7	70.7	70.2	70.9
CI	63.2	68.1	65.0	68.2

Performance in the Regulatory Year was better than Ofgem's target for both CML and CI and showed improvement in both categories in comparison with the previous regulatory year and contributed to the Company's improved customer service performance in the Regulatory Year.

The Regulatory Year was the fourth year in which the Ofgem discretionary reward for stakeholder engagement had been in operation and the second year that a financial incentive had been available and Ofgem announced that the Company's submission in respect of the regulatory year to 31 March 2013 had achieved a score of 78.5%. As a result, the Company, together with its affiliate Northern Powergrid (Yorkshire) plc, was ranked as the third placed DNO group and secured a reward which could total up to £0.9 million for the Northern Powergrid Group. On 30 May 2014, the Company put forward a submission to Ofgem in respect of its stakeholder engagement during the Regulatory Year, which included initiatives with increased focus on the Company's social obligations, such as its partnership with the Trussell Trust food banks, and improved on-line services for its customers. The Company presented its submission to Ofgem's panel on 9 July 2014 and improved its position from the previous year, being ranked as the second placed DNO group and securing a reward of £0.7 million for the Northern Powergrid Group. The Company intends to reinvest its reward in its key initiatives and continue to build on this strong stakeholder engagement performance.

Under the Broad Measure of Customer Service, an independent market research company, Accent, carries out telephone surveys with the Company's customers to find out how satisfied they are with the services provided. During the Regulatory Year, Accent surveyed a number of customers who had contacted the Company regarding an unplanned or a planned power cut, had requested a price quotation and a subsequent connection or had a general enquiry where a service had been provided or a job completed. The Company recorded an overall satisfaction score of 81.8% for the Regulatory Year and expects that its customer service improvement plan, including the range of initiatives noted on pages 6 and 7, will improve the services provided to customers and so increase the satisfaction rating year-on-year.

##### **Connections to the Network**

During the year, the Company continued to improve the connections services provided to its customers, while also actively facilitating the development of competition from independent connections providers ("ICPs"), so providing increased choice to customers in the region. The Company continued to engage regularly with its connections customers in groups and individually, holding monthly customer surgeries, twice yearly customer events and contributing to national stakeholder forums and events. Taking account of feedback from such events, the Company introduced a new online application process in April 2013, which allows customers to apply for certain types of new connection quickly, easily and conveniently. Work also began on developing an online self-quotation service for high volume connections customers which, when launched, will deliver a significant reduction in the overall time to serve those customers. Other online services include 'ask our expert', an indicative pricing tool and a small scale embedded generation single connection notification process. The Company was the first DNO to offer customers such a wide variety of connection services online.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

###### **Connections to the Network (continued)**

As part of the DPCR5 final proposals, Ofgem put in place a competition test to encourage all of the DNOs to make it easier for ICPs to provide competing offers to customers and, in line with Ofgem's deadline for submission, the Company put forward a case to Ofgem, in the form of the requisite Competition Notices, to prove that competition exists in eight market segments. This was in addition to the high voltage segment, in respect of which the Company passed Ofgem's test in October 2012. Having considered and consulted on the Company's Competition Notices, Ofgem announced, on 17 April 2014, that it had not accepted any of the alternative market segments proposed by the Company and, therefore, was not allowing an unregulated margin to be charged in any of those segments because it did not have sufficient evidence that customers' interests would be protected if that price regulation were removed.

Although there was a substantial reduction in volumes of housing and new development works due to the recession, connection requests for low carbon generation have remained very buoyant with the area covered by the Northern Powergrid Group being one of the busiest for such developments in the UK. Interest in the development of solar farms has begun to increase more recently and, as the new housing market starts to recover, the Company is seeing an increase in the number of requests for connections of new housing to the network.

The Company continues to seek feedback from its customers on a regular basis in order to assist with developing further improvements to its services and, in that respect, its connections customers have been instrumental in shaping the Company's strategy regarding the structure required of its connections business in preparation for ED1. The services provided in future will be tailored to the requirements of customers in the different market segments so that the Company provides a faster and more flexible service.

###### **Corporate responsibility**

The Company values its relationship with its customers and other stakeholders and recognises the importance of maintaining a secure and safe power supply for its customers and their local communities. That commitment is underpinned by five customer promises, which are to put safety first, to respect the Company's customers, their time and property, to do a really good job, to be there when needed and to care for the local environment.

The Company maintained its key partnerships with the Environment Agency, the local authorities and the local resilience forums, via a Civil Contingency Co-ordinator, so that it can respond quickly to significant faults on or threats to the network. In the event that river levels rise and flood warnings are issued, staff can be deployed immediately to erect perimeter flood defences at major substation sites and portable defence barriers at lower risk sites. In addition, the Company has well-established emergency procedures that are triggered in times of weather-related incidents or long-duration power cuts when people are without power for some time. The Company responded well to a number of major weather-related incidents during the Regulatory Year, which impacted on its assets, including the highest tidal surges on the Northeast coast for a number of years in early December.

As well as redeploying staff from planned works to help restore power as quickly as possible when major incidents occur, the Company has a number of customer service vehicles, which are dispatched to the areas affected. Those vehicles are able to distribute hot drinks and to microwave meals and generally assist with the welfare of customers in order to alleviate the impact of the incident. The Company also utilised its 'customer ambassadors' to address customers' concerns and resolve their complaints and worked with the British Red Cross in order to pay particular attention to the welfare of customers on the priority services register so that those customers are kept informed of the situation throughout the event and after the power has been restored. Having begun work to improve the quality of the information held on the priority services register, the Company is promoting the benefits of being on that register more widely and has revised the criteria for registration so that customers with short-term health or welfare issues are now able to benefit.

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

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

The Company has in place a small donation programme, which is focused on its key priorities of support for youth, education and the environment and from which grants were made during the Regulatory Year to organisations such as charitable trusts and community groups.

Safety remains the Company's first priority and underpins every aspect of its operations. During the Regulatory Year, the Company continued to participate, 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 Company's school safety programme included Crucial Crew events, school visits, participation in safety days and the "prison me - no way" campaign and is delivered by two dedicated safety presenters who promote the safety messages through an interactive presentation. The programme is also supported through an interactive website and mobile phone game.

##### **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, £207.8 million was invested in the improvement of the distribution network, a 9% increase on the £190.1 million recorded in the previous regulatory year. The Company's continued and substantial investment in its distribution network has seen reliability increase throughout DPCR5. During that period, an electricity supply has been available to the Company's customers for approximately 99.98% of the time and the Company has generally outperformed the targets set by Ofgem in respect of CI and CML. The Company's inspection and maintenance regimes have ensured that the underlying health of the network assets has been sustained and none of the leading indicators used by the Company suggest any diminishing performance in this respect in the future.

##### **Operational activity**

The Company continues to implement an investment strategy, which is designed to deliver improvements in an efficient and cost-effective manner in order to improve the network's resilience. In its well-justified business plan, the Company committed to enhancing the reliability of the network such that fewer power cuts affect customers and, when power cuts do happen, they are shorter in duration.

The Company's Field Operations structure is currently based on six individual business units. 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 and training services. As a new guaranteed standard for the restoration of supply within 12 hours of a power cut occurring will apply from 1 April 2015, the Company began a review of its operational structure in order to provide a more localised focus and, therefore, improved response times in the event of a power cut. If the Company fails to meet that 12 hour standard, it will make an automatic payment to customers, whenever it is aware of such a failure, rather than customers having to make a claim.

The Company's priorities during the Regulatory Year included delivering a similar, significant level of capital expenditure on the network as in the previous regulatory year, a further reduction in the average level of fault repair work in progress, a robust approach to the control of operations on the low voltage network and continued focus on the restoration times associated with both high and low voltage power cuts, with the Company's high voltage restoration performance averaging some 58.8 minutes, after allowing for severe weather incidents and other exemptions.

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### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

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

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

- The replacement of the 20kV switchboard at Hartmoor and twelve 66kV circuit breakers, which included two at Cramlington, six at Grangetown and four at Coalburns;
- The replacement of both the 33kV transformers at Mount Road substation in Sunderland and one of the 66/11kV transformers at Linton;
- Extensive refurbishment works were undertaken on one of the 33/11kV transformers at Darlington West and on both of the 33/11kV transformers at Denwick and minor refurbishment work was undertaken on another 100 primary transformers;
- The commencement of a project to replace twenty eight 66kV circuit breakers and four 66/11kV transformers at North Tees;
- The continuation of reinforcement of the network in a number of areas, including
  - The installation and pre-commissioning of a new 132/33kV transformer in Harrogate and commencement of the excavation and duct installation for the 11kV outlets;
  - The civil works for the new 66kV and 20kV switchgear at Potterhouse in Durham; and
  - Replacement of the 66/11kV transformers and 20kV switchgear at Sunderland;
- The replacement of over 2km of 33kV fluid-filled cable, including removal of the Carville cable tunnel, and the commencement of a £7 million project to replace 20km of 132kV cable in the York city area;
- On-going overhead line work to refurbish over 300 overhead towers (100 at 66kV with the remainder at 132kV) and the replacement of over 400 sets of fittings and insulators (100 at 66kV with the remainder at 132kV) and over 200 extra high voltage overhead line poles;
- The refurbishment or rebuilding of 331km of high voltage overhead line and 114km of low voltage overhead line;
- Replacement of 38 units of high voltage outdoor switchgear, 51 high voltage distribution substations and 272 units of high voltage indoor switchgear;
- The upgrade and reinforcement of 35 sites to address the quality of supply performance issues relating to those circuits; and
- The installation and commissioning of 381 new remote control points on the network.

In order to deliver its investment strategy, the Company used a mix of its own staff and contractors to undertake its activities, including affiliated companies in the Northern Powergrid Group.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

##### **Employee commitment**

###### **Health and safety**

The focus on health and safety continued to be of paramount importance for the directors, as it is for all employees. There is a continuous drive for improvement in safety performance through the setting of challenging goals and the pursuit of a comprehensive safety and health improvement plan, which reflects the Company's fundamental objective 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.

The Company's safety record over a number of years suggests that it is one of the safest companies in the electricity distribution sector and it will strive to maintain that position over the coming years. Having identified issues that may pose an increased safety risk such as metal theft and the impending roll-out of smart meters, the Company intends to implement various measures through its safety and health improvement plan that will build incrementally on the existing strong safety record and ensure that safety considerations are always a part of the investment decision-making and appraisal process.

The Company measures its safety performance in calendar years and uses several key performance indicators to monitor safety performance, with the goal of achieving performance that is below the target number.

The main key performance indicators are as follows:

	2013		2012	
	Target	Actual	Target	Actual
Lost time accidents	1	3	2	3
Restricted duty accidents	1	0	1	0
Medical treatment accidents	1	0	2	1
Operational incidents	3	9	3	5
Preventable vehicle accidents	11	11	11	13

In common with the Berkshire Hathaway Energy group, the Northern Powergrid Group measures its safety performance in terms of the Occupational Safety and Health Administration ("OSHA") rate, which is a measure used in the United States to capture safety incidents down to minor levels of medical treatment, such as a stitch or the use of prescription pain killers. As part of its plan to reduce the OSHA rate across the group, Berkshire Hathaway Energy issues daily e-mail updates in respect of performance against its overall OSHA rate and preventable vehicle accident targets, which include information on incidents that have occurred. The Company's safety and health improvement plan targets continuous improvement and delivery of the various initiatives contained in that plan contributed to the Northern Powergrid Group achieving an OSHA rate of 0.43 against a target of 0.4, which represented its best ever performance.

Although the number of lost time accidents experienced by the Company was the same as in 2012 and the Company only slightly missed its internal target, overall safety performance was disappointing. One of those lost time accidents was an electrical contact incident, which had the potential to be more serious than the ultimate outcome, and an employee of a contractor to the Company tragically died while working on the network. The Northern Powergrid Group worked with the Health and Safety Executive as part of its investigation into that incident, which concluded with the Health and Safety Executive not taking any further action against the Company.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

###### **Health and safety (continued)**

Performance in respect of preventable vehicle accidents met the target for 2013 and showed an improvement compared with 2012. None of those incidents gave rise to any significant safety-related risks.

As part of the safety and health improvement plan and in order to reinforce the operational safety values, the Company continued to implement its cross-business operational assurance audit programme and introduced a field engagement programme designed to link up the leadership of the Company with its employees in the field for the purposes of improving two-way communication on safety and other key business issues. The Company continued to implement a robust road risk management plan, which involved electronic driving licence checking, delivering road risk awareness workshops to new employees and using risk reduction tools such as online driver assessment and training followed by an on-road refresher training session if required. The driver training programme provides practical driving training to a targeted population of drivers and is the primary route to improving driver skills in the longer term.

Following a detailed research and design project, the Company issued innovative protective work wear to its employees, which provides protection against the effects of events such as electrical flashovers. The Company invested a substantial amount in this new clothing, believes that it is unique in the industry and that it will be a significant factor in reducing the risk to its employees. The Company also delivered operational seminars and stand down briefings and issued regular safety newsflashes to staff in order to cascade information on safety trends, issues and incidents.

During the Regulatory Year, the Company was awarded a President's Award from the Royal Society for the Prevention of Accidents for achieving 13 consecutive Gold Awards in recognition of achievements in 2013 and for continued or improving standards of health and safety over a sustained period. In October and November 2013, the Company's health and safety management systems were subject to the three-yearly, seven day renewal assessment by Lloyds Register under the Occupational Health and Safety Assessment Series ("OHSAS") 18001 accreditation, which included all of the Company's personnel, processes, systems and operations. The assessment raised eight new, minor non-conformances, which were generally of a housekeeping nature and have been addressed by agreed remedial actions, and, on conclusion of the assessment, the auditor recommended recertification of the Company's OHSAS 18001 accreditation. The Company also continued to maintain its environmental management system ISO 14001 certification.

The sickness absence rate across the Northern Powergrid Group for 2013 was 2.22% (2012: 2.55%), which was an improvement on 2012 and does not give rise to any particular cause for concern.

###### **Management structure**

Operational management of the Company's business and that of its affiliate, Northern Powergrid (Yorkshire) plc, is undertaken by a single senior management team, with specific functional responsibilities. Those functional responsibilities are in respect of field operations, health, safety and environment, asset management (including procurement), commercial (including customer operations and information technology), regulation and strategy, human resources, organisation development, legal and finance. Certain of those functions also provide services across the Northern Powergrid Group.

###### **Employees**

The Company continued to apply appropriate control to its headcount policy and to place significant emphasis on the importance and application of high standards of management and performance in support of the Core Principles. The Company ensures that a level of consistency is adopted in so doing and, in respect of employee relations, continued to work towards building constructive and partnered relationships with the trades unions. In that respect, the Company has long-term pay agreements in place with the various employment groups such that the relevant terms and conditions are consistent across the Northern Powergrid Group.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

###### **Employees (continued)**

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 throughout DPCR5. 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 Northern Powergrid Group recruited a total of 227 members of staff in 2013, including 92 trainees under its workforce renewal programme. A total of 52 trainees recruited under that programme in previous years graduated from their training programmes during 2013 and commenced work as part of the Northern Powergrid Group's operations. The plan remains in place to have recruited a total of 275 graduate trainees, technical trainees and craft apprentices by the end of DPCR5.

The Company is committed to proper business conduct and, in common with Berkshire Hathaway Energy, 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. A "speaking up" policy is in place so that members of staff are able 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 employed 1,086 staff at 31 March 2014 (2013: 1,008). As at 31 March 2014, the numbers of males and females in the following categories were:

	<b>Male</b>	<b>Female</b>
<b>Directors</b>	6	0
<b>Senior Managers</b>	35	8
<b>Employees</b>	884	202

As noted in the paragraph on management structure, operational management of the Company's business and that of its affiliate, Northern Powergrid (Yorkshire) plc, is undertaken by a single senior management team, which is reflected in the above analysis.

##### **Environmental respect**

The Company's approach to environmental compliance is governed by its environmental policy and the policy of Environmental RESPECT (Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training) implemented by Berkshire Hathaway Energy. 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.

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 and a three-yearly certificate renewal assessment by an accredited external certification body in order to retain that status.



## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

The most recent visit was a full certificate renewal assessment carried out by Lloyd's Register Quality Assurance in March 2014. The assessment report drew management attention to eight minor non-conformances to be addressed by agreed proposed actions. The report also noted that significant improvements had been made to the environmental management system over the past three years.

Procedures and processes have been reviewed and developed to improve the effectiveness of the aspects register, legal register and internal audits. Operational controls at depots were also seen to have significantly improved over the past three years which correlated to a reducing number of minor non-conformances raised at surveillance visits. There were no major non-conformances noted and continued certification was recommended and subsequently confirmed.

Improvements in support of the Company's environmental policy objectives 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 and using gas tracer technology to locate cable fluid leaks quicker, where it was practicable to do so. In addition, the Company provided environmental awareness training for new personnel and contractors and periodic refresher training for all staff.

The Company's commitment to the Environmental RESPECT policy and its overall performance shows that it can be relied on to keep its impact on the environment to a minimum. In preparing its well-justified business plan, the Company engaged directly with the Environment Agency in respect of a number of issues and will continue to maintain strong and open relationships with its various environmental stakeholders, particularly in respect of the network's visual impact.

The main environmental elements of the well-justified business plan included significant programmes to replace fluid-filled cables and place overhead lines underground in national parks, reduce electrical losses and implement further improvements to the network that take account of protected structures, features, areas, wildlife and habitat. This includes protecting bird life by placing bird-diverters on power lines where they are in proximity to reserves, wetlands, flight paths or in locations where rare species of bird are known to live or breed and also in response to information obtained from incident trends.

##### **Sustainability**

The Company's activities have an important part to play in the United Kingdom's transition to a low carbon economy, both in its capacity as a major participant in the United Kingdom energy industry and in terms of its own carbon footprint. As the country takes action to make significant reductions in its carbon emissions, the way electricity is produced and used is expected to have a significant impact on the electricity network over time. The Company is taking actions to be able to demonstrate that its network will be ready to handle the energy flows its customers need when required and by working with customers to assist in solving issues raised by the installation of low-carbon generation and technologies. The Company is also actively involved in working with the industry and other interested parties in order to develop national policies and strategies to assist the low-carbon transition.

The business carbon footprint associated with the Company's activities for the year ended 31 December 2013 was 23,368 tonnes carbon dioxide equivalent, which includes work undertaken on the Company's behalf by its contractors but excludes electrical losses from the distribution network. The Northern Powergrid Group has achieved a 16% reduction in its business carbon footprint (excluding electrical losses) since the start of DPCR5 and has set a target to reduce its carbon footprint by a further 10% by the end of ED1. In line with Ofgem's requirements, the Company has contributed to the sustainability agenda through public reporting on its carbon footprint and its reporting framework is certified under CEMARS (the Certified Emissions Measurement and Reduction Scheme) for compliance with ISO 14064.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

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

The number of installations by customers of low-carbon technologies such as photovoltaic solar panels and heat pumps continued to increase during the Regulatory Year. The greater diversity of demands being placed on the network arising from the decarbonisation of the energy market means that the Company needs to develop smart solutions that avoid the need for expensive reinforcement of the network. In that respect, the Northern Powergrid Group's Customer-Led Network Revolution project aims to learn how novel network technology and changes in customers' energy usage habits may lead to the speedier and lower cost connection of low-carbon technologies to the network.

More than 10,000 customers are now participating in the trials and installation of the related equipment has been largely completed, with over 500 customers having taken part in a feedback survey and 230 interviews having taken place. Six electrical storage devices have been commissioned, as planned, and the initial results from the monitoring of customers' load profiles, including the impact of time-of-use tariffs, and from industrial and commercial trials of demand side management have been published and presented at over 50 events attended by various interested parties.

The well-justified business plan presented the Company's proposition for a sustainable network over ED1 including the need for investment in enabling technology, reinforcement of the network to alleviate the constraints associated with low carbon technologies and supporting the roll-out of smart meters. The Company believes that its plan will not only create some immediate benefits for customers during ED1 but also pave the way for much greater benefits after 2023.

##### **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 Governance and Risk Management Group ("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 Licence and other regulatory obligations, the Company operates a regulatory compliance affirmation process, under which ownership of approximately 1,700 regulatory obligations contained within the compliance database is currently assigned to around 60 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 identified non-compliances or 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 during 2010 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 continued to engage with Ofgem and other industry participants during the Regulatory Year in order to resolve the complex issues surrounding the losses incentive arrangements for both the current and previous price control periods.

Ofgem removed the DPCR5 losses incentive and, on 21 March 2014, published its decision on the restatement of the 2009/2010 data and closing out the Distribution Price Control Review 4 losses incentive, together with details of the final sums to be returned by the Company during ED1. In accordance with International Financial Reporting Standards, the Company has not included any recognition of this issue in these Accounts.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **CORE PRINCIPLES (CONTINUED)**

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

Under the 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. Ofgem triggered the ED1 review process in the first quarter of 2012 and finalised its price control policies early in 2013, following which the Company submitted its well-justified business plan for Ofgem's consideration on 28 June 2013. Ofgem announced on 22 November 2013 that it had decided that the Company's plan was not to proceed on the "fast track" and, while recognising that the Company had submitted a strong plan, had certain reservations about the future cost efficiency and asset replacement elements. Following Ofgem's decision, the Company revisited its plan and provided Ofgem with a revised version including further justification of the associated costs on 17 March 2014. Ofgem is considering the revised plan, further discussions of the details have taken place with the Company and Ofgem is expected to issue its draft determination by the end of July 2014. A final decision is expected by December 2014 and, on conclusion of the process, the Company's revenues will be set for the period from 2015 to 2023.

During the Regulatory Year, the Company continued its voluntary involvement with the other DNOs in developing and trialling more formalised arrangements for assuring the accuracy of the information returns submitted to Ofgem. This exercise has involved the development of risk-assessment matrices and the preparation and submission to Ofgem of a risk-based data-assurance plan, followed by the submission of a report detailing the assurance work actually carried out and the findings of that work. The DNOs have been joined in the trial by transmission and gas distribution licensees and the new regime will continue to be developed in the light of experience gained. The finalised arrangements will be incorporated into the licences of all the network operators in April 2015.

#### **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 maximum permitted revenue for each regulatory year and is a control on revenue that operates independently of most of the electricity distribution licence holder's costs. Where the Company recovers more, or less, than this maximum the difference is carried forward, with interest. For amounts relating to the Regulatory Year, the carry forward is into the entitlement for the regulatory year ended 31 March 2015. For amounts relating to the regulatory year ended 31 March 2015, the carry forward will typically be into the entitlement for the regulatory year after the following regulatory year.

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. A resetting of the formula is now made by GEMA without the consent of the electricity distribution licence holder but a licensee can appeal to the Competition and Markets Authority against a decision by GEMA to proceed with such a modification. Certain other interested parties have the same right. 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 current price control, the rate of inflation as measured by the Retail Prices Index ("RPI") is taken into account in setting the Company's allowed income in respect of each regulatory year. Consequently, one of the risks faced by the Company is that its costs may increase by more than RPI. Any changes in costs incurred will have a direct impact on the Company's financial results, as will changes in performance under incentive schemes, such as in customer service, which can lead to adjustments to allowed revenues.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)**

##### **Financial risk (continued)**

Ofgem recognises that defined benefit pension schemes and, particularly, the current deficit positions of various schemes, represent a significant cost to the DNOs and, in its DPCR5 final proposals, confirmed that DNOs would be allowed to recover the actuarial value of the deficits attributable to a licensee's distribution business in existence as at 31 March 2010 via its regulated revenues (after an adjustment to reflect the residual of unfunded early retirement deficiency costs as at 31 March 2010).

However, given the stable and regulated nature of the DNOs' businesses, Ofgem took the view that a notional repair period of 15 years was appropriate for the purpose of assessing the DNOs' allowed revenues in respect of pension costs in DPCR5.

The other financial risks facing the Company are outlined on pages 5 and of this Strategic Report and on page 22 of the Directors' Report.

##### **Operational risk**

There are a number of risks to the Company's operational performance in respect of which mitigating actions have been taken. Appropriate credit cover arrangements are in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism and a robust major incident management plan is implemented whenever severe weather impacts on the distribution network's performance. Metal theft continued to be a significant issue for the Company during the Regulatory Year with the activities of metal thieves causing power cuts on various occasions, which affected a large number of customers in aggregate. In response, the Company maintained the programme of risk-assessed and enhanced security measures at its sites and pursued awareness raising activity at a national and local level. Those risk mitigation actions were supported by a change in the law which prohibited scrap metal dealers from paying for scrap metal in cash.

The Company recognises that there are uncertainties around the future take-up of low carbon technologies and the resulting capacity requirements for the network and from the fitting of smart meters throughout the Company's distribution services area, which is expected to result in a requirement to address a substantial number of reported defects. The Company believes that it can effectively manage these issues through its usual risk management practices.

##### **Commercial risk**

Managing commercial risk continued to be of key importance and the Company remained 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, underground cable laying 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.

**PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)**

**Risk Management**

The Northern Powergrid Group operates a structured and disciplined approach to the management of risk as part of its overall risk management policy and, in DPCR5 and previous price control periods, has accepted and successfully managed substantial cost and delivery risks by developing a culture of cost and risk management over that period of time. Risks are assessed with due regard to probability and impact and the risk environment is reviewed continually in order that new or emerging potential risks are identified. Those risks assessed to be significantly high are logged within a risk register that the GRMG reviews regularly and key indicators are used to track and monitor those risks considered to be significant.

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 residual, mitigated risk is within an acceptable level of tolerance.

The Northern Powergrid 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. The risk management programme includes regular review of the crisis management, disaster recovery and major incident plans, which are periodically tested, the sharing of best practice on disaster preparedness and response, penetration tests against firewall systems and disaster recovery tests of IT servers and priority processes and a peer review of the Northern Powergrid Group's risk management systems by Berkshire Hathaway Energy.

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 that of the wider Berkshire Hathaway Energy group, whose activities have continued to include a structured benchmarking of risk management activities across its business units, including the sharing of significant lessons learned associated with risk management.

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 Northern Powergrid 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 Northern Powergrid 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. Berkshire Hathaway Energy 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 United States Sarbanes-Oxley Act and, while no significant areas of weakness have been identified, any recommended improvements are implemented.

In addition, the Company employs comprehensive business planning and financial reporting procedures, regularly reviews key performance indicators to assess progress towards its goals and has a strong internal audit function to provide independent scrutiny of its internal control systems. The Company has risk management procedures in place, including the standards required by the United States Sarbanes-Oxley Act, and has centralised treasury operations and established procedures for the planning, approving and monitoring of major capital expenditure.

The Northern Powergrid Group is committed to preventing corruption in all its forms and continues to have a zero-tolerance approach to corruption in its business or by those with whom it does business. The board of Northern Powergrid Holdings Company has addressed the risks introduced by the Bribery Act 2010 through a compliance policy, changes to contractual terms, training and other staff awareness measures.

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

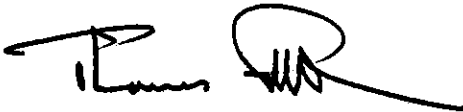
**PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)**

**Internal Control (continued)**

The introduction of annual risk assessments and enhanced due diligence in respect of new business transactions has further assisted in ensuring compliance. The Northern Powergrid Group requires staff, suppliers of services and business partners to comply with the Bribery Act. Its policies encourage an employee who has any suspicion of bribery or other form of corruption within or related to the Northern Powergrid Group to report the suspicion to a manager or via the international, anonymous help line mentioned in the employee section.

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.

**ON BEHALF OF THE BOARD:**

A handwritten signature in black ink, appearing to read 'T E Fielden', followed by a large, stylized circular flourish.

T E Fielden  
Director

18 July 2014

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014**

#### **DIVIDENDS**

During the Regulatory Year, an interim dividend of £30.0 million (15p per ordinary share) was paid (2013: £30.0 million, 15p per ordinary share). The directors recommended that no final dividend be paid in respect of the statutory accounting year ended 31 December 2013. No interim dividend was paid during the period from 1 January 2014 to 31 March 2014.

#### **RESEARCH AND DEVELOPMENT**

During the Regulatory Year, the Company continued working, on behalf of the Northern Powergrid Group and in partnership with British Gas, Durham University and EA Technology, on its major project under Ofgem's Low Carbon Networks Fund, known as the Customer-Led Network Revolution. This remains the largest project supported by Ofgem in the four years of the fund and the Company will incur expenditure of £31.0 million over the life of the project. Of that expenditure, 90% is funded by electricity customers in Great Britain. Successful delivery of the project over the period agreed with Ofgem will enable recovery of the additional 10% from customers and potentially qualify for a further discretionary award.

The project is assessing the potential for new network technology and flexible customer response to facilitate speedier and more economical take-up by customers of low-carbon technologies and the connection to the distribution network of increasing amounts of low-carbon or renewable energy generation. 2013 saw further, and increasingly mature, trialling of equipment and operational techniques to allow the efficient application of low carbon technologies on the network. The scale of the project's output is such that additional time has been sought from Ofgem, extending the project to four years, to ensure that the quality of learning delivered is relevant, timely and provides value-for-money for all stakeholders.

The Company also supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. New activities in the areas of voltage stabilisation, the real-time rating of assets to increase current carrying capacity and the improved ultrasonic integrity assessment of overhead line assets have been commissioned. Other work completed during 2013, included the further application of network risk methodologies to a range of business processes, allowing better planning and operational execution, and research to better understand the environmental variation within network substations and its impact on the condition and service lifetime of the Company's assets.

During the Regulatory Year, the Company invested £6.7 million (2013: £9.4 million) (Note 6 to the Regulatory Accounts) in its research and development activities.

#### **FUTURE DEVELOPMENTS**

The financial position of the Company, as at 31 March 2014, is shown in the statement of financial position on page 35. There have been no significant events since the end of the Regulatory Year.

During the Regulatory Year, the Company published its well-justified business plan for the future of its electricity distribution business and submitted that plan to Ofgem for consideration as part of the ED1 price control review process. That plan set out the Company's priorities for and the challenges it expects to see during ED1, which will last for the eight years until March 2023. The Company plans to provide its customers with more for less by improving performance in respect of all of the outputs expected of it, reducing prices in the first year of ED1 and then maintaining those prices at a relatively consistent level over the remainder of the period, delivering 20% shorter power cuts and providing a connections service that is 30% faster, together with a range of new and improved services. Having resubmitted the well-justified business plan for Ofgem's consideration on 17 March 2014, the directors intend to continue to develop the Company's business by operating that business with the goal of out-performing the allowances in the price control, while efficiently investing in the network and improving the quality of supply and service provided to its customers. Ofgem is expected to issue its draft determination by the end of July 2014 and its final determination by December 2014.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **DIRECTORS**

The directors shown below have held office during the whole of the period from 1 April 2013 to the date of this report.

J P Barnett	Commercial Director
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

On 1 April 2014, A R Marshall and P C Taylor were appointed to the board in the capacity of sufficiently independent directors in accordance with condition 43A of the Licence.

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.

#### **FINANCIAL RISK MANAGEMENT**

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.

#### **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 2014 and during the Regulatory Year it was the Company's policy not to hold any derivative financial instruments.

#### **POLITICAL DONATIONS**

During the Regulatory Year, no contributions were made to political organisations (2013: £nil).

#### **EMPLOYEES**

##### **Employee consultation**

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

The Northern Powergrid 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 increased use of the Company's intranet to improve communication and engagement with the workforce.

During the Regulatory Year, the President and Chief Executive Officer delivered broadcast briefings using telephone conference call facilities in order to provide employees with updates on the Northern Powergrid Group's financial, organisational, safety and customer service performance and posted weekly blogs on the Company's intranet in order to provide updates on key elements of the Company's performance during the preceding week.



## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **EMPLOYEES (CONTINUED)**

##### **Disabled employees**

The Northern Powergrid Group is committed to equality at work and, as such, its policy is 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.

##### **Corporate Governance Statement**

Although the Company does not have securities listed on the main market of the London Stock Exchange, this statement is provided pursuant to standard licence condition 44(6) of the 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.

In September 2012, the Financial Reporting Council made available on its website a revised version of the UK Corporate Governance Code (the "Code"). The Company, therefore, provides the following statement setting out how it has applied the main principles in the Code and, to the extent that it departs from the Code, explains from which parts of the Code it departs and the reasons for so doing.

##### **Compliance statement**

Set out below and in the review of the Regulatory Year in the Strategic Report are the areas in which the Company adopts and complies with the main principles of the Code. The Company has not complied with certain of the main principles of the Code, including main principles A2, A3, B2, B6, B7, C3, D1, D2 and E2. 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 Berkshire Hathaway Energy and includes regular reporting to and meetings with the Chairman and senior management of Berkshire Hathaway Energy, the presence of independent, non-executive directors at board meetings of the Company and a strong internal control environment designed to meet the standards required by the United States Sarbanes-Oxley Act.

The Code is based on the "comply or explain" approach and the directors are of the opinion that, in the instances noted above where the Company does not comply with the Code, this approach is justifiable, given that the Company is a wholly-owned subsidiary of Berkshire Hathaway Energy and the governance framework in place throughout the Northern Powergrid Group is agreed with Berkshire Hathaway Energy.

##### **Section A: Leadership**

##### **Main Principle A1: The Role of the Board**

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 include general business performance, regulatory compliance, operational issues and key business activities.

In addition, the President and Chief Executive Officer participates in weekly performance review meetings with the Chairman of Berkshire Hathaway Energy and other senior managers of the Berkshire Hathaway Energy group, including the Executive Vice President and Chief Financial Officer. At those weekly meetings, the views of the Chairman of Berkshire Hathaway Energy and the senior management team regarding the key, current issues facing the Northern Powergrid Group are discussed.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section A: Leadership (continued)**

##### **Main Principle A1: The Role of the Board (continued)**

The Chairman of Berkshire Hathaway Energy also receives weekly, monthly, quarterly and ad-hoc reports on the Northern Powergrid Group's performance from the President and Chief Executive Officer. Berkshire Hathaway Energy's Executive Vice President and Chief Financial Officer and Executive Vice President, General Counsel and Corporate Secretary also hold similar weekly review meetings in respect of Berkshire Hathaway Energy's financial and legal functions, at which the Northern Powergrid Group'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 five occasions during the Regulatory Year, with the attendance of the directors being as follows:

J P Barnett	Commercial Director	5
R Dixon	Non-Executive Director	5
T E Fielden	Finance Director	5
J M France	Regulation Director	4
N M Gill	Field Operations Director	5
P A Jones	President and Chief Executive Officer	5

Operational management of the Company's business (and that of its affiliate, Northern Powergrid (Yorkshire) 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 Northern Powergrid 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 Northern Powergrid Group are provided in the Strategic Report.

The directors have overall responsibility for the internal control environment, which, within the Northern Powergrid 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, Berkshire Hathaway Energy 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 United States Sarbanes-Oxley Act. The assessments undertaken during the Regulatory Year did not identify any significant weaknesses in the process but resulted in the implementation of various recommended improvements. The key features of the Company's internal control system and the issues addressed by the Company during the Regulatory Year can be found in the Strategic Report.

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 the Northern Powergrid Group and, therefore, Company policy. As part of their approved terms of reference, certain of those committees report regularly to the board on their activities.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section A: Leadership (continued)**

##### **Main Principle A1: The Role of the Board (continued)**

The committees are as follows:

##### **Health and Safety Management Committee**

The board of Northern Powergrid Holdings Company has established the Northern Powergrid Group Health and Safety Management Committee with delegated powers to manage the health and safety policy and performance of the Northern Powergrid Group. Membership of the committee comprises:

J P Barnett	Commercial 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
A J MacLennan	Managing Director, Integrated Utility Services Limited (an affiliated company)
G M Earl	Director of Health, Safety and Environment

The committee meets on a regular basis in order to oversee implementation of the health and safety policy, review and agree strategy for the management of health and safety issues, monitor health and safety performance across the Northern Powergrid Group, review the effectiveness of the health and safety policies and the health and safety management system and consider recommendations for changes in 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 Strategic Report and the Directors' Report, and comprises:

G E Abel	Chairman, Berkshire Hathaway Energy
D Brady	Treasurer
T E Fielden	Finance Director
P J Goodman	Executive Vice President and Chief Financial Officer, Berkshire Hathaway Energy
P A Jones	President and Chief Executive Officer
S J Lockwood	Group Financial Controller
O Sutherland	Investor Reporting Manager
S Gormally	Corporate Accountant and Secretary to the Committee

##### **Pensions Committee**

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

N Dawson	Pensions Manager
T E Fielden	Finance Director
J M France	Regulation Director
L Hutchinson	Director of Human Resources
S J Lockwood	Group Financial Controller
K Mawson	Head of Finance Development and Systems
L Tweedie	Head of Field Change

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section A: Leadership (continued)**

##### **Main Principle A1: The Role of the Board (continued)**

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

The GRMG is the principal management forum in the Northern Powergrid Group with regard to corporate governance. Its purpose is to ensure that companies in the Northern Powergrid Group 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 Northern Powergrid Group's Audit Committee. The GRMG comprises:

D Anderson	Head of Internal Audit
J P Barnett	Commercial Director
R Dixon	Non-Executive Director
M Drye	Director of Asset Management
G Earl	Director of Safety, Health and Environment
J Elliott	Company Secretary
T E Fielden	Finance Director
J M France	Regulation Director
N M Gill	Field Operations Director
L Hutchinson	Director of Human Resources
A J MacLennan	Managing Director, Integrated Utility Services Limited (an affiliated company)
O Sutherland	Investor Reporting Manager

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 Northern Powergrid Group's approach to corporate governance and the management of internal controls can be found in the Strategic Report.

As explained in respect of main principles B2 and D1, the Company does not have either a remuneration committee or a nomination committee.

##### **Main Principle A2: Division of Responsibility**

Mr G E Abel, the Chairman of Berkshire Hathaway Energy, is also Chairman of Northern Powergrid Holdings Company. As President and Chief Executive Officer, Dr Jones is responsible for the operation and management of both the Company and the Northern Powergrid Group and reports directly to Mr Abel.

##### **Main Principle A3: The Chairman**

The board does not have a formally appointed Chairman. Dr Jones chairs board meetings, is responsible for the operation and management of both the Company and the Northern Powergrid Group and divides his time accordingly between his various commitments within the Northern Powergrid Group. Dr Jones reports directly to Mr Abel.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section A: Leadership (continued)**

##### **Main Principle A4: Non-Executive Directors**

Mr Dixon was the Company's sole independent non-executive director during the Regulatory Year and acts under agreed terms of reference.

##### **Section B: Effectiveness**

##### **Main Principle B1: The composition of the board**

During the Regulatory Year, the board comprised five executive directors and Mr Dixon, an independent non-executive director, who, collectively, bring a range of skills and experience to the board. Mrs A R Marshall and Professor P C Taylor were appointed to the board as non-executive directors with effect from 1 April 2014 in accordance with the terms of the Licence. Although 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.

##### **Main Principle B2: Appointments to the board**

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

##### **Main Principle B3: Commitment**

The Company's non-executive directors commit sufficient time to preparation for and attendance at board meetings, although their terms of reference do not quantify the time commitment required.

##### **Main Principle B4: Development**

The directors continually update their knowledge of and familiarity with the operations of the Company due to the robust reporting arrangements in place and have on-going access to the Company's operations and its staff.

##### **Main Principle B5: Information and support**

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 directors, as appropriate.

##### **Main Principle B6: Evaluation**

As part of their approved terms of reference, certain 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. Berkshire Hathaway Energy has a performance appraisal and development scheme in place, under which each senior manager of the Northern Powergrid Group is subject to a formal annual appraisal of performance against his individual and Berkshire Hathaway Energy's goals.

##### **Main Principle B7: Re-election**

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

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section C: Accountability**

##### **Main Principle C1: Financial and business reporting**

The board considers that the Regulatory Accounts, which include the Strategic Report and the Directors' Report, taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

The directors explain, at page 2, the Core Principles behind the Company's strategy and, at pages 30 and 31, their responsibility for preparing the Strategic Report, the Directors' Report and the Regulatory Accounts, have reported, at page 30 in the Directors' Report that the Company is a going concern and have included the Report of the Independent Auditor to the Company at pages 32 and 33 of these Regulatory Accounts.

##### **Main Principle C2: Risk management and internal control**

Details of the principal risks and uncertainties facing the Company and its internal control system, together with details of the issues addressed by the Company during the Regulatory Year, can be found at pages 16 to 19 of the Strategic Report.

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, which provides independent scrutiny of internal control systems and risk management procedures, including the standards required by the United States 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 OHSAS 18001, which is subject to external certification and regular assessment;
- An external obligations register, which assists with 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.

## **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

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

##### **Section C: Accountability (continued)**

##### **Main Principle C3: Audit committee and auditor**

The board of Northern Powergrid Holdings Company has established an audit committee for the Northern Powergrid 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 comprises one member who is independent and one member who has competence in accounting and receives annual reports from the GRMG and from the Northern Powergrid 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. The Audit Committee comprises:

R Dixon	Non-Executive Director
T E Fielden	Finance Director

Details of the fees paid by the Company to Deloitte LLP in relation to non-audit services during the Regulatory Year are provided in Note 6 to the Regulatory Accounts.

The employee section on pages 13 and 14 of the Strategic Report contains details of the Company's "speaking up" policy.

##### **Section D: Remuneration**

##### **Main Principle D1: The level and components of remuneration**

The Company does not have a remuneration committee. Annual remuneration awards for the senior management of the Northern Powergrid Group are subject to the performance appraisal and development scheme process and consideration by the Chairman of Berkshire Hathaway Energy 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.

##### **Main Principle D2: Procedure**

As noted under main principle D1, the Company does not have a remuneration committee. Annual remuneration awards for the senior management of the Northern Powergrid Group are subject to the performance appraisal and development scheme process and consideration by the Chairman of Berkshire Hathaway Energy and the President and Chief Executive Officer. No director is involved in deciding his own remuneration.

##### **Section E: Relations with shareholders**

##### **Main Principle E1: Dialogue with Shareholders**

As a wholly-owned subsidiary of a privately held group of companies, the board is in continuing dialogue with Berkshire Hathaway Energy.

##### **Main Principle E2: Constructive use of the AGM**

This section of the 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 POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

### **DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

#### **Going Concern**

A review of the Company's business activities during the Regulatory Year, together with details regarding its future development, performance and position, its 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 set out in the Strategic Report, the Directors' Report and the appropriate notes to the Regulatory Accounts.

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

- 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 15 years and has access to borrowing facilities provided by Lloyds 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 Regulatory Accounts.

#### **Responsibility statement of the Directors for the preparation of the Regulatory Accounts**

The directors are responsible for preparing the Regulatory Accounts, including the Strategic Report and 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 2013.

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;
- 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 Company's financial position and financial performance; and
- Make an assessment of the Company's ability to continue as a going concern.



**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**DIRECTORS' REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**Responsibility statement of the Directors for the preparation of the Regulatory Accounts (continued)**

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's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**Audit of the accounts**

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

- a) so far as he is aware, there is no relevant audit information of which the Company's auditor is 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 auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

**Auditor**

Deloitte LLP will continue in office in accordance with the provisions in section 487 of the Companies Act 2006 and has indicated its willingness to do so.

**ON BEHALF OF THE BOARD:**



T E Fielden  
Director

18 July 2014

## **INDEPENDENT AUDITOR'S REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY ("THE REGULATOR") AND NORTHERN POWERGRID (NORTHEAST) LIMITED ("THE COMPANY")**

We have audited the Regulatory Accounts of the Company for the year ended 31 March 2014 (the "Regulatory Accounts") on pages 34 to 66 which comprise the Statement of Profit or Loss and Other Comprehensive Income, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and the related notes numbered 1 to 27. 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 (the "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 auditor**

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 pages 30 and 31.

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 38 to 44, the results and financial position of the Company for the regulatory year ended 31 March 2014. 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 strategic report, 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.

**INDEPENDENT AUDITOR'S REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY  
("THE REGULATOR") AND NORTHERN POWERGRID (NORTHEAST) 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 the 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, on which we reported on 2 April 2014, which are prepared for a different purpose. Our audit report in relation to the Statutory Accounts (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 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, 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

- present fairly in accordance with Standard Condition 44 of the Regulatory Licence and the accounting policies set out on pages 37 to 43, the financial position of the Company as at 31 March 2014 and of its financial performance and cash flows for the year then ended; and
- have been properly prepared in accordance with Standard Condition 44 of the Regulatory Licence and the Company's accounting policies.

*Deloitte LLP*

**Deloitte LLP**  
Chartered Accountants and Registered Auditor  
Newcastle upon Tyne

28 July 2014

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2014**

	Notes	2014 £m	2013 £m
Revenue	3	315.0	309.2
Cost of sales		<u>(12.1)</u>	<u>(7.5)</u>
<b>Gross profit</b>		302.9	301.7
Distribution costs		(93.2)	(88.4)
Administrative expenses		<u>(67.9)</u>	<u>(64.6)</u>
<b>Operating profit</b>	6	141.8	148.7
Profit on disposal of property, plant and equipment		0.4	0.3
Investment income	4	0.2	0.1
Finance costs	5	<u>(26.1)</u>	<u>(27.1)</u>
<b>Profit before tax</b>		116.3	122.0
Income tax expense	9	<u>(9.0)</u>	<u>(18.5)</u>
<b>Profit for the financial year</b>		<u>107.3</u>	<u>103.5</u>

All activities relate to continuing operations.

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2014**

There has been no other comprehensive income for the Company. Therefore, total comprehensive income for the year is £107.3 million (2013: £103.5 million).

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2014**

	Notes	2014 £m	2013 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	11	1,870.7	1,722.3
Intangible assets	12	18.2	9.5
		<u>1,888.9</u>	<u>1,731.8</u>
<b>Current assets</b>			
Inventories	14	9.6	10.4
Trade and other receivables	15	49.8	48.3
		<u>59.4</u>	<u>58.7</u>
<b>Total assets</b>		<u>1,948.3</u>	<u>1,790.5</u>
<b>Equity</b>			
Called-up share capital	21	200.0	200.0
Retained earnings		461.6	384.3
		<u>661.6</u>	<u>584.3</u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	16	83.9	79.0
Tax payable	16	14.1	16.4
Borrowings	17	111.7	34.8
Deferred revenue	19	19.4	20.1
Provisions	20	1.6	1.5
		<u>230.7</u>	<u>151.8</u>
<b>Non-current liabilities</b>			
Borrowings	17	466.7	466.6
Deferred tax	18	97.7	112.2
Deferred revenue	19	491.3	475.2
Provisions	20	0.3	0.4
		<u>1,056.0</u>	<u>1,054.4</u>
<b>Total liabilities</b>		<u>1,286.7</u>	<u>1,206.2</u>
<b>Totally equity and liabilities</b>		<u>1,948.3</u>	<u>1,790.5</u>

The financial statements were approved by the board of directors and authorised for issue on 18 July 2014 and were signed on its behalf by:



T E Fielden  
Director

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2014**

	<b>Share Capital</b>	<b>Retained Earnings</b>	<b>Total Equity</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
At 1 April 2012	200.0	310.8	510.8
Total comprehensive income for the year	-	103.5	103.5
Dividends paid	-	(30.0)	(30.0)
At 1 April 2013	200.0	384.3	584.3
Total comprehensive income for the year	-	107.3	107.3
Dividends paid	-	(30.0)	(30.0)
At 31 March 2014	200.0	461.68	661.6

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2014**

	<b>Notes</b>	<b>2014 £m</b>	<b>2013 £m</b>
<b>Cash Flows from operating activities</b>			
Cash generated from operations	22	186.3	175.6
Finance costs paid		(28.9)	(29.0)
Dividends received		0.1	-
Group relief paid		-	(1.9)
Tax paid		(25.8)	(25.2)
<b>Net cash from operating activities</b>		<b>131.7</b>	<b>119.5</b>
<b>Cash flows used in investing activities</b>			
Purchase of property, plant and equipment		(202.8)	(182.1)
Purchase of intangible assets		(10.6)	(5.5)
Proceeds from disposals of property, plant and equipment		0.4	0.3
Receipt of customer contributions		34.4	33.9
<b>Net cash used in investing activities</b>		<b>(178.6)</b>	<b>(153.4)</b>
<b>Cash flows from financing activities</b>			
Equity dividends paid		(30.0)	(30.0)
Repayment of borrowings		-	(18.0)
New borrowings		41.5	-
Movement in loans from Group undertaking		35.4	24.9
<b>Net cash from/(used in) financing activities</b>		<b>46.9</b>	<b>(23.1)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>-</b>	<b>(57.0)</b>
<b>Cash and cash equivalents at beginning of year</b>		<b>-</b>	<b>57.0</b>
<b>Cash and cash equivalents at end of year</b>		<b>-</b>	<b>-</b>

# **NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

## **NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014**

### **1 GENERAL INFORMATION**

Northern Powergrid (Northeast) Limited is a company originally incorporated in England and Wales under the Companies Act 1985 and is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group"). The company is domiciled in England and Wales. The address of the registered office is Lloyds Court, 78 Grey Street, Newcastle-upon-Tyne, NE1 6AF.

The nature of the Company's business model, strategic objectives, operations and activities are set out in the Strategic Report and in the Directors' Report.

### **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.

#### **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; and
- Impairment reviews carried out to evaluate the carrying value of assets held at the statement of financial position 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.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**2 ACCOUNTING POLICIES (CONTINUED)**

**Adoption of new or revised standards**

In the Regulatory 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:

**IAS 19 Employee Benefits**

The Northern Powergrid Group has applied IAS 19 Employee Benefits (as revised in 2011) and the related consequential amendments for the first time. IAS 19 (as revised in 2011) changes the accounting for defined benefit plans and termination benefits. The changes do not impact the accounting for the defined benefit scheme in these financial statements as it is accounted for as though it were a defined contribution scheme. IAS 19 (as revised in 2011) does however introduce certain changes in presentation of the defined benefit cost including more extensive disclosures which are reflected within these financial statements (see note 23).

The directors are not aware of any other newly issued or modified Standards and Interpretations that are not yet effective which would have 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.

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 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.



**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**2 ACCOUNTING POLICIES (CONTINUED)**

**Research costs**

Expenditure on research activities is written off to the statement of profit or loss in the year in which it is incurred.

**Operating profit**

Operating profit is stated before investment income, finance costs, profit on sale of property, plant and equipment and income from other fixed asset investment.

**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 statement of profit or loss 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 statement of financial position 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 statement of financial position 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 statement of financial position 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 statement of financial position date.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (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
Distributed generation assets.....	15 years
Metering equipment included in distribution system assets .....	up to 5 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 statement of financial position and amortised on a straight line basis 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.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (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 statement of financial position 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 statement of financial position 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 statement of profit or loss 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 statement of profit or loss 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 statement of profit or loss 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. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**2 ACCOUNTING POLICIES (CONTINUED)**

**Financial instruments**

Financial assets and financial liabilities are recognised on the statement of financial position when the Company becomes a party to the contractual provisions on the instrument.

Financial assets are assessed for indicators of impairment at each statement of financial position 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 statement of profit or loss.

**Fair value measurements**

For financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

**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.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**2      ACCOUNTING POLICIES (CONTINUED)**

**Pensions**

The Company contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Northern Powergrid Group of the ESPS"). The Northern Powergrid 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 Powergrid Group of the ESPS as if it were a defined contribution scheme. Contributions to the Northern Powergrid Group of the ESPS are charged to the statement of profit or loss or capitalised as appropriate. The capital costs of ex-gratia and supplementary pensions are normally charged to the statement of profit or loss 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 statement of profit or loss in the year or capitalised as appropriate. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

# NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

## NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)

### 3 SEGMENTAL REPORTING

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 Northern Powergrid Group in order to allocate resources to these segments and to assess their performance.

In practice, the President and Chief Executive Officer allocates resources and assesses performance based upon the aggregate results of the Company and Northern Powergrid (Yorkshire) plc, another distribution network operator in the Northern Powergrid Group, suggesting that no segmental reporting is required. However, in accordance with the Company's distribution licence, the Company must publish certain segmental information in the Regulatory Accounts, as follows:

	Distribution 2014 £m	Distributed Generation 2014 £m	Excluded Services 2014 £m	Metering 2014 £m	De Minimis 2014 £m	Total 2014 £m
<b>STATEMENT OF PROFIT OR LOSS</b>						
Revenue	289.9	0.7	2.2	5.2	17.0	315.0
Cost of sales	(9.8)	-	(0.6)	-	(1.7)	(12.1)
Gross profit	280.1	0.7	1.6	5.2	15.3	302.9
Distribution costs	(86.1)	(3.5)	(0.2)	(3.4)	-	(93.2)
Administration costs	(53.1)	-	(0.3)	(0.1)	(14.4)	(67.9)
Operating profit/(loss)	140.9	(2.8)	1.1	1.7	0.9	141.8
<b>OTHER INFORMATION</b>						
Capital tangible additions	178.9	7.0	23.3	1.0	-	210.2
Capital intangible additions	9.9	0.2	0.5	-	-	10.6
	Distribution 2013 £m	Distributed Generation 2013 £m	Excluded Services 2013 £m	Metering 2013 £m	De Minimis 2013 £m	Total 2013 £m
<b>STATEMENT OF PROFIT OR LOSS</b>						
Revenue	286.8	0.9	2.0	5.1	14.4	309.2
Cost of sales	(6.6)	-	(0.7)	-	(0.2)	(7.5)
Gross profit	280.2	0.9	1.3	5.1	14.2	301.7
Distribution costs	(82.2)	(2.7)	(0.2)	(3.3)	-	(88.4)
Administration costs	(51.0)	-	(0.3)	-	(13.3)	(64.6)
Operating profit/(loss)	147.0	(1.8)	0.8	1.8	0.9	148.7
<b>OTHER INFORMATION</b>						
Capital tangible additions	153.7	16.4	20.7	0.9	-	191.7
Capital intangible additions	4.8	0.4	0.3	-	-	5.5

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

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**4 INVESTMENT INCOME**

	2014 £m	2013 £m
Interest receivable from Group undertakings	0.1	0.1
Income from other fixed asset investment	0.1	-
	<u>0.2</u>	<u>0.1</u>

**5 FINANCE COSTS**

	2014 £m	2013 £m
Interest payable on loans from Group undertakings	23.4	22.8
Interest payable on other loans	5.8	5.9
	<u>29.2</u>	<u>28.7</u>
Total interest expense	(3.1)	(1.6)
Amounts included in the cost of qualifying assets		
	<u>26.1</u>	<u>27.1</u>

**6 OPERATING PROFIT**

	2014 £m	2013 £m
This is stated after charging/(crediting):		
Staff costs (Note 7)	44.2	41.0
Research costs	6.7	9.4
Depreciation of property, plant and equipment	61.8	56.7
Amortisation of deferred revenue	(18.7)	(16.1)
Amortisation of intangibles	1.9	0.9
Impairment loss on trade and other receivables	-	-
	<u>-</u>	<u>-</u>
Analysis of auditor's remuneration is as follows:		
	2014 £000	2013 £000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	68	65
Other services supplied pursuant to legislation	39	38
Other assurance services	9	9
Other services	130	-
	<u>130</u>	<u>-</u>

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

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**7 STAFF COSTS**

	2014 £m	2013 £m
Salaries	46.7	43.3
Social security costs	4.6	4.2
Defined benefit pension costs	31.0	30.4
Defined contribution pension costs	1.0	0.6
	<u>83.3</u>	<u>78.5</u>
Less charged to property, plant and equipment	<u>(39.1)</u>	<u>(37.5)</u>
	<u>44.2</u>	<u>41.0</u>

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

The average monthly number of employees during the year was:

	2014 No.	2013 No.
Technical	309	288
Industrial	449	454
Administration	190	177
Other	92	79
	<u>1,040</u>	<u>998</u>

**8 DIRECTORS' & KEY PERSONNEL REMUNERATION**

DIRECTORS' REMUNERATION	2014 £	2013 £
<u>Highest Paid</u>		
Short-term employee benefits	256,930	178,207
Post-employment benefits	23,379	24,902
Other long-term benefits	269,900	242,468
	<u>550,209</u>	<u>445,577</u>
	2014 £	2013 £
<u>Total</u>		
Short-term employee benefits	581,215	493,439
Post-employment benefits	84,176	84,663
Other long-term benefits	630,065	561,004
	<u>1,295,456</u>	<u>1,139,106</u>
Directors who are members of the defined benefit scheme	<u>4</u>	<u>4</u>
Accrued pension benefit relating to highest paid director	<u>-</u>	<u>-</u>



**NORTHERN POWERGRID (NORTHEAST) LIMITED**

**REGISTERED NUMBER 02906593**

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**8 DIRECTORS' & KEY PERSONNEL REMUNERATION (CONTINUED)**

OTHER KEY PERSONNEL REMUNERATION	2014 £	2013 £
<u>Total</u>		
Short-term employee benefits	216,933	181,672
Post-employment benefits	46,118	44,641
Other long-term benefits	119,975	83,923
	<u>383,026</u>	<u>310,236</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 Northern Powergrid Group, of which the Company is a subsidiary. The figures above represent the share of the costs borne by the Company.

**9 INCOME TAX EXPENSE**

	2014 £m	2013 £m
Analysis of tax expense:		
Current tax expense:		
Corporation tax charge for the year	24.7	27.8
Payments for use of group losses	-	-
Over provision for prior years	<u>(1.2)</u>	<u>(2.6)</u>
Total current tax charge	23.5	25.2
Deferred tax:		
Deferred tax expense/(income) relating to the origination and reversal of temporary differences	0.2	(1.8)
Effect of changes in legislation	<u>(14.7)</u>	<u>(4.9)</u>
Total deferred tax credit	<u>(14.5)</u>	<u>(6.7)</u>
Tax on profit before tax	<u>9.0</u>	<u>18.5</u>
The total charge can be reconciled to the accounting profit as follows:		
Profit before tax	<u>116.3</u>	<u>122.0</u>
Tax on profit before tax at standard rate of corporation tax in United Kingdom of 23% (2012: 24%)	26.7	29.3
Effect of changes in tax rate	(14.7)	(4.9)
Release of deferred tax provision in relation to temporary differences	-	(4.1)
Under provision for prior years	<u>(3.0)</u>	<u>(1.8)</u>
Tax on profit before tax	<u>9.0</u>	<u>18.5</u>

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**9 INCOME TAX EXPENSE (CONTINUED)**

The Finance Act 2013 included provisions that the standard rate of corporation tax in the United Kingdom would reduce from 23% to 21% from April 2014 and to 20% from April 2015. These were substantively enacted on 2 July 2013. Accordingly, the rate of 20% has been applied when calculating deferred tax assets and liabilities as at 31 March 2014.

**10 DIVIDENDS**

	2014 Pence per share	2013 Pence per share	2014 £m	2013 £m
Dividend paid	<u>15.0</u>	<u>15.0</u>	<u>30.0</u>	<u>30.0</u>

**11 PROPERTY, PLANT AND EQUIPMENT**

	Distribution system  £m	Fixtures and Equipment  £m	Non- Operational Land & Buildings  £m	Total  £m
<b>COST</b>				
At 1 April 2012	1,894.4	21.0	3.7	1,919.1
Additions	190.1	1.1	0.5	191.7
Disposals	<u>(6.6)</u>	<u>-</u>	<u>-</u>	<u>(6.6)</u>
At 1 April 2013	2,077.9	22.1	4.2	2,104.2
Additions	207.8	2.4	-	210.2
Disposals	<u>(8.7)</u>	<u>-</u>	<u>-</u>	<u>(8.7)</u>
At 31 March 2014	<u>2,277.0</u>	<u>24.5</u>	<u>4.2</u>	<u>2,305.7</u>
<b>ACCUMULATED DEPRECIATION</b>				
At 1 April 2012	314.7	17.1	-	331.8
Charge for the year	54.8	1.9	-	56.7
Disposals	<u>(6.6)</u>	<u>-</u>	<u>-</u>	<u>(6.6)</u>
At 1 April 2013	362.9	19.0	-	381.9
Charge for the year	59.0	1.5	1.3	61.8
Disposals	<u>(8.7)</u>	<u>-</u>	<u>-</u>	<u>(8.7)</u>
At 31 March 2014	<u>413.2</u>	<u>20.5</u>	<u>1.3</u>	<u>435.0</u>
Net book value at 31 March 2014	<u>1,863.8</u>	<u>4.0</u>	<u>2.9</u>	<u>1,870.7</u>
Net book value at 31 March 2013	<u>1,715.0</u>	<u>3.1</u>	<u>4.2</u>	<u>1,722.3</u>

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**11 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

Assets in the course of construction included above

	Distribution system	Fixtures and Equipment	Non- Operational Land & Buildings	Total
	£m	£m	£m	£m
At 1 April 2012	90.7	-	-	90.7
Additions	190.1	-	-	190.1
Available for use	(132.6)	-	-	(132.6)
At 1 April 2013	148.2	-	-	148.2
Additions	207.8	-	-	207.8
Available for use	(158.9)	-	-	(158.9)
At 31 March 2014	197.1	-	-	197.1

The net book value of non-operational land and buildings comprises:

	2014 £m	2013 £m
Freehold	2.2	3.5
Long-leasehold	0.7	0.7
	2.9	4.2

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £32.5m (2013: £34.9m).

**NORTHERN POWERGRID (NORTHEAST) LIMITED****REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)****12 INTANGIBLE ASSETS**

	Software Development Costs £m
COST	
At 1 April 2012	22.5
Additions	5.5
	<hr/>
At 1 April 2013	28.0
Additions	10.6
	<hr/>
At 31 March 2014	<u>38.6</u>
AMORTISATION	
At 1 April 2012	17.6
Charge for the year	0.9
	<hr/>
At 1 April 2013	18.5
Charge for the year	1.9
	<hr/>
At 31 March 2014	<u>20.4</u>
Net book value at 31 March 2014	<u>18.2</u>
Net book value at 31 March 2013	<u>9.5</u>

**13 INVESTMENTS**

Details of the principal investments of the Company at 31 March 2014 are listed below:

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

The above investments are unlisted. The cost and net book value of the investments are Electralink Limited £62 (2013: £62), MRA Service Company Limited £1 (2013: £1), DCUSA Limited £1 (2013: £1) and Northern Electric Finance plc £50,000 (2013: £50,000).

**NORTHERN POWERGRID (NORTHEAST) LIMITED****REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)****14 INVENTORIES**

	2014 £m	2013 £m
Raw materials and consumables	9.5	10.3
Work in progress	0.1	0.1
	<u>9.6</u>	<u>10.4</u>

**15 TRADE AND OTHER RECEIVABLES**

	2014 £m	2013 £m
Distribution use of system receivables	46.3	45.8
Amounts receivable from sale of goods and services	1.5	0.1
Prepayments and accrued income	1.2	2.1
Other receivables	0.8	0.3
	<u>49.8</u>	<u>48.3</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 statement of financial position date. The maximum exposure to risk to the Company is the book value of these receivables less any provisions for impairment. The fair valuation of assets is based on Level 1 inputs.

**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 27% of distribution revenues in the regulatory year to 31 March 2014 (2013: 27%). 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 £Nil as at 31 March 2014 (2013: £Nil).

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 £Nil, which have been placed into administration. Consequently, no provision was required at the year-end (2013: £Nil).

**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 26 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 POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**15 TRADE AND OTHER RECEIVABLES (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 £0.9m (2013: £0.8m) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.4m (2013: £0.4m) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 611 days (2013: 619 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.2m (2013: £0.2m). 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 61 days (2013: 65 days).

Ageing of past due but not impaired receivables

	2014 £m	2013 £m
30-60 days	0.2	0.2
Total	0.2	0.2

**Movement in the allowance for doubtful debts**

	£m	£m
At 1 April	0.4	0.4
Amounts recognised in statement of profit or loss	-	-
At 31 March	0.4	0.4

In determining the recoverability of the trade and other receivables, the Company considers any change in the credit quality of the trade and other receivables 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 no further credit provision is 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 (2013: £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 POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**15 TRADE AND OTHER RECEIVABLES (CONTINUED)**

**Categories of financial assets**

	2014 £m	2013 £m
Loans and receivables at amortised cost	48.6	46.2
Total financial assets	<u>48.6</u>	<u>46.2</u>
Non-current assets	1,888.9	1,731.8
Inventories	9.6	10.4
Prepayments and accrued income	1.2	2.1
Total non-financial assets	<u>1,899.7</u>	<u>1,744.3</u>
Total Assets	<u>1,948.3</u>	<u>1,790.5</u>

**16 OTHER FINANCIAL LIABILITIES**

**Trade and other payables**

	2014 £m	2013 £m
Payments received on account	30.1	30.0
Trade payables	4.2	4.3
Amounts owed to Group undertakings	0.4	0.4
Other taxes and social security costs	3.2	2.9
Accruals	36.0	31.8
Other payables	10.0	9.6
	<u>83.9</u>	<u>79.0</u>

**Current income tax liabilities**

	2014 £m	2013 £m
Corporation tax	14.1	11.7
Group relief	-	4.7
	<u>14.1</u>	<u>16.4</u>

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the statement of financial position date. The fair valuation of liabilities is based on Level 1 inputs. 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 POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**16 OTHER FINANCIAL LIABILITIES (CONTINUED)**

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

	Less than 3 months £m	3 months To 1 year £m	1 to 5 Years £m	5+ Years £m	Total £m
2014:					
Non-interest bearing	53.9	-	-	-	53.9
Variable Interest Rate Liability	23.5	-	-	-	23.5
Fixed interest rate liability	<u>2.6</u>	<u>24.9</u>	<u>190.0</u>	<u>637.4</u>	<u>854.9</u>
	<u>80.0</u>	<u>24.9</u>	<u>190.0</u>	<u>637.4</u>	<u>932.3</u>
2013:					
Non-interest bearing	49.1	-	-	-	49.1
Fixed interest rate liability	<u>27.5</u>	<u>24.9</u>	<u>110.0</u>	<u>744.9</u>	<u>907.3</u>
	<u>76.6</u>	<u>24.9</u>	<u>110.0</u>	<u>744.9</u>	<u>956.4</u>

**Categories of financial liabilities**

	2014 £m	2013 £m
Loans and payables at amortised cost	<u>593.0</u>	<u>515.7</u>
Total financial liabilities	<u>593.0</u>	<u>515.7</u>
Payments received on account	30.1	30.0
Income tax liabilities	111.8	128.6
Other taxes and social security	3.2	2.9
Accruals	36.0	31.8
Deferred revenue	510.7	495.3
Provisions	<u>1.9</u>	<u>1.9</u>
Total non-financial liabilities	<u>693.7</u>	<u>690.5</u>
Total liabilities	<u>1,286.7</u>	<u>1,206.2</u>



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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**17 BORROWINGS**

The Directors' consideration of liquidity, interest rate and foreign currency risk is described in the Strategic Report on pages 5 and 6.

	Book value		Fair value	
	2014 £m	2013 £m	2014 £m	2013 £m
Loans	161.1	119.6	170.6	134.9
Amounts owed to Group undertakings	417.3	381.8	481.1	462.7
	<u>578.4</u>	<u>501.4</u>	<u>651.7</u>	<u>597.6</u>
The borrowings are repayable as follows:				
On demand or within one year	111.7	34.8	111.7	34.7
After one years	466.7	466.6	540.0	562.9
	<u>578.4</u>	<u>501.4</u>	<u>651.7</u>	<u>597.6</u>
Analysis of borrowings:				
Short-term loan	41.5	-	41.5	-
Inter-company short-term loan	60.3	24.9	60.3	24.9
Northern Electric Finance plc 2020 – 8.875%	104.1	104.1	136.1	144.3
Northern Electric Finance plc 2035 – 5.125%	50.1	50.1	57.8	57.8
Yorkshire Electricity Group plc 2037 – 5.9%	101.5	101.5	119.0	123.7
Northern Electric Finance plc 2037 – 5.125%	101.3	101.2	107.9	112.0
European Investment Bank 2018 – 4.065%*	40.2	40.2	42.9	44.5
European Investment Bank 2019 – 4.241%*	40.2	40.2	43.4	45.5
European Investment Bank 2020 – 4.386%*	39.2	39.2	42.8	44.9
	<u>578.4</u>	<u>501.4</u>	<u>651.7</u>	<u>597.6</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. The fair valuation of liabilities is based on Level 1 inputs.

\* 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 is as follows:

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

Interest on short-term loans and inter-company short-term loans is charged at a floating rate of LIBOR plus 1.25%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £1.1m 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 loans are non-secured and are denominated in sterling.

**NORTHERN POWERGRID (NORTHEAST) LIMITED**

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**17 BORROWINGS (CONTINUED)**

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 2014 totalled £569.2m. Using the RAV value as at March 2014, 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 Prices Index ("RPI") gives an approximation for the RAV value as at 31 March 2014 of £1,177.7m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 48.3% (2013: 44.4%).

At 31 March 2014, the Company had available £52.5m (2013: £79.0m) 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 2012	119.1	(0.2)	118.9
Credit to statement of profit or loss	(6.7)	-	(6.7)
At 1 April 2013	112.4	(0.2)	112.2
Credit to statement of profit or loss	(14.5)	-	(14.5)
At 31 March 2014	97.9	(0.2)	97.7

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)

19 DEFERRED REVENUE

	£m	
At 1 April 2012	465.7	
Additions	45.7	
Amortisation	<u>(16.1)</u>	
At 1 April 2013	495.3	
Additions	34.1	
Amortisation	<u>(18.7)</u>	
At 31 March 2014	<u>510.7</u>	
	2014	2013
	£m	£m
Included in current liabilities	19.4	20.1
Included in non-current liabilities	<u>491.3</u>	<u>475.2</u>
	<u>510.7</u>	<u>495.3</u>

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

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**20 PROVISIONS**

	Claims £m	Other £m	Total £m
At 1 April 2012	1.2	0.8	2.0
Utilised/paid in the year	(1.0)	-	(1.0)
Charged to the statement of profit or loss	0.9	-	0.9
At 1 April 2013	1.1	0.8	1.9
Utilised/paid in the year	(0.5)	-	(0.5)
Charged to statement of profit or loss	0.5	-	0.5
At 31 March 2014	1.1	0.8	1.9
		2014 £m	2013 £m
Included in current liabilities		1.6	1.5
Included in non-current liabilities		0.3	0.4
		1.9	1.9

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 15 years.

**21 SHARE CAPITAL**

	2014 No./£	2013 No./£
Ordinary shares of £1 each		
Allotted, called-up and fully paid	200,000,100	200,000,100

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

**NORTHERN POWERGRID (NORTHEAST) LIMITED****REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)****22 RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS**

	2014 £m	2013 £m
Profit before income tax	116.3	122.0
Depreciation and amortisation	63.7	57.6
Profit on disposal of fixed assets	(0.4)	(0.3)
Amortisation of deferred revenue	(18.7)	(16.1)
Increase/(decrease) in provisions	-	(0.1)
Interest receivable	(0.1)	(0.1)
Finance costs	26.1	27.1
Investment income	(0.1)	-
Operating cash flows before movements in working capital	186.8	190.1
Decrease/(increase) in inventories	0.8	(2.0)
Increase in receivables	(1.6)	(2.6)
Increase/(decrease) in payables	0.3	(9.9)
Cash generated from operations	<u>186.3</u>	<u>175.6</u>

**23 PENSION COMMITMENTS****Introduction**

The Company contributes to two pension schemes, which are operated by Northern Electric plc on behalf of the participating companies within the Northern Powergrid Group. Those pension schemes are:

- The Northern Powergrid Group of the ESPS (the "DB Scheme"); and
- The Northern Powergrid Pension Scheme.

The Northern Powergrid Pension Scheme was introduced for new employees of the Northern Powergrid Group from July 1997 and is a money purchase arrangement accounted for as a defined contribution scheme.

The DB Scheme is a defined benefit scheme for directors and employees, which provides pension and other related retirement benefits based on final pensionable pay. The DB Scheme closed to staff commencing employment with the Northern Powergrid Group on or after 23 July 1997. Members who joined before this date, including some Protected Persons under The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990, continue to build up future pension benefits.

Under the DB Scheme, employees are typically entitled to annual pensions on retirement at age 63 of one-eightieth of final pensionable salary for each year of service plus an additional tax-free cash lump sum at retirement of three times pension. Benefits are also payable on death and following other events such as withdrawing from active service.

The Company does not provide any other post-retirement benefits to these employees.

**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**23 PENSION COMMITMENTS (CONTINUED)**

**Role of Trustees**

The DB Scheme is administered by a board of Trustees which is legally separate from the Company. The assets of the DB Scheme are held in a separate trustee-administered fund. The board of Trustees is made up of Trustees appointed by Northern Electric plc, as the Principal Employer of the DB Scheme, Trustees elected by the membership and an independent trustee. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible in particular for the asset investment policy plus the day-to-day administration of the benefits. They are also responsible for jointly agreeing with the Principal Employer the level of contributions due to the DB Scheme.

**Funding requirements**

UK legislation requires that pension schemes are funded prudently (i.e. to a level in excess of the current expected cost of providing benefits). The last funding valuation of the DB scheme was carried out by the Group Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2010. Such valuations are required by law to take place at intervals of no more than three years and, therefore, an actuarial valuation is currently ongoing with an effective date of 31 March 2013. Following each valuation, the Trustees and the Northern Powergrid Group must agree the contributions required (if any) to ensure the DB Scheme is fully funded over time on the basis of suitable, prudent assumptions. Contributions agreed in this manner constitute a minimum funding requirement.

Agreement was reached during June 2011 with the Group Trustees to repair the funding deficit of £276m as at 31 March 2010 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 (of which £20.7m is borne by the Company) per annum over the period to 31 March 2015, made on a monthly basis, followed by an agreed profile of payments to be made over the remaining ten years of the recovery plan, as set out below:

1 April 2015 to 31 March 2016	£24.5m p.a.
1 April 2016 to 31 March 2023	£16.3m p.a.
1 April 2023 to 31 March 2025	£17.4m p.a.

All contributions set out above are in 2010/11 terms and increase in line with increases in RPI over the period until they fall due. However, this recovery plan is currently under review as part of the 31 March 2013 valuation.

The contributions payable by the Company to the DB Scheme in respect of future benefits, which are accruing, are 47.0% (for certain senior management) and 29.4% (for other employees) of pensionable pay. These contributions were determined as part of the 31 March 2010 actuarial valuation and are payable in addition to the deficit repair contributions mentioned above. These rates will remain in place until such a time as a new schedule of contributions is agreed between the Trustees and Northern Electric plc as part of the 31 March 2013 valuation.

Under the rules of the DB Scheme, any future surplus in the DB Scheme may, following consultation with the Group Trustees, be allocated for the benefit of the members of the DB Scheme and/or the Principal and Participating Employers.

**Regulation**

The UK pensions market is regulated by the Pensions Regulator whose key statutory objectives in relation to UK defined benefit plans are to:

- protect the benefits of members;

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## NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)

### 23 PENSION COMMITMENTS (CONTINUED)

#### Regulation (continued)

- promote, and to improve understanding of good administration; and
- reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF).

The Pensions Regulator has various powers including to:

- wind up a scheme where winding up is necessary to protect members' interests;
- appoint or remove a trustee;
- impose a schedule of company contributions or the calculation of the technical provisions where trustees and company fail to agree on appropriate contributions; and
- impose a contribution where there has been a detrimental action against the scheme.

#### Reporting at 31 March 2014

For the purposes of this disclosure, the DB Scheme's current and future pension costs have been assessed by Aon Hewitt, a qualified independent actuary using assumptions set out below, which the actuary has confirmed facilitate a reasonable best estimate of those costs. This review has been based on the same membership and other data as at 31 March 2010. The board has accepted the advice of the actuary and formally approved the use of those assumptions for the purpose of this disclosure note.

The results of the latest funding valuation at 31 March 2010 have been adjusted to the statement of financial position date taking account of experience over the period since 31 March 2010, changes in market conditions and differences in the financial and demographic assumptions. The present value of the defined benefit obligation (the "DBO"), and the related current service cost, were measured using the Projected Unit Credit Method.

For schemes closed to new members, such as the DB Scheme, the current service cost calculated under the Projected Unit Credit Method is expected to increase as the members of the scheme approach retirement.

The Company pension cost for the regulatory year ended 31 March 2014 was £32.0m (2013: £31.0m).

The principal assumptions used to calculate the liabilities under IAS 19 are set out below:

Main financial assumptions	2014	2013
	% p.a.	% p.a.
RPI Inflation	3.10	3.30
Rate of long-term increase in salaries	3.10	3.30
Pension increases	3.00	3.30
Discount rate for scheme liabilities	4.30	4.50

The financial assumptions reflect the nature and term of the DB Scheme's liabilities.

Main demographic assumptions	2014	2013
Life expectancy for a male currently aged 60	27.2	28.0
Life expectancy for a female currently aged 60	28.9	28.2
Life expectancy at 60 for a male currently aged 45	28.9	29.7
Life expectancy at 60 for a female currently aged 45	30.7	29.9
Proportion of pension exchanged for additional cash at retirement	10%	0%

The mortality assumptions are based on recent actual mortality experience of DB Scheme members and allow for expected future improvements in mortality rates.

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**23 PENSION COMMITMENTS (CONTINUED)**

The DB Scheme's funds are invested in the following assets:

<b>Asset allocation</b>	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
Developed market equity	<b>291.4</b>	261
Emerging market equity	<b>12.2</b>	13.2
Property	<b>115.3</b>	104.1
Reinsurance	<b>62.4</b>	60.1
Listed infrastructure	<b>72.3</b>	63.6
Investment grade corporate bonds	<b>343.7</b>	335.2
Other debt	<b>38.6</b>	40.2
Fixed interest gilts	<b>20.7</b>	15.5
Index-linked gilts	<b>361.6</b>	391.3
Cash	<b>28.5</b>	16.8
<b>Total</b>	<b><u>1,346.7</u></b>	<b><u>1,301.0</u></b>

The fair values of the above equity and debt instruments are determined based on quoted market prices in active markets whereas the fair values of properties are not based on quoted prices in active markets.

As at 31 March 2014, the fair value of the DB Scheme's assets, which related to self-investment, amounted to £Nil (2013: £Nil).

**Changes to the present value of the defined benefit obligation of the Northern Powergrid Group during the year**

	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
Opening defined benefit obligation	<b><u>1,378.5</u></b>	<u>1,227.4</u>
Current service cost	<b>14.7</b>	12.6
Interest expense on defined benefit obligation	<b>61.2</b>	58.1
Contributions by DB Scheme participants	<b>1.5</b>	1.7
Actuarial (gains)/losses on DB Scheme liabilities arising from changes in demographic assumptions	<b>(29.2)</b>	-
Actuarial (gains)/losses on DB Scheme liabilities arising from changes in financial assumptions	<b>(26.9)</b>	130.6
Actuarial losses/(gains) on DB Scheme liabilities arising from experience	<b>3.6</b>	(1.9)
Net benefits paid out	<b><u>(53.7)</u></b>	<u>(50.0)</u>
Closing defined benefit obligation	<b><u><u>1,349.7</u></u></b>	<u><u>1,378.5</u></u>



**NORTHERN POWERGRID (NORTHEAST) LIMITED****REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)****23 PENSION COMMITMENTS (CONTINUED)****Changes in the fair value of DB Scheme assets of the Northern Powergrid Group during the year**

	2014 £m	2013 £m
Opening fair value of DB Scheme assets	<u>1,301.0</u>	<u>1,156.8</u>
Interest income on DB Scheme assets	58.5	55.6
Re-measurement (losses)/gains on DB Scheme assets	(10.1)	87.6
Contributions by the employer	51.0	50.4
Contributions by DB Scheme participants	1.5	1.7
Net benefits paid out	(53.7)	(50.0)
Administration costs incurred	<u>(1.5)</u>	<u>(1.1)</u>
Closing fair value of DB Scheme assets	<u><u>1,346.7</u></u>	<u><u>1,301.0</u></u>

**Profile of the DB Scheme**

The DBO includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 17 years based on the provisional results of the 31 March 2013 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

Approximately 40% of the DBO is attributable to current employees (duration about 23 years), 10% to former employees (duration about 24 years) and 50% to current pensioners (duration about 12 years).

**Risks associated with the Company's defined benefit pensions**

The DB Scheme exposes the Company to a number of risks, the most significant of which are:

<b>Risk</b>	<b>Description</b>	<b>Mitigation</b>
<b>Volatile asset returns</b>	The DBO is calculated using a discount rate set with reference to corporate bond yields. If assets underperform this discount rate, this will create an element of deficit. The DB Scheme holds a significant proportion (29%) of its assets in growth assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term.	To avoid concentration risk the allocation to UK equity is restricted to approximately 35% of the total equity allocation. The allocation to growth assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from growth seeking assets and have recently diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk.

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## NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)

### 23 PENSION COMMITMENTS (CONTINUED)

<b>Changes in bond yields</b>	A decrease in corporate bond yields will increase the value placed on the DBO for accounting purposes, although this will be partially offset by an increase in the value of the DB Scheme's bond holdings.	The DB Scheme also holds a substantial proportion of its assets (35%) as bonds, which provide a hedge against movements in the DBO. There are some differences in the credit quality of bonds held by the DB Scheme and the bonds analysed to decide the DBO discount rate, such that there remains some risk should yields on different quality bond/swap assets diverge.
<b>Inflation risk</b>	A significant proportion of the DBO is indexed in line with price inflation (specifically in line with RPI) and higher inflation will lead to higher liabilities	The DB Scheme holds around 30% in UK government index-linked bonds which provide a hedge against higher than expected inflation increases of the DBO (rising inflation will increase both the DBO and the value of the index-linked bond portfolio).
<b>Currency risk</b>	To increase diversification, the DB Scheme invests in overseas assets. This leads to a risk that foreign currency movements negatively impact the value of assets in Sterling terms.	The DB Scheme hedges a proportion of the overseas investments currency risk for those overseas currencies that can be hedged efficiently. The DB Scheme's currency hedging ratio is currently 50% in respect of overseas developed market currencies.
<b>Life expectancy</b>	The majority of the DB Scheme's obligations are to provide benefits for the pensionable lifetime of the member, so increases in life expectancy will result in an increase in the liabilities.	The Trustees regularly review actual experience of the membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption.

#### **Other risks**

There are a number of other risks of running the DB Scheme including operational risks (such as paying out the wrong benefits), legislative risks (such as the government increasing the burden on pension schemes through new legislation) and other demographic risks (such as a higher proportion of members dying than assumed with a dependant eligible to receive a survivor's pension from the DB Scheme).

A particular legislative risk exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"), a quasi-state benefit accrued by many UK plans over the period 1978 to 1997 as a result of a UK government programme allowing pension plans to "contract out" of the State Second Pension. The UK Government has announced its intention to ensure that these benefits, which currently pay out at different levels for men and women, are gender-equalised in accordance with sex-discrimination legislation. This would increase the DBO but it is not possible to fully quantify the impact of this change at this stage. However, it could lead to an increase in the order of 2% to the DBO for a typical scheme.

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**NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)**

**23 PENSION COMMITMENTS (CONTINUED)**

**Sensitivity to key assumptions**

The key assumptions used for IAS 19 are discount rate, inflation and mortality. If different assumptions were used, it could have a material effect on the results of the Northern Powergrid Group. The sensitivity of the results to these assumptions is as follows.

	<b>Changes in DBO</b>	<b>Revised DBO</b>
Current Figures		1,349.7
Following a 10 bps decrease in the discount rate	23.2	1,372.9
Following a 10 bps increase in the discount rate	(22.8)	1,326.9
Following a 10 bps increase in the inflation assumption	22.0	1,371.7
Following a 10 bps decrease in the inflation assumption	(21.7)	1,328.0
Following a 1 year increase in life expectancy	42.1	1,391.8
Following a 1 year decrease in life expectancy	(42.8)	1,306.9

The sensitivity information shown above has been prepared using the same method as adopted when adjusting the results of the latest funding valuation to the statement of financial position date. This is the same approach as has been adopted in previous periods.

**24 OPERATING LEASE ARRANGEMENTS**

	<b>2014 £m</b>	<b>2013 £m</b>
Minimum lease payments under operating leases recognised in the year	<u>6.7</u>	<u>6.1</u>

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

	<b>2014 £m</b>	<b>2013 £m</b>
Within one year	4.5	4.3
In the second to fifth year inclusive	15.9	15.8
After five years	<u>3.8</u>	<u>7.9</u>
	<u>24.2</u>	<u>28.0</u>

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

**25 RELATED PARTY TRANSACTIONS**

The Company has advanced loans to companies in the Northern Powergrid Group. The total interest included in investment income in the statement of profit or loss for the year ended 31 March 2014 was £0.1m (2013: £0.1m).

The Company has received loans from other companies in the Northern Powergrid Group. The total interest included in finance costs in the statement of profit or loss for the year ended 31 March 2014 was £23.5m (2013: £22.8m). Included within borrowings is £417.3m as at 31 March 2014 (2013: £381.8m).

Interest on loans to/from Northern Powergrid Group companies is charged at a commercial rate.

**NORTHERN POWERGRID (NORTHEAST) LIMITED****REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2014 (CONTINUED)****26 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	Purchases from Related Party	Amounts Owed to Related Party (Note 16)
	£m	£m	£m
2014:			
CE Insurance Services Limited	-	0.5	-
Integrated Utility Services Limited	0.4	1.6	-
Integrated Utility Services Limited (registered in Eire)	-	1.3	0.3
Northern Electric plc	0.1	6.6	-
Northern Powergrid (Yorkshire) plc	15.2	9.6	-
Vehicle Lease and Service Limited	-	3.6	0.4
2013:			
CE Insurance Services Limited	-	0.8	-
Integrated Utility Services Limited	0.4	0.7	-
Integrated Utility Services Limited (registered in Eire)	-	1.0	-
Northern Electric plc	0.1	6.7	-
Northern Powergrid (Yorkshire) plc	12.1	5.9	-
Vehicle Lease and Service Limited	-	3.6	0.4

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

During the regulatory year ended 31 March 2013 the Company purchased land and buildings for £0.5m from Northern Electric Properties Limited, an affiliated company in the Northern Powergrid Group.

**27 IMMEDIATE PARENT UNDERTAKING AND CONTROLLING PARTY**

The immediate parent undertaking of Northern Powergrid (Northeast) 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 Powergrid (Northeast) Limited and the group accounts of Northern Electric plc, the smallest parent undertaking to prepare group accounts in the United Kingdom, can both be obtained from the Company Secretary, Northern Powergrid Holdings Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.