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**STRATEGIC REPORT, REPORT OF THE DIRECTORS AND
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016
FOR
NORTHERN POWERGRID (NORTHEAST) LIMITED**

NORTHERN POWERGRID (NORTHEAST) LIMITED

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NORTHERN POWERGRID (NORTHEAST) LIMITED

**COMPANY INFORMATION
FOR THE YEAR ENDED 31 DECEMBER 2016**

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N M Gill
P A Jones
A J Maclellan
A R Marshall
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COMPANY SECRETARY:

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REGISTERED NUMBER:

02906593 (England and Wales)

AUDITOR:

Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle upon Tyne
United Kingdom

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

The directors present the annual reports and accounts for the year ended 31 December 2016 of Northern Powergrid (Northeast) Limited (the "Company"), which include the Strategic Report, the Report of the Directors and the audited financial statements for that year. Pages 2 to 20 inclusive comprise the Strategic Report and pages 21 to 24 comprise the Report of the Directors, which have been drawn up and are presented in accordance with the Companies Act 2006.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

These annual reports and accounts have been prepared for the members of the Company only. The Company, its directors, employees or agents do not accept or assume responsibility to any other person in connection with this document and any such responsibility or liability is expressly disclaimed. These annual reports and 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, forward-looking 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 these annual reports and accounts and will not be updated during the year. Nothing in these annual reports and accounts should be construed as a profit forecast.

BUSINESS MODEL

The Company is part of the Northern Powergrid Holdings Company group of companies, (the "Northern Powergrid Group"), which is ultimately owned by Berkshire Hathaway Inc. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. As a distribution network operator ("DNO"), the Company 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. Some 14,862 gigawatt-hours (GWh) of electricity were distributed to those customers during the year. The Company's distribution network includes over 41,000 kilometres (km) of overhead and underground cables and over 27,000 substations. Electricity is received from the National Grid's transmission system and from generators connected directly to the network and then distributed at voltages of up to 132 kilovolts (kV).

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:

Principle	Strategy	Indicator
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.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

BUSINESS MODEL - continued

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 and accordingly remain consistent 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 community and environment.

REVIEW OF THE YEAR

The Company delivered a satisfactory financial performance for the year, benefitting from a further change to the rate of taxation, settlement of a prior year tax claim, and continued effective cost control, with revenue at £333.0 million being £9.7 million less than in 2015. The decrease in revenue was mainly due to the reduction in tariffs introduced with effect from the start of the current regulatory period, which runs from 1 April 2015 to 31 March 2023 (the "ED1 Period").

Throughout 2016, the Company continued its policy of enhancing the efficiency of its electricity distribution network by investing £181.5 million in order to deliver the improvements required to maintain an effective supply of electricity to customers. As was the case in 2015, the resilience of the network was tested during the year by several major weather events, including intense lightning storms, periods of very heavy rain and high winds. The Company's major incident management processes were implemented in these instances to ensure that interruptions to customers were minimised. The on-going investments in the network, including those to assist with the management of environmental incidents, and the responses put in place to mitigate the effects of such events, supported the Company's achievements made against the incentive scheme operated by the Office of Gas and Electricity Markets ("Ofgem") for quality of service targets with the number of customer minutes lost and customer interruptions both below the target levels.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

REVIEW OF THE YEAR - continued

The Company remained focussed on the affordability, availability and reliability of the service it provides. Accordingly, the way in which the Company interacted with and supported its stakeholders continued to be important. The results of Ofgem's stakeholder engagement and customer vulnerability submission were disappointing. When compared against the other five DNOs, the Northern Powergrid Group ranked in fifth place (a decline from its previous position of second). In response, the opportunity was taken to further engage with vulnerable customers, those who struggle with fuel poverty, customers who require priority services and those whose welfare could be affected in the event of an interruption to supply. Collaboration with partners including the Children's Society, the British Red Cross and Citizens Advice was undertaken to deliver enhanced support to those groups with a greater need for assistance.

Customer satisfaction continued to be a management priority and therefore multi-year programmes continued throughout the year to embed improvements into the overall customer experience. To further develop the quality of customer conversations, defined performance standards were implemented, supported by a pilot recognition and reward scheme for employees. The Customer Relationship Management ("CRM") IT system was further deployed allowing faster responses with a greater degree of accuracy for the management of customer complaints, general enquiries services and service alterations. The use of technology (including the CRM system) was further embedded to enhance the ways in which customers can make contact with the Company. Due to the initiatives in place, with the Company writing, emailing and sending text messages to remind customers 72 hours and then 24 hours ahead of any planned power cuts taking place, further progress was made during the year to improve the level of customer satisfaction relating to planned power cuts.

The effect of the Company's operations on the local landscape, and upon wildlife and birds remained important and, accordingly, progress continued in the implementation of measures designed to protect the environment. Incidents reportable to the Environment Agency, including oil spills and leaks from the Company's assets and SF₆ gas discharges from electrical plant, were all significantly better than target. Given the impact on the environment of such events, the Company remains committed to reducing losses from fluid-filled cables and, during the ED1 period, plans to replace a significant number of those assets on a phased and prioritised basis.

The health and safety of the Company's employees, its contractors and customers continued to be a key priority in 2016, with the focus on delivering a safety and health improvement plan designed to accomplish a world class safety performance. Education concerning the dangers of coming into contact with the network's assets and how people can identify these dangers remained a firm commitment. A number of approaches were therefore deployed during the year to communicate health and safety messages to the Company's employees and stakeholders, including delivering regional school safety presentations, running operational seminars for the Company's engineers and circulating regular safety newsflashes to all staff. The Company also placed emphasis on the identification of significant health and safety risks and allocating the necessary resource to put actions in place to mitigate those risks. Driving the Company's vehicles has been identified as one such risk, and therefore a robust road risk management plan was expanded throughout 2016. This included the completion of the programme to install a telematics system in all fleet vehicles to increase driver and vehicle safety and to assist with vehicle safety checks.

In terms of health and safety performance, the Company made a strong contribution to the health and safety performance of the Northern Powergrid Group and the long-term overall trend continued to compare well with that of the industry. In recognition of the on-going health and safety initiatives in place, the Company was awarded a President's Award from the Royal Society for the Prevention of Accidents.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES

Financial strength

During the 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 ED1 price control provides the Company with some stability in terms of its income until 31 March 2023. The ED1 price control has been set for eight years with provision for a mid-period review of the outputs that the Company is required to deliver and, in that respect, the Company recognises that it needs to continue to show that it is delivering reliable services to its customers, while operating in an efficient and effective manner.

Key aspects of financial performance for the year were as follows:

Revenue

The Company's revenue at £333.0 million was £9.7 million lower than the prior year mainly due to the reduction in tariffs introduced with effect from the start of the ED1 period.

Operating profit and position at the year end

The Company's operating profit of £150.0 million was £9.7 million lower than the previous year, primarily reflecting decreased revenues and higher depreciation charges, partly offset by lower grid exit charges. The statement of financial position on page 29 shows that, as at 31 December 2016, the Company had total equity of £912.8 million. The directors consider the Company to have a strong statement of financial position which, when coupled with the preference of its parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy"), for operating with lower levels of debt than equivalent companies in the sector, creates a stable base for continued strong performance during the ED1 period.

Finance costs and investments

Finance costs net of finance income at £28.6 million were £2.2 million higher than the prior year due to higher net borrowings including a new credit facility with the European Investment Bank (the "EIB") from 16 December 2015.

Taxation

The effective tax rate in the year was 4.2%. The effective tax rate before adjusting for the impact of the changes in tax rates by the Finance Act 2016 and settlement of a prior year tax claim would be 19.8%. Details of the income tax expense are provided in Note 7 to the accounts.

Results and dividends

The Company made a profit after tax for the year of £116.3 million (2015: £119.5 million). An interim dividend of £21.8 million was paid during the year (2015: £20.6 million) and the directors recommended that no final dividend be paid in respect of the year to 31 December 2016.

Share capital and debt structure

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

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 £173.0 million was £19.6 million higher than the previous year, mainly as a result of lower tax paid.

Investing activities: Net cash used in investing activities at £154.0 million was £7.1 million lower than the previous year, reflecting lower capital expenditure partially offset by lower receipt of customer contributions.

Financing activities: The net cash used in financing activities at £18.9 million was £26.7 million higher than £7.8 million inflow in the previous year, reflecting net movements in borrowings required to fund business operations.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Financial strength - continued

Liquidity risk

As at 31 December 2016, the Company had 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. This expires on 30 April 2020. 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.

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 December 2016, 100% of the Company's long-term borrowings were at fixed rates and the average maturity for these borrowings was 12 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. Further details of the Company's commitments to the Scheme and the associated deficit repair payments are provided in Note 22 to the financial statements.

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 insurance policies, which cover risks associated with employers, third party motor 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 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 safe, reliable and dependable supply of electricity, together with a high standard of service to its customers.

Customer service improvements are a priority for the Company, which, in recent years had been consistently ranking in the lower half of Ofgem's customer service league tables. The Company has a long-term goal to improve this position and has a multi-year programme of actions in place to support improvements to the overall customer experience.

Customer satisfaction with the Company's response to unplanned power cuts showed gradual improvement in the year and the focus remains on improving restoration times and proactively communicating more timely and accurate information to customers. Continuous improvements were made to the interactive voice response telephony system throughout the year to make it easier for customers to talk to a customer service advisor and to route their calls appropriately. Customer satisfaction with planned power cuts also showed some improvement with the Company continually enhancing the content of written customer communications and continuing to provide a text and email service to remind customers 72 hours and then 24 hours ahead of the planned power cut taking place.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Customer service - continued

A framework was introduced during 2016 to define the high standards required of our staff when interacting with our customers, supported by a pilot recognition and reward scheme as well as a performance management structure.

The Company has continued to invest in improving the reliability of under-performing parts of the distribution network by identifying "hot spots" of substandard network performance and taking specific action to address the issues in those areas. In the customer service support areas, further investment has been directed towards information technology with the continued deployment of the new CRM system for customer complaints, additional general enquiries services and service alterations, to both improve the self-service offering and provide quicker and more accurate information to customers with workflows automatically routed within both the Company and its contractors. This technology will enable customers to communicate with the Company in a range of accessible and easy ways across several channels.

During the year the Company has continued to build on the industry-leading communications and engagement approaches used to support its business plan and maintains a number of engagement channels. Independently chaired expert panels continue to play a key role in challenging the Company's plans, monitoring its performance and helping to deliver innovative initiatives and services. Guided by these panels, the Company has been able to direct effort towards public meetings in the operating zones, community energy workshops aimed at enhancing the take-up of low-carbon technologies and wider collaborations such as with other utilities via Infrastructure North. The feedback received as part of the stakeholder engagement process helped the Company to further develop its customer experience improvement and social obligations programme.

The Company recognised that the evolving nature of the environment and the level of customer service provided in respect of new connections to the network required additional significant focus and, as such, initiated a fundamental business process re-engineering review of this area of the business. Further details regarding the connections activity in the year are provided under "Connections to the network" below.

The single emergency number, 105, went live in September 2016, providing customers with a free national easy to remember phone number. During the winter period of 2016, approximately 28% of all inbound calls relating to power cuts were received via the 105 number, calls that previously would all have been made to the Company's Freephone contact numbers.

In May 2016, the Company put forward its stakeholder engagement and customer vulnerability submission to Ofgem in respect of its work during the year. This included initiatives such as expanding the role of digital solutions in providing customer services and the enhancement of the Company's relationship with some voluntary sector organisations, with which it works closely in developing and delivering certain services particularly in respect of those customers on the Company's Priority Services Register. Following the submission to Ofgem's panel, the position of the Company in the context of the wider DNO group dropped from second place to fifth. The outcome was disappointing and in response to Ofgem's feedback some changes were initiated.

Under the Broad Measure of Customer Satisfaction, an independent market research company carried out telephone surveys with the Company's customers to find out how satisfied they were with the services provided. During the year, surveys were carried out with 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 86.4% for the financial year and expects that the customer experience 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 ratings year-on-year.

While recognising that its customer service performance can continually be improved, the Company made significant progress during the year ameliorating its overall customer satisfaction scores.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Customer service - continued

Connections to the Network

During the year, the Company continued to deliver its action plans to improve the connections services provided to its customers, whilst also actively facilitating the development of competition from independent connections providers ("ICPs"). The Company continued to engage regularly with its connections customers both in groups and individually, by holding monthly customer surgeries, twice yearly customer stakeholder events and contributing to national stakeholder forums and events.

There were three main areas of development in the Company's connections business during the year: the introduction of the new Competition in Connections Code of Practice, compliance with which became a licence condition with effect from the end of October 2015, the introduction of the full Incentive on Connections Engagement ("ICE") regime in April 2015 and the introduction of a customer service improvement programme to deliver improvements in customer satisfaction for connections customers.

The delivery of the customer satisfaction improvement programme continued to evolve during 2016, with its focus being in response to actions derived from customers' feedback obtained from weekly Ofgem telephone surveys. The programme is designed to support the Company's goal to be the leading provider of customer service within the electricity distribution sector.

The Company participated with other DNOs in the development of the new Competition in Connections code of practice and implemented the required new processes, including the provision of dual quotations, enabling ICPs to self-determine and approve points of connection to the network, and simplifying the authorisation process for ICPs' operational staff.

The start of the ED1 period saw the introduction of ICE in respect of customers requiring larger connections to the network, so that the needs of those customers can be met more effectively. Under ICE, the Company is required to submit a customer service improvement work plan for the forthcoming regulatory year at the end of April, followed by a comprehensive "looking back and forward" report commenting on the actions delivered in the previous year and future actions proposed in the service improvement plan. The Company worked throughout the year to deliver those actions and continued to engage actively with customers through both informal and formal stakeholder events.

Corporate responsibility

The Company places significant value on the relationships that it has with its customers and other stakeholders and also understands the importance of ensuring a secure and safe power supply for its customers and their local communities. To further embed these values, the Company has developed a vision to maximise the value of contact with customers, especially those who are vulnerable and hard to reach, while ensuring that all stakeholders have the opportunity to influence the local and national energy agenda through effective engagement. This vision applies Ofgem's feedback to the Company in the Stakeholder Engagement and Consumer Vulnerability review directed at a cohesive approach to customer experience; consumer vulnerability and stakeholder engagement. The Company has made a commitment to tailor and enhance the support provided for more vulnerable and hard to reach customers and to ensure an optimum overall customer experience. In addition, through effective engagement, stakeholders can shape and influence the Company's agenda and have the opportunity to help shape and prioritise plans according to customer preference.

The Company continued to work closely with key partners such as the Environment Agency, the local authorities and the local resilience forums so that it can respond quickly to significant faults on, or threats to, the network. An example of this collaboration in the year included the cascade of the new national '105' number, designed to make it easier for partners and customers to quickly get in touch to report a problem. The Company has well-established emergency procedures that are implemented when customers are without power for some time and, as such, the Company responded well to the significant weather-related incidents, which affected the distribution network during the year.

To address customer concerns and resolve any complaints, the Company utilises its customer ambassadors and customer liaison officers, who are allocated to each of its operating zones. Dedicated Priority Service Register co-ordinators contact our vulnerable customers to offer support during and after a power cut. Support may include liaising with staff from the British Red Cross who check on the welfare of the customer.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Customer service - continued

The Company has developed its support for vulnerable customers based on market research which defined where and what assistance was most needed. This work has been supported by the Company's Social Issues Expert Group which comprises external experts and advises on service improvements. Membership of the internal Social Responsibility Management Group has been widened to include more business representatives to help develop this programme. The Company continued to campaign to promote the Priority Services Register to eligible customers and now has a clear view of service need profiles for each customer to inform the appropriate priority service response. The Company has undertaken a comprehensive data cleanse process for the Register and developed a proactive contact programme to routinely renew records and ensure that the quality of the information held on the register and the services offered to priority services customers continue to improve.

The Northern Powergrid Group has maintained its support to charitable organisations through sponsorship and the "Safety Champions" initiative, which is aimed at enhancing safety performance in the operational zones. Furthermore, a volunteering policy was implemented permitting employees to volunteer on schemes specifically designed to support the five priority areas within the Company's community investment programme.

Safety remains the Company's first priority and underpins all operations. During the year, the Company continued to deliver initiatives that reached thousands of school children including its regular series of school safety presentations. The Company participated in 'Crucial Crew', which is a schools-based safety initiative that teaches children to recognise and avoid situations that put them in danger.

Other programmes expanded during the year included Make the Grade in Energy, an education, skills and employability programme, Energy Heroes, a new educational programme, which uses the maths curriculum at primary school level to promote awareness of energy costs and ways of saving energy, and Green Doctors, a multi-partner project which helped to install energy saving measures and give advice to fuel poor households. New projects undertaken in the year included a partnership with the Children's Society, which aims to support young people and families through specialist support services, including work sessions and group activities, and the creation of an outreach worker in Citizens Advice to train volunteers to help more vulnerable people, particularly those with fuel debt.

Operational excellence

The Company's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the year, £181.5 million was invested in the improvement of the distribution network. 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.

Ofgem's incentive scheme for quality of service provides a measure of the level of customer service. As a result of the Company's continued and substantial investment in its distribution network, reliability has increased over a sustained period and the Company has generally outperformed in relation to the customer service targets set by Ofgem in respect of customer interruptions ("CI") and customer minutes lost ("CML").

CML and CI are the key performance indicators used by the Company to measure the quality of supply and system performance. Both indicators are measured on a Regulatory Year basis, which runs annually to 31 March, (being 31 March 2016 for the period covered by this report). 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 per every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - 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. The Company's currently reported performance for the Regulatory Year is as follows:

	Year to 31 March 2016		Year to 31 March 2015	
	Actual	Target	Actual	Target
CML	50.1	<65.9	56.1	<70.6
CI	58.3	<63.8	65.3	<68.1

Consequently, performance in the Regulatory Year was better than Ofgem's target for both CML and CI and contributed to the Company's improved customer service performance.

Operational activity

During 2016, the Company continued to implement its approved network investment strategy, which is designed to deliver improvements in an efficient and cost-effective manner in order to improve the network's resilience. The Company is 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 Operations structure is designed to respond effectively to the needs of customers and local communities by delivering improved performance standards in the restoration of power following power cuts and in new connection activities for small works. That structure is organised into operating zones around the main conurbation of Tyne and Wear, the industrialised area around the Tees and the rural areas of Northumberland, Durham and North Yorkshire, including the Dales, the Vale of York and the North Yorkshire Moors. The guaranteed standard for the restoration of supply within 12 hours of a power cut occurring came into effect from 1 April 2015 and the Company's operational structure provides a localised focus to optimise response times in the event of a power cut.

During the year, the Company continued to invest in technology to support its drive to improve response times, including the expansion of the automated power restoration system ("APRS") which operates within the existing network management system. In the event of a high-voltage fault, APRS analyses the information presented by intelligent assets installed on the network and, from that information, determines where the fault is located and executes switching to restore power to the 'healthy' network in a safe manner in under three minutes.

It is planned to enable APRS at 306 primary substations across the Northern Powergrid Group by the end of the ED1 period. The Company expects, therefore, that APRS will significantly improve the service to customers due to the speed with which it can understand the information presented and then complete the switching required to restore power.

The Company responded well to the major weather events that impacted its network during the year including as a result of three significant events which resulted in the Company invoking its full major incident management plan on each occasion.

Storm Gertrude brought 70 to 80mph winds widely across the whole licence area on the 29 January 2016, causing almost 100 separate incidents, of which 50 were on the high-voltage network. Approximately 25,000 customers experienced power cuts mainly in Northumberland, County Durham and Tyne and Wear with 98% restored within 12 hours. Over 300 field staff were deployed in response with helicopter patrols assisting with fault location when the weather allowed.

An intense lightning storm crossed Northumberland and Tyne & Wear during the early hours of 16 September. Due to the high overnight temperatures and atmospheric conditions, the localised lightning was very damaging and gave rise to over 86 faults on the high-voltage network affecting supplies to some 42,000 customers. 99% of affected customers' supplies were restored in 12 hours with only 17 customers being off supply for more than 24 hours.

Following a particularly dry month, heavy rain caused accelerated low-voltage cable failures across Northumberland, Durham, Tyne and Wear and Teesside on 22 November. Due to the localised nature of each incident, overall numbers of customers affected were small, but the nature of repairs required meant that over 584 customers were off supply for more than 12 hours.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Operational excellence - continued

The Company's priorities during the year included delivering a significant level of capital expenditure on the network as in the previous year, a further reduction in the average level of fault repair work in progress and continued focus on the restoration times associated with both high-voltage and low-voltage power cuts, with high-voltage restoration performance averaging some 60.0 minutes (2015: 55.6 minutes), after allowing for severe weather incidents and other exemptions.

The Company undertook various major projects during the year in support of those targets and as part of the investment strategy, including:

- Completion of the work to reinforce the network around Potterhouse substation and replacement of one 66kV circuit breaker at Peterlee Industrial substation;
- Refurbishment of eight EHV transformers, including four at 66kV and four at 33kV;
- Cable replacement work on the Coalburns – Prudhoe 66kV underground cable circuit with 1.8km of oil filled cable decommissioned and on the Bowesfield – Urray Nook 1 33kV circuit 1km of solid cable was replaced. Work also commenced on the second phase of the Sunderland – West Boldon scheme which will result in the eventual decommissioning of 16km of 66kV oil-filled underground cable assets;
- Commissioning of 20km of 66kV underground cable on the 66kV circuit route which runs between Malton, Thornton Dale and Whitby in order to facilitate the decommissioning of the overhead towers from the North Yorkshire Moors in 2017;
- Refurbishment of twelve 132kV overhead line towers and 286 EHV overhead line towers and replacement of two EHV poles based on their condition;
- 96km of high-voltage overhead line and 78km of low-voltage overhead line were rebuilt and/or refurbished;
- 14 units of high-voltage outdoor switchgear, 36 high-voltage distribution substations and 190 units of high-voltage indoor switchgear were replaced; and
- 360 additional remote control points were installed and commissioned.

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

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 every employee and contractor should go home uninjured and in good health after a productive day's work. 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 in the sector in which it operates. There is an intention to improve performance still further and, in doing so, maintain its position over the coming years. Having identified issues that may pose an increased safety risk, such as metal theft and the roll-out of smart meters, the Company is implementing 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 part of the investment decision-making and appraisal process.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Employee commitment – continued

The Company measures its health and safety performance in calendar years and operational incident performance for the year ended 31 December 2016 had significantly improved with only three switching-related incidents experienced on the high-voltage network against a target of five and compared with eight events recorded in 2015. As one of the key deliverables in the Company's safety and health improvement plan is to raise awareness and improve the concentration skills of its operational engineers and other employees, the Company continued its operational audit programme of senior authorised persons such that the operational practices of 81% of senior authorised persons were verified during the year. The Company also delivered operational seminars, stand-down briefings, and regular safety newsflashes to staff in order to cascade information on safety trends, issues and incidents.

Several key performance indicators are used to monitor safety performance, with the goal of achieving performance that is below the target number. The main key performance indicators are as follows:

	2016		2015	
	Target	Actual	Target	Actual
Lost time accidents	1	1	1	2
Restricted duty accidents	1	0	1	0
Medical treatment accidents	1	1	1	0
Operational incidents	5	3	5	8
Preventable vehicle accidents	10	11	10	9

The Company experienced one lost time accident in 2016 as opposed to two in 2015. In addition the Company incurred one accident that required medical treatment (none during 2015). Performance in respect of preventable vehicle accidents was one accident above the target for the year and marginally worse when compared with 2015. Consequently, the Company made a strong contribution to the Northern Powergrid Group and the long-term overall trend continued to compare well with that of the industry. None of those incidents reported gave rise to any significant safety-related risks.

In common with the Berkshire Hathaway Energy Group, the Northern Powergrid Group measures its safety performance in terms of the 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 Director of Safety, Health and Environment also delivered updates using conference call facilities, which were available to the entire workforce, regarding performance and other safety-related issues.

Delivery of the various initiatives in the safety and health improvement plan also contributed to the Northern Powergrid Group achieving an OSHA rate of 0.30 against a target of 0.30, which equated to seven recordable incidents; this was one more than performance recorded in 2015. The Company recorded an OSHA rate for 2016 of 0.20 (2015: 0.20) against a target of 0.32.

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 its senior management field engagement programme in order to improve two-way communication on safety and other key business issues. During the year, a robust road risk management plan was effective 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. Recognising that driving is one of most hazardous activities undertaken on a daily basis, the programme has continued to expand further throughout 2016 via an interactive, web-based system designed to assess skills and then provide individual training plans to 'improve hazard perception' and reinforce specific aspects of driving-related skills. The Company also completed a programme to install a telematics system in all of its fleet vehicles in order to support driver and vehicle safety by encouraging responsible and safe driving styles, assist with the completion and management of vehicle safety checks, and expedite investigation of vehicle accidents and incidents.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Employee commitment – continued

During the year, the Company received an Order of Distinction Award from the Royal Society for the Prevention of Accidents for achieving 15 consecutive Gold Awards in recognition of achievements in 2015 and for continued or improving standards of health and safety over a sustained period. The Company's OHSAS 18001 health and safety management systems successfully retained certification having been subject to a ten-day recertification audit by an external auditor.

The sickness absence rate across the Northern Powergrid Group for 2016 was 2.96% (2015: 2.71%), which was a slight increase on that experienced in 2015.

Management structure

Operational management of the Company and that of its affiliate, Northern Powergrid (Yorkshire) plc ("NPg Yorkshire"), is undertaken by a single senior management team with specific functional responsibilities. Those functional responsibilities are in respect of operations, safety, health and environment, asset management (including procurement), customer service, business development (including new connections to the network), policy and markets (including trading and innovation), regulation, human resources, organisation development, legal and finance (including property management, stakeholder engagement and information technology). Some 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 build constructive and partnered relationships with the trades unions. In that respect, the Company has secured multi-year pay agreements with the various employment groups such that the relevant terms and conditions are fair and appropriate across the Northern Powergrid Group.

The Northern Powergrid Group will continue to recruit trainees under its workforce renewal programme during the ED1 period taking account of the rate at which existing employees either leave or retire from the Northern Powergrid Group. A total of 71 new recruits joined the workforce renewal programmes during 2016. In addition, 73 trainees who were part of the workforce renewal programme in previous years graduated from their training programmes. In total, the Northern Powergrid Group recruited 95 new employees from the external market.

As a member of the Berkshire Hathaway Inc. group of companies, Berkshire Hathaway Energy sets high expectations for honesty and integrity in the conduct of all business activity. Consequently, the Company is committed to proper business conduct and has adopted the Berkshire Hathaway Energy code of business conduct, which details the commitment to ethics and compliance with the law, provides reporting mechanisms for known or suspected ethical or legal violations, and establishes minimum standards of behaviour expected of all employees. All employees must complete annual training on the code of business conduct. A "speaking up" policy is also 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.

In order to support the welfare of its employees, the Northern Powergrid Group provides an employee assistance service to its staff via an independent company that supports over 350 organisations in the United Kingdom. The programme is a confidential, self-referral counselling and information service to assist with personal or work-related problems that may be affecting health, wellbeing or performance and is available 24 hours a day, 365 days a year. The services available include health, wellbeing and family-care information, financial information and debt counselling, and legal guidance. Working in partnership with its occupational health provider, the Northern Powergrid Group is delivering a long-term strategic programme aimed at improving the health of its staff.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Employee commitment - continued

Progress continued to be made during the year on the key priorities in the human resources and organisational development functions, including recruitment, employee engagement, and performance management and development. Throughout the year, the Company continued to set and uphold the promotion of high standards of probity among staff. In addition, the Company's organisational structure has been developed to control business units and to delegate authority and accountability, having regard to acceptable levels of risk.

As at 31 December 2016, the Company employed 1,066 staff (2015:1,089).

Environmental respect

The Company's approach to environmental compliance is governed by an environmental policy and, in addition, 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.

The most recent visit was a surveillance assessment carried out by Lloyd's Register Quality Assurance in October 2016. The assessment reported the continued improvement made to the environmental management system over the past three years. There were no non-conformances noted and, after a rigorous three-day surveillance audit, continued certification was recommended and subsequently confirmed.

Procedures and processes were reviewed and developed in the year to improve the effectiveness of the environmental management system. Operational controls at depots have also significantly improved, which has supported the reduced number of minor non-conformances raised at recent surveillance visits, with zero minor non-conformances reported in 2016. In the event that fluid leakages do occur, the Company has in place an emergency incident response support contract with a specialist service provider, under which 24-hour environmental incident assistance is provided, including contamination mitigation, remediation and incident-validation reporting.

Improvements in support of the Company's environmental policy objectives continued to focus on 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. The Company also provided environmental awareness training for staff via an online system to avoid the need for travelling to central training locations. These improvements support the Company in delivering sustained environmental performance, which it measures on a calendar year basis, and, in the year ended 31 December 2016, only five incidents were reportable to the Environment Agency, which was significantly better than the target of seven. Oil spills and leaks from the Company's assets were under the target of 17,142 litres by 1% with a loss of 17,044 litres and SF6 gas discharges from electrical plant were also under the target of 28 kilogrammes by 49% with a loss of 14 kilogrammes.

During the year, work continued with many of the Company's key stakeholders, including the Environment Agency, to enhance the advanced environmental management processes already in place and, in 2017, the Company plans to maintain this progress so that the impact on the environment in which it works is reduced and the most effective ways of doing so are utilised. The Company's business plan contains a commitment to reduce its business carbon footprint by 10% by the end of ED1 and performance remains on course to achieve that target.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Environmental respect - continued

The Company's commitment to the Environmental RESPECT policy and its improved overall performance contributes towards minimising its impact on the environment. As part of its annual environmental improvement plan, the Company has mobilised significant programmes to replace fluid-filled cables and place overhead lines underground in National Parks and Areas of Outstanding Natural Beauty, reduce electrical losses and implement further improvements to the network that take account of protected structures, features, areas, wildlife and habitat. Birdlife is being protected by placing bird-diverters on power lines where they are in proximity to nature 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. The Company continues to work with local social enterprises that rescue waste timber in order to provide affordable reclaimed timber products to the local community.

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 in which electricity is produced and used is expected to have a significant impact on the electricity network over time. Evidence of this has already been seen through the number of installations made by customers of low-carbon technologies such as photovoltaic solar panels, electric vehicles and heat pumps which continued to increase during the year and are reported via the regulatory reporting process. The volume and total capacity of decentralised energy generation has also been growing steadily for the last few years and, given the greater range of load and generation technologies now being connected to the network, the Company is taking action to develop innovative solutions that will reduce the need for traditional and potentially expensive reinforcement of the network.

The Company's innovation projects have continued this year from the platform established by the ground-breaking Customer-Led Network Revolution ("CLNR") programme of work that concluded in 2015. The four priorities of smart grids, smart meters, digital-enabled services and issues of affordability continue to be highly relevant to our stakeholders. In the smart grid area, the transition to distribution system operator is taking increased prominence in the innovation portfolio. During the year, the Company completed work to better understand how local energy markets may develop, the potential impact of future market models and the role of new players such as local authorities. Deployment of innovation in the year has delivered £7.5 million of value, with around half of that centred on releasing capacity and providing flexible connections for immediate customer benefit.

The Northern Powergrid Group climate change adaptation strategy outlines the impact that climate change is anticipated to have on the business, the risks that this poses and the proposals recommended to mitigate these risks. The proposals include flood defences, vegetation management, network specifications for changing temperatures, improved weather prediction, and adequate staff availability. The planned number of flood defences to be installed during the year was not achieved. This was primarily due to the re-tendering of the delivery contract. Under the re-phased programme the delivery of the overall commitment to install further flood defences during the ED1 period remains on-track.

Environmental performance was strong with incidents reportable to the Environment Agency, fluid loss and the Company's carbon footprint being lower than targeted. The Company policy of installing over-sized cables continues to save network losses, which contributed to further carbon emission reductions.

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") is the principal risk management forum in the Northern Powergrid Group, and monitors and manages performance in risk-related and compliance areas. The GRMG met on three occasions during the year in order to review the mechanisms for meeting external obligations, to strengthen the business-control-improvement environment, and to consider and advise on key strategic risks facing the Company.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

CORE PRINCIPLES - continued

Regulatory integrity- continued

Breaches by a DNO of its licence conditions and certain other statutory requirements 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 1,780 regulatory obligations contained within the compliance database is currently assigned to around 75 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 Head of Regulatory Compliance reports to the board of directors on the outcome of each quarter's exercise.

Under the RIIO (revenue = incentives + innovation + outputs) model for regulation, price controls are set for eight years (rather than five as has previously been the case), with provision for a mid-period review of the outputs that network companies are required to deliver. The ED1 price control became effective on 1 April 2015 and is due to end on 31 March 2023.

Under the ED1 price control, excluding the effects of incentive schemes and any deferred revenues from the prior price control, the Company's base allowed revenue before inflation reduced by 1.0% for the regulatory year ended 31 March 2017, relative to the previous year. Base allowed revenues before inflation will then be constant for each subsequent regulatory year through to the regulatory year ended 31 March 2023. Nominal base allowed revenues will therefore increase in line with inflation (as measured by the United Kingdom's Retail Prices Index).

The ED1 price control is the first to be set for electricity distribution in Great Britain since Ofgem completed its review of network regulation (known as the RPI-X @ 20 project). The key changes to the price control calculations, compared to those used in previous price controls are that:

- the period over which new regulatory assets are depreciated is being gradually lengthened, from 20 years to 45 years, with the change being phased over eight years;
- allowed revenues will be adjusted during the price control period, rather than at the next price control review, to partially reflect cost variances relative to cost allowances;
- the allowed cost of debt will be updated within the price control period by reference to a long-run trailing average based on external benchmarks of public debt costs;
- allowed revenues will be adjusted in relation to some new service standard incentives, principally relating to speed and service standards for new connections to the network; and
- there is scope for a mid-period review and adjustment to revenues in the latter half of the period for any changes in the outputs required of licensees for certain specified reasons.

Many other aspects of the previous price control remain in place (either in their previous or similar form), including adjustments to revenues in relation to the number and duration of service interruptions and customer service standards. In addition, network tariffs, from which actual revenues are derived, are now set further in advance than was previously the case.

With the start of the new price control, changes were also made to the legislation that prescribes the standards of service to be provided by the DNOs in specified circumstances and payments to be made to end-customers for failure to meet those standards. The most significant of these changes reduced from 18 to 12 hours the time that is allowed for restoration of supplies following an unplanned power cut in normal weather conditions.

The Company submits a number of information returns to Ofgem and is required, under the terms of the Company's licence, to assure the accuracy of those returns. These arrangements involve the preparation and submission to Ofgem, by the end of February in each year, of a risk-based data-assurance plan for the regulatory year ahead, together with a report detailing the assurance work actually carried out in the regulatory year just ended and the findings of that work.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

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 the maximum permitted revenue for each regulatory year, taking into account base allowed revenues and movements in Retail Prices Index ("RPI"), as well as factors such as performance against certain regulatory incentives. Where the Company recovers more, or less, than this maximum the difference is carried forward, with interest. For amounts relating to the regulatory year ended 31 March 2016, the carry forward will be into the entitlement for the regulatory year ended 31 March 2018.

The price control for ED1 has been set for the eight-year period commencing on 1 April 2015, although the price control formula may be reviewed at other times at the discretion of Ofgem, and it is Ofgem's intention to use eight-year price control periods in the future. A resetting of the formula is 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.

During the term of the price control, the rate of inflation as measured by 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.

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 final proposals in respect of the previous price control period ("DPCR5"), Ofgem 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). Ofgem re-affirmed these principles in its ED1 final determination.

However, given the stable and regulated nature of the DNOs' businesses, Ofgem took the view that a notional repair period of 15 years from 1 April 2010 was appropriate for the purpose of assessing the DNOs' allowed revenues in respect of pension costs. Moreover, Ofgem reviews the reasonableness of the triennial actuarial valuations of DNOs' pension schemes and calculates new deficit funding allowances, including any adjustments that may be necessary to account for differences between allowances received and payments actually made to the relevant pension scheme.

The other financial risks facing the Company are outlined on page 6 of this Strategic 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. Given the regular instances of metal theft experienced in previous years, the Company maintained its programme of risk-assessed and enhanced security measures at its sites and pursued awareness raising activity at a national and local level, including commencing a social media campaign in early 2016 in partnership with Crimestoppers.

The electricity distribution business has an inherently increased health and safety risk due to the network operating at up to 132kV. Employees work at height, in closed spaces and with live electricity increasing the risk of potential safety matters. Health and safety is given the highest priority within the Company and strict policies and procedures are in place to ensure the safety of both employees and customers.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

PRINCIPAL RISKS AND UNCERTAINTIES - continued

Cyber security is an increasing risk. The Company has a robust cyber security risk mitigation programme in place including gaining accreditation under of ISO 27001 Information Security (process security) standard for certain discrete business areas, plus compliance with the Centre for Internet Security Critical Security Controls. Further advances to this are being continuously implemented and managed.

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 proportionate 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 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, SSE and Scottish Power.

The Company operates 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 refurbishment 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.

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, 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 divided into a number of risk sectors which, in turn, align to the Northern Powergrid Group's Core Principles, as detailed on pages 5 to 16 of this Strategic Report. A report regarding the effectiveness of each risk sector in terms of risk management, control activity, key success factors and supporting measures is presented at meetings of the GRMG. The risk environment is reviewed continually in order that new or emerging potential risks are identified.

The Northern Powergrid Group identifies and assesses risks associated with the achievement of its strategic objectives so that any 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, disaster recovery tests of IT servers and priority processes, penetration tests against firewall systems, 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 identify lower probability, high consequence threats to business success or continuity. This approach is reinforced by that of the Berkshire Hathaway Energy Group, whose activities have continued to include benchmarking of risk management activities across its business units, including the sharing of significant lessons learned associated with risk management.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

PRINCIPAL RISKS AND UNCERTAINTIES - continued

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 certain senior managers are required to confirm that the system of internal control in their area of the business is operating effectively. Consequently, the directors believe that a robust system of risk assessment and management is in place.

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 risk control assessment to be undertaken by certain 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 Northern Powergrid Group 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 Northern Powergrid Group 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 maintaining the highest ethical standards in the conduct of its business and, in that respect, implements Berkshire Hathaway Energy's code of business conduct for employees. The code of conduct sets out and emphasises the required standards and commitment to ethical behaviour, provides reporting mechanisms for known or suspected ethical issues, helps prevent wrongdoing, and creates and sustains an ethical work environment across the Northern Powergrid Group. All employees are required to complete annual training on the code of business conduct and then confirm that they understand the requirements outlined in the code. The training is available online and employees who do not have access to the online system attend a briefing with their line manager.

The Company does not have a specific human rights policy but, as noted in this Strategic Report, it bases its operations on the Core Principles in order to deliver its long-term objectives. Accordingly, the Company remains fully committed to operating ethically and responsibly and with fairness and integrity through the policies and procedures it has in place which set the approach to its employees, their health, safety and welfare, its dealings with customers, particularly those who are vulnerable and on the Priority Services Register, its impact on the environment and its contribution to the sustainability agenda within the energy industry. The Core Principles are a key factor in the responsible way in which the Company operates its electricity distribution business, examples of which are described throughout this Strategic Report.

The Northern Powergrid Group is also 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. 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 commitment 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.

In preparing these accounts, the directors have assessed the viability of the Company for the purposes of making the statement below and do so on an ongoing basis as part of the preparation and approval of the Company's ten-year business plan.

NORTHERN POWERGRID (NORTHEAST) LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

PRINCIPAL RISKS AND UNCERTAINTIES - continued

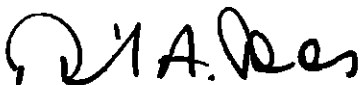
The directors have chosen the eight-year period from 1 April 2015 for the purposes of making this statement because it equates to the ED1 regulatory period, though longer periods may be appropriate given the 45-year life ascribed by Ofgem to the Company's new assets, the enduring nature of the Company's business and the fact that the notice period for revocation of the Company's electricity distribution licence is 25 years. The Company's income has been set for the ED1 regulatory period, although there is scope for a mid-period review and Ofgem may adjust revenues in the latter half of the period for any changes in the outputs required of the Company for certain specified reasons. Consequently and given the general stability associated with the regulatory environment in which the Company operates, the directors have been able to prepare sufficiently robust forecasts as part of the Company's annual business planning process, taking account of the principal risks and uncertainties which might have an impact on those forecasts. The Company's forecasts look forward for a 10-year period and anticipate the Company's continued stable operations beyond the ED1 price control period.

Details of the principal risks and uncertainties, which could have an impact on the Company, are provided on pages 17 and 18 of the Strategic Report and details of how those principal risks are assessed and managed are provided in the Risk Management section of the Strategic Report.

The directors' ongoing assessment of the principal risks and uncertainties facing the Company also includes meeting the obligations in the Company's licence to provide Ofgem with annual certificates, approved by the board, confirming that the directors have a reasonable expectation that the Company will have sufficient financial resources, financial facilities and operational resources available to it so that the Company is able to carry on its Distribution Business for a period of 12 months from the dates of those certificates. Assumptions taken into account when approving those certificates include (i) the potential for significant adverse financial impact from the various incentive schemes that can lead to variations in the Company's allowed income under its price control arrangements; (ii) the occurrence of catastrophic natural or other events, which could have a significant impact on the operating performance of the distribution network or involve significant expenditure; (iii) whether significant customer payment defaults may be experienced; and (iv) the continued availability to the Company of suitably qualified and experienced staff. Given the regulatory environment in which the Company operates, it is currently considered unlikely that there will be material variances to the assumptions used in providing those certificates during the ED1 period.

The stable nature of the Company's business is evidenced by the fact that the commitments made by the Company in its well-justified business plan, which was originally submitted to Ofgem as part of the ED1 price control review process, have not changed materially. Consequently, assuming that the principal risks and uncertainties facing the Company continue to be managed effectively, the directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the ED1 period.

ON BEHALF OF THE BOARD:



P A Jones
Director
24 March 2017

NORTHERN POWERGRID (NORTHEAST) LIMITED

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

The directors present their report with the financial statements of the company for the year ended 31 December 2016.

DIVIDENDS

During the year, an interim dividend of £21.8 million (10.9p per ordinary share) was paid (2015: £20.6 million, 10.3p per ordinary share). The directors recommended that no final dividend be paid in respect of the statutory accounting year ended 31 December 2016. No interim dividend was paid during the period from 1 January 2017 to 24 March 2017.

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

RESEARCH AND DEVELOPMENT

The Company supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. Projects to investigate enhanced load reduction opportunities from customer participation, the accessing of disbursed domestic demand-side response and, alongside other utilities, to determine optimum energy system technology approaches appropriate to local socio-economic factors have continued. New activities initiated in the year included projects regarding the use of domestic electricity storage in conjunction with small-scale photovoltaic solar generation, an improved methodology to determine network load growth and a project to improve circuit reliability and reduce restoration times through fault monitoring and anticipation on the low-voltage network. In addition, a wood replacement technology for overhead line support was evaluated and an investigations into environmentally acceptable alternative systems for wood preservation, was undertaken.

During the year, the Company invested £0.8 million (2015: £2.1 million) (Note 6 to the accounts) in its research and development activities.

FUTURE DEVELOPMENTS

The financial position of the Company, as at 31 December 2016, is shown in the statement of financial position on page 29.

There have been no significant events since the year end and the directors intend that the Company will continue to implement its well-justified business plan that was revised as part of the ED1 price control review process and will develop its business by operating with the goal of efficiently investing in the network and improving the quality of supply and service provided to customers.

DIRECTORS

The directors who held office during the year under review and to the date of signing were:

R Dixon	Non-executive Director
T E Fielden	Finance Director
J M France	Regulation Director
T H France	General Counsel (appointed 15 December 2016)
N M Gill	Operations Director
P A Jones	President and Chief Executive Officer
A J Maclellan	Business Development Director
A R Marshall	Non-executive Director
P C Taylor	Non-executive Director

During the year, no director was interested in any contract which was significant in relation to the business of the Company.

During the year and up to the date of approval of the Directors' Report, an indemnity contained in the Company's Articles of Association was in force for the benefit of the directors of the Company and as directors of associated companies, which was a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

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

Financial derivatives

As at 31 December 2016 and during the year it was the Company's policy not to hold any derivative financial instruments.

Further details of the financial risks facing the Company are provided in the Financial Strength section on page 6, and Principal Risks and Uncertainties section on pages 17 and 18 of the Strategic Report.

POLITICAL DONATIONS

No contributions were made to political organisations during the year (2015: £nil).

EMPLOYEES

Employee consultation

The Company has a constitutional framework in place for employee consultation and has agreed that framework with trade union representatives. In addition, the Company communicates directly and through the management structure with non-collectively bargained staff, who are primarily of management grade, and keeps them informed of and involved as appropriate in developments that may impact on them now or in the future.

The Company is committed to maintaining and improving effective engagement and communication with employees. Following the employee engagement survey in 2016, the results continue to show improvement and work has been undertaken to analyse the feedback and develop local action plans. This approach is augmented by routine communication channels including regular staff briefs on current issues, meetings with staff and their representatives, and utilising Northern Powergrid Group's intranet to communicate and engage with employees.

During the year, the President and Chief Executive Officer of the Northern Powergrid Group continued to provide employees with updates on the Northern Powergrid Group's financial, organisational, safety and customer service performance through postings and weekly blogs on Northern Powergrid Group's intranet on key elements of performance during the preceding week.

Disabled employees

The Company 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 make reasonable adjustments, wherever possible.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Strategic Report, the Report of the Directors and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

STATEMENT OF DIRECTORS' RESPONSIBILITIES - continued

In preparing these financial statements, International Accounting Standard 1 requires the directors 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 IFRSs are 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.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The directors are responsible for the maintenance and integrity of any corporate and financial information relating to the Company, which is included on the Northern Powergrid Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

GOING CONCERN

A review of the Company's business activities during the 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 Report of the Directors and the appropriate notes to the accounts.

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

- The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Company is profitable with strong underlying cash flows and holds investment grade credit ratings; and
- The Company is financed by long-term borrowings with an average maturity of 12 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 reports and accounts.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2016**

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITOR

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 or she is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- b) he or she has taken all the steps he/she ought to have taken as a director in order to make himself/herself 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:



P A Jones
Director
24 March 2017

REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF NORTHERN POWERGRID (NORTHEAST) LIMITED

We have audited the financial statements of Northern Powergrid (Northeast) Limited ("the Company") for the year ended 31 December 2016, which comprise the Statement of Profit or Loss, the Statement of Profit or Loss and Other Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in a Report of the Auditor 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 Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Strategic Report and the Report of the Directors to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Report of the Directors have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Report of the Directors.

**REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF
NORTHERN POWERGRID (NORTHEAST) LIMITED**

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or
- returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



David M Johnson FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle upon Tyne
United Kingdom

24 March 2017

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
CONTINUING OPERATIONS			
Revenue	3	333,012	342,703
Cost of sales		<u>(13,982)</u>	<u>(13,151)</u>
GROSS PROFIT		319,030	329,552
Operating expenses	9	<u>(169,449)</u>	<u>(170,318)</u>
OPERATING PROFIT		149,581	159,234
Other gains		400	474
Finance costs	5	<u>(29,082)</u>	<u>(26,478)</u>
Finance income	5	<u>482</u>	<u>126</u>
PROFIT BEFORE INCOME TAX	6	121,381	133,356
Income tax	7	<u>(5,090)</u>	<u>(13,900)</u>
PROFIT FOR THE YEAR		<u>116,291</u>	<u>119,456</u>

The notes on pages 32 to 63 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016**

	2016 £'000	2015 £'000
PROFIT FOR THE YEAR	116,291	119,456
OTHER COMPREHENSIVE INCOME	—	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>116,291</u>	<u>119,456</u>

The notes on pages 32 to 63 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED (REGISTERED NUMBER: 02906593)

**STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	10	40,857	31,623
Property, plant and equipment	11	2,232,507	2,120,077
Investments	12	50	50
		<u>2,273,414</u>	<u>2,151,750</u>
CURRENT ASSETS			
Inventories	13	12,085	12,806
Trade and other receivables	14	55,194	54,679
		<u>67,279</u>	<u>67,485</u>
TOTAL ASSETS		<u>2,340,693</u>	<u>2,219,235</u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	15	200,000	200,000
Retained earnings	16	712,822	618,331
TOTAL EQUITY		<u>912,822</u>	<u>818,331</u>
LIABILITIES			
NON-CURRENT LIABILITIES			
Trade and other payables	17	562,308	526,800
Borrowings			
Interest bearing loans and borrowings	18	586,949	586,851
Deferred tax	21	89,519	92,597
Provisions	20	98	262
		<u>1,238,874</u>	<u>1,206,510</u>
CURRENT LIABILITIES			
Trade and other payables	17	103,568	115,122
Borrowings			
Interest bearing loans and borrowings	18	75,217	72,391
Tax payable		9,582	6,014
Provisions	20	630	867
		<u>188,997</u>	<u>194,394</u>
TOTAL LIABILITIES		<u>1,427,871</u>	<u>1,400,904</u>
TOTAL EQUITY AND LIABILITIES		<u>2,340,693</u>	<u>2,219,235</u>

The financial statements were approved by the Board of Directors on 24 March 2017 and were signed on its behalf by:



P A Jones
Director

The notes on pages 32 to 63 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Called up share capital £'000	Retained earnings £'000	Total equity £'000
Balance at 1 January 2015	200,000	519,475	719,475
Changes in equity			
Dividends	-	(20,600)	(20,600)
Total comprehensive income	-	116,291	116,291
Balance at 31 December 2015	<u>200,000</u>	<u>618,331</u>	<u>818,331</u>
Changes in equity			
Dividends	-	(21,800)	(21,800)
Total comprehensive income	-	116,291	116,291
Balance at 31 December 2016	<u>200,000</u>	<u>712,822</u>	<u>912,822</u>

The notes on pages 32 to 63 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	2016 £'000	2015 £'000
Cash flows from operating activities			
Cash generated from operations	24	208,634	208,923
Finance costs paid		(31,533)	(29,586)
Dividends received		37	35
Interest received		445	91
Tax paid		<u>(4,600)</u>	<u>(26,068)</u>
Net cash from operating activities		<u>172,983</u>	<u>153,395</u>
Cash flows used in investing activities			
Purchase of intangible fixed assets		(12,964)	(10,476)
Purchase of tangible fixed assets		(186,633)	(207,471)
Sale of tangible fixed assets		488	467
Receipt of customer contributions		<u>45,063</u>	<u>56,357</u>
Net cash used in investing activities		<u>(154,046)</u>	<u>(161,123)</u>
Cash flows (used in)/from financing activities			
Movements in borrowings		-	50,855
Movements in loans from Group		2,863	(22,527)
Equity dividends paid		<u>(21,800)</u>	<u>(20,600)</u>
Net cash (used in)/from financing activities		<u>(18,937)</u>	<u>7,728</u>
Movement in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of year		-	-
Cash and cash equivalents at end of year		<u>-</u>	<u>-</u>

The notes on pages 32 to 63 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. GENERAL INFORMATION

Northern Powergrid (Northeast) Limited (the "Company") is a company incorporated in England and Wales and is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group"). 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.

2. ACCOUNTING POLICIES

Accounting convention and basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements have also been prepared in accordance with IFRSs as adopted by the European Union and with those parts of the Companies Act 2006 (the "Act") that are applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for leasing transactions which are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

In addition, 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 Company 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.

The principal accounting policies are set out below.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES- continued

Application of new and revised IFRSs

In the current year, the Company has a number of amendments to IFRSs issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for an accounting period that begins on or after 1 January 2016:

- Amendments to IAS 1 Disclosure Initiative The amendments clarify that an entity need not provide specific disclosure required by an IFRS if the information resulting from that disclosure is not material, and give guidance on the bases of aggregating and disaggregating information for disclosure purposes. However, the amendments reiterate that an entity should consider providing additional disclosures when compliance with the specific requirements of IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance.

The application of these amendments has not resulted in any impact on the financial performance or financial position of the Company.

- IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortisation of an intangible asset. This presumption can only be rebutted in the following two limited circumstances:-when the intangible asset is expressed as a measure of revenue; or-when it can be demonstrated that revenue and consumption of the economic benefits or the intangible asset are highly correlated.

As the group already uses the straight line method for depreciation for its property, plant and equipment, and intangible assets respectively, the application of these amendments has had no impact on the Company's financial position.

- Annual Improvements to IFRSs 2012-2014 Cycle The Annual Improvements to IFRSs 2012-2014 Cycle include a number of amendments to various IFRSs. The application of these amendments has had no effect on the Company's financial statements.

New and revised standards in issue but not yet effective

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective for the year ended 31 December 2016:

- IFRS 9 - Financial Instruments (1 January 2018). A revised version of IFRS 9, Financial Instruments, was issued in July 2014 mainly to include: a) impairment requirements for financial assets; and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' ("FVTOCI") measurement category for certain simple debt instruments.

The directors of the Company anticipate that the application of IFRS 9 in the future is unlikely to have an impact on amounts reported in respect of the Company's financial assets and financial liabilities.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES- continued

- IFRS 15 - Revenue from Contracts with Customers (1 January 2018).

In May 2014, IFRS 15, Revenue from Contracts with Customers, was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 11 Construction Contracts, IAS 18 Revenue and the related Interpretations.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

The directors anticipate that the application of IFRS 15 will not have a material impact on the Company's financial statements.

- IFRS 16 - Leases (1 January 2019)

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective.

IFRS 16 distinguishes between leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions between operating leases and finance leases are removed for lessee accounting, and is replaced by a model where right-of-use asset and a corresponding liability have to be recognised for all leases by lessees except for short term leases and leases of low-value assets.

As of 31 December 2016, the Company has non-cancellable operating lease commitments of £22.4 million, IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Company will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16.

- Amendments to IAS 7 (1 January 2017)

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The directors of the Company do not anticipate the application of these amendments will have a material impact on the Company's financial statements.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES- continued

Critical judgements in applying accounting policies

The following are the critical judgements, apart from those involving estimations, that the directors have made in the process of applying the Company's accounting policies and that have the most significant effect on amounts recognised in the financial statements:

- Revenue recognition

Key sources of estimation uncertainty

The following are the key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

- Useful economic lives for property, plant and equipment;
- The split of operating and capital expenditure and the allocation of overheads to capital;
- Impairment reviews carried out to evaluate the carrying value of assets held at the end of the reporting period; and
- Fair valuation measurements and valuation processes.

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 is measured at the fair value of consideration received or receivable.

Revenue represents charges for the use of the Company's distribution network, rental of meters, 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, judgement 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 from a financial asset is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES - continued

Software development costs

Costs in respect of major developments are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over the estimated useful life of the software of up to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. 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.

Depreciation is recognised so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method:

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.

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any material changes in those estimates accounted for on a prospective basis. Due to the significance of the Company's investment in property, plant and equipment, variations in estimates could impact operating results both positively and negatively although, historically, few changes have been required.

Assets in the course of construction are carried at cost, less any recognised impairment loss. Costs include professional fees, and, for qualifying assets, borrowing costs capitalised in accordance with the Company's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation on these assets, on the same basis as other assets, commences when the assets are commissioned.

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 of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES - continued

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. Raw materials and goods for resale are valued at purchase cost 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.

Taxation

The 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 before tax' as reported in the statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

Deferred tax is recognised on temporary 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. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from the initial recognition of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. In addition, deferred tax liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax liabilities recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

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

Research costs

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

Other than the software development, the Company does not carry out any other development activity that would give rise to an intangible asset.

Foreign currencies

Transactions in foreign currencies are recognised at the rate of exchange prevailing at the date of the transaction. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at that date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES - continued

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 recognised in the statement of profit or loss or in property, plant and equipment on a straight-line basis over the lease term.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Pensions

The Group contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Northern Powergrid Group of the ESPS"), a defined benefit scheme.

The cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at the end of each annual reporting period. Re-measurement, comprising actuarial gains and losses, the effect of the changes to the asset ceiling and the return on plan assets (excluding interest) are reflected immediately in the statement of financial position with a charge or credit recognised in other comprehensive income in the period in which they occur. Re-measurement recognised in other comprehensive income is reflected immediately in retained earnings and will not be reclassified to profit or loss. Past service cost is recognised in profit or loss in the period of a plan amendment. Net interest is calculated by applying a discount rate at the beginning of the period to the net defined liability or asset. Defined benefit costs are categorised as service cost, net interest expense or income and re-measurement.

The retirement benefit obligation recognised in the statement of financial position represents the actual deficit or surplus in the Group's defined benefit plan. Any surplus resulting from this calculation is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The Group 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 when employees have rendered service entitling them to the contributions.

A liability is recognised for benefits accruing to employees in respect of wages and salaries, annual leave and sick leave in the period in which the related service is rendered at the undiscounted amount of the benefits expected to be paid in exchange for that service. Liabilities recognised in respect of short-term employee benefits are measured at the undiscounted amount of the benefits expected to be paid in exchange for the related service. Liabilities recognised in respect of other long-term employee benefits are measured at the present value of the estimated future cash outflows expected to be made by the Company in respect of services provided by employees up to the reporting date.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

2. ACCOUNTING POLICIES - continued

Financial assets

Financial assets, including trade and other receivables and cash and cash equivalents, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment.

The effective interest method is a method of calculating the amortised cost of an instrument and of allocating income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the instrument to the net carrying amount on initial recognition.

Interest income is recognised by applying the effective interest rate, except for short-term receivables when the effect of discounting is immaterial.

Cash and cash equivalents (which are presented as a single class of assets on the face of the statement of financial position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be 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 affected.

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

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

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 Going Concern Statement in the Report of the Directors.

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.

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

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

4. EMPLOYEES AND DIRECTORS

	2016	2015
	£'000	£'000
Salaries	50,354	49,623
Social security costs	5,543	4,931
Defined benefit pension costs	23,004	29,246
Defined contribution pension costs	1,574	1,394
	80,475	85,194
Less charged to property, plant and equipment	(42,129)	(41,591)
	38,345	43,603

The majority of the Company's employees are members of the Northern Powergrid Group of the ESPS, most of the remaining employees are members of the Northern Powergrid Pension Scheme, details of both are given in the employee benefits note (note 22).

The average monthly number of employees during the year was:

	2016	2015
Technical	329	320
Industrial	440	434
Administration	198	216
Other	98	103
	1,065	1,073

DIRECTORS' REMUNERATION

	2016	2015
	£'000	£'000
Highest Paid:		
Short-term employee benefits	319	255
Post-employment benefits	10	20
Other long-term benefits	370	322
	699	597

	2016	2015
	£'000	£'000
Total:		
Short-term employee benefits	667	627
Post-employment benefits	52	82
Other long-term benefits	612	496
	1,331	1,205

Directors who are a member of the defined benefit scheme	3	3
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NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

OTHER KEY PERSONNEL REMUNERATION

	2016	2015
	£'000	£'000
Total:		
Short-term employee benefits	424	306
Post-employment benefits	81	74
Other long-term benefits	250	227
	<u>755</u>	<u>607</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.

Other long-term benefits relate to deferred bonus plan accrued over the period of the plan.

5. NET FINANCE COSTS

	2016	2015
	£'000	£'000
Finance income:		
Dividends received	37	35
Interest on tax refund	388	-
Deposit account interest	57	91
	<u>482</u>	<u>126</u>
Finance costs:		
Bank interest	105	891
Interest payable on other loans	8,284	5,466
Interest payable on loans from Group undertakings	23,353	23,370
Borrowing costs capitalised	(2,660)	(3,249)
	<u>29,082</u>	<u>26,478</u>
Net finance costs	<u>28,600</u>	<u>26,352</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

6. PROFIT BEFORE INCOME TAX

The profit before income tax is stated after charging:

	2016	2015
	£'000	£'000
Depreciation - owned assets	74,186	71,085
Software development costs amortisation	3,730	2,674
Research and development costs	830	2,052
Amortisation of deferred revenue	(19,342)	(22,203)
Impairment of trade and other receivables	440	100
Profit on disposal of fixed assets	(400)	(474)

Analysis of auditor's remuneration is as follows:

	2016	2015
	£'000	£'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	125	130
Other assurance services	45	75
Total fees payable to the Company's auditor	170	205

7. INCOME TAX

Analysis of tax expense

	2016	2015
	£'000	£'000
Current tax	8,168	21,779
Deferred tax	(3,078)	(7,879)
Total tax expense in statement of profit or loss	5,090	13,900

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

7. INCOME TAX - continued

Factors affecting the tax expense

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. The difference is explained below:

	2016	2015
	£'000	£'000
Profit before income tax	<u>121,381</u>	<u>133,356</u>
Profit multiplied by the standard rate of corporation tax in the UK of 20% (2015 - 20.25%)	24,276	27,005
Effects of:		
Changes in legislation	(5,043)	(9,610)
Over provision for prior years	(14,390)	(3,238)
Tax free income and disallowable costs	(130)	-
Tax free capital gains	-	(204)
Prior year deferred tax	369	-
Other	<u>8</u>	<u>(188)</u>
Tax expense	<u>5,090</u>	<u>13,900</u>

	2016	2015
	£'000	£'000
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	22,588	25,017
Under provision for prior years	<u>(14,390)</u>	<u>(3,238)</u>
Total current tax charge	8,168	28,255
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	1,965	1,731
Effect of changes in legislation	<u>(5,043)</u>	<u>(9,610)</u>
Total deferred tax charge	<u>(3,078)</u>	<u>(7,879)</u>
Tax on profit before tax	<u>45,090</u>	<u>13,900</u>

The Finance No2 Act 2015 reduced the rate of corporation tax to 19% effective from 1 April 2017 and to 18% effective from 1 April 2020. The Finance Act 2016, which was substantively enacted on 6 September, 2016 further reduced the rate of corporation tax effective from 1 April 2020 to 17%. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2016**

8. DIVIDENDS

	2016 £'000	2015 £'000
Interim dividend at 10.9p per share (2015: 10.3p per share)	<u>21,800</u>	<u>20,600</u>

9. OPERATING EXPENSES

	2016 £'000	2015 £'000
Operating expenses comprise		
Distribution costs	101,879	99,607
Administrative expenses	<u>67,570</u>	<u>70,711</u>
	<u>169,449</u>	<u>170,318</u>

10. INTANGIBLE ASSETS

	Software development costs £'000
COST	
At 1 January 2016	55,703
Additions	<u>12,964</u>
At 31 December 2016	<u>68,667</u>
AMORTISATION	
At 1 January 2016	24,080
Amortisation for year	<u>3,730</u>
At 31 December 2016	<u>27,810</u>
NET BOOK VALUE	
At 31 December 2016	<u>40,857</u>

	Software development costs £'000
COST	
At 1 January 2015	45,227
Additions	<u>10,476</u>
At 31 December 2015	<u>55,703</u>
AMORTISATION	
At 1 January 2015	21,406
Amortisation for year	<u>2,674</u>
At 31 December 2015	<u>24,080</u>
NET BOOK VALUE	
At 31 December 2015	<u>31,623</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2016

11. PROPERTY, PLANT AND EQUIPMENT

	Non operational land & buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2016	4,191	2,626,332	35,964	2,666,487
Additions	-	181,503	5,236	186,739
Disposals	-	(10,761)	(217)	(10,978)
At 31 December 2016	<u>4,191</u>	<u>2,797,074</u>	<u>40,983</u>	<u>2,842,248</u>
DEPRECIATION				
At 1 January 2016	1,871	519,357	25,182	546,410
Charge for year	292	70,480	3,414	74,186
Eliminated on disposal	-	(10,638)	(217)	(10,855)
At 31 December 2016	<u>2,163</u>	<u>579,199</u>	<u>28,379</u>	<u>609,741</u>
NET BOOK VALUE				
At 31 December 2016	<u>2,028</u>	<u>2,217,875</u>	<u>12,604</u>	<u>2,232,507</u>
	Non operational land & buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2015	4,191	2,434,655	28,657	2,467,503
Additions	-	201,452	7,747	209,199
Disposals	-	(9,775)	(440)	(10,215)
At 31 December 2015	<u>4,191</u>	<u>2,626,332</u>	<u>35,964</u>	<u>2,666,487</u>
DEPRECIATION				
At 1 January 2015	1,565	460,767	23,208	485,540
Charge for year	306	68,365	2,414	71,085
Eliminated on disposal	-	(9,775)	(440)	(10,215)
At 31 December 2015	<u>1,871</u>	<u>519,357</u>	<u>25,182</u>	<u>546,410</u>
NET BOOK VALUE				
At 31 December 2015	<u>2,320</u>	<u>2,106,975</u>	<u>10,782</u>	<u>2,120,077</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued **FOR THE YEAR ENDED 31 DECEMBER 2016**

11. PROPERTY, PLANT AND EQUIPMENT - continued

Assets in the course of construction included above:

	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
At 1 January 2016	162,715	-	162,715
Additions	181,503	5,236	186,739
Available for use	<u>(173,551)</u>	<u>(5,236)</u>	<u>(178,787)</u>
At 31 December 2016	<u>170,667</u>	<u>-</u>	<u>170,667</u>

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £32.8m (2015: £25.5m).

The net book value of non-operating land and buildings comprise:

	2016 £'000	2015 £'000
Freehold	1,534	1,764
Long leasehold	<u>494</u>	<u>556</u>
	<u>2,028</u>	<u>2,320</u>

12. INVESTMENTS

	Shares in group undertakings £'000
COST	
At 1 January 2016 and 31 December 2016	<u>50</u>
NET BOOK VALUE	
At 31 December 2016	<u>50</u>
	Shares in group undertakings £'000
COST	
At 1 January 2015 and 31 December 2015	<u>50</u>
NET BOOK VALUE	
At 31 December 2015	<u>50</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

12. INVESTMENTS - continued

Details of the investments of the Company at 31 December 2016 are listed below:

Name of Company	Country of Registration	Holding of Ordinary Shares	Proportion	Nature of Business	Cost and Net Book Value
Electralink Limited	England and Wales	619 at 10p	6.7%	Data transfer network operator	£62
MRA Service Company Limited	England and Wales	1 at £1	1.0%	Governance of the electricity industry's Master Registration Agreement	£1
DCUSA Limited	England and Wales	1 at £1	1.0%	Management and governance of the Distribution Connection and Use of System Agreement	£1
Northern Electric Finance plc	England and Wales	50,000 at £1	100%	Finance company	£50,000

The above investments are unlisted and are held by the Company. The registered office addresses of:

Electralink Limited is Ground Floor, Grafton House, 2-3 Golden Square, London, W1F 9HR

DCUSA Limited is Ground Floor, Grafton House, 2-3 Golden Square, London, W1F 9HR

MRA Service Company Limited is 8 Fenchurch Place, London, EC3M 4AJ, England EC3M 4AJ

Northern Electric Finance plc is Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF

13. INVENTORIES

	2016 £'000	2015 £'000
Stocks	11,853	12,541
Work-in-progress	232	265
	<u>12,085</u>	<u>12,806</u>

14. TRADE AND OTHER RECEIVABLES

	2016 £'000	2015 £'000
Current:		
Distribution use of system receivables	50,280	45,055
Other receivables	2,185	5,664
Prepayments and accrued income	2,729	3,960
	<u>55,194</u>	<u>54,679</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

14. TRADE AND OTHER RECEIVABLES - continued

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 end of the reporting period. The fair valuation of the assets is based on Level 1 inputs. The maximum exposure to risk to the Company is the book value of these receivables less any provisions for impairment.

Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 22% of distribution revenues in 2016 (2015: 24%) and British Gas plc accounting for approximately 15% of distribution revenues in 2016 (2015: 16%). 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 £0.4 million as at 31 December 2016 (2015: £0.4 million).

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £0.2 million, which have been placed into administration and have therefore been provided in full at the year-end (2015: £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 meter rentals, amortisation of customer contributions in relation to distribution system assets and recovery of amounts for damage caused by third parties to the distribution system.

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

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £1.1 million (2015: £0.8 million) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.2 million (2015: £0.2 million) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 207 days (2015: 207 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.2 million (2015: £0.2 million). 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 66 days (2015: 66 days).

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

14. TRADE AND OTHER RECEIVABLES - continued

Ageing of past due but not impaired receivables

	2016 £'000	2015 £'000
30-60 days	116	133
60-120 days	66	49
120-210 days	7	12
Total	<u>189</u>	<u>194</u>

Movement in the allowance for doubtful debts

	2016 £'000	2015 £'000
At 1 January	192	338
Amounts utilised/written off in the year	(228)	(246)
Amounts recognised in statement of profit or loss	<u>440</u>	<u>100</u>
At 31 December	<u>404</u>	<u>192</u>

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

Included in the allowance for doubtful debts are specific trade receivables, with a balance of £0.3 million (2015: £0.1 million), which have been placed in administration. The impairment represents the differences between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

Categories of financial assets

	2016 £'000	2015 £'000
Loans and receivables at amortised cost	<u>52,465</u>	<u>50,719</u>
Total financial assets	<u>52,465</u>	<u>50,719</u>
Non-current assets	2,273,414	2,151,750
Inventories	12,085	12,806
Prepayments and accrued income	<u>2,729</u>	<u>3,960</u>
Total non-financial assets	<u>2,288,228</u>	<u>2,168,516</u>
Total assets	<u>2,340,693</u>	<u>2,219,235</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2016**

15. CALLED UP SHARE CAPITAL

Allotted, issued and fully paid:		Nominal value:	2016 £'000	2015 £'000
Number:	Class:			
200,000,100	Ordinary share capital	£1	<u>200,000</u>	<u>200,000</u>

16. RESERVES

	Retained earnings £'000
At 1 January 2016	618,331
Profit for the year	116,291
Dividends	<u>(21,800)</u>
At 31 December 2016	<u>712,822</u>
	Retained earnings £'000
At 1 January 2015	519,475
Profit for the year	119,456
Dividends	<u>(20,600)</u>
At 31 December 2015	<u>618,331</u>

17. TRADE AND OTHER PAYABLES

	2016 £'000	2015 £'000
Current:		
Payments on account	37,203	48,943
Trade creditors	3,985	6,488
Owed to group	583	499
Social security and other taxes	5,304	3,439
Other creditors	2,436	4,733
Deferred revenue	20,920	19,790
Accrued expenses	<u>33,137</u>	<u>31,230</u>
	<u>103,568</u>	<u>115,122</u>
Non-current:		
Deferred revenue	<u>562,308</u>	<u>526,800</u>
Aggregate amounts	<u>665,876</u>	<u>641,922</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

17. TRADE AND OTHER PAYABLES - continued

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 end of the reporting period. The valuation of liabilities set out above 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.

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities. The tables have been drawn up based on the discounted 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 £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2016:					
Non-interest bearing	45,445	-	-	-	45,445
Variable interest rate liability	66,639	-	-	-	66,639
Fixed interest rate liability	5,031	25,539	325,057	600,736	956,363
	<u>117,115</u>	<u>25,539</u>	<u>325,057</u>	<u>600,736</u>	<u>1,068,447</u>
2015:					
Non-interest bearing	46,389	-	-	-	46,389
Variable interest rate liability	64,227	-	-	-	64,227
Fixed interest rate liability	5,031	25,539	339,016	617,400	986,986
	<u>115,647</u>	<u>25,539</u>	<u>339,016</u>	<u>617,400</u>	<u>1,097,602</u>

Categories of financial liabilities

	2016 £'000	2015 £'000
Loans and payables at amortised cost	<u>669,170</u>	<u>670,962</u>
Total financial liabilities	<u>669,170</u>	<u>670,962</u>
Payments received on account	37,203	48,943
Income tax liabilities	99,101	98,611
Other taxes and social security	5,304	3,439
Accruals	33,137	31,230
Deferred Revenue	583,228	546,590
Provisions	<u>728</u>	<u>1,129</u>
Total non-financial liabilities	<u>758,701</u>	<u>729,942</u>
Total liabilities	<u>1,427,871</u>	<u>1,400,904</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

17. TRADE AND OTHER PAYABLES - continued

Deferred Revenue

	2016	2015
	£'000	£'000
At 1 January	546,590	522,532
Additions	55,980	46,261
Amortisation	<u>(19,342)</u>	<u>(22,203)</u>
At 31 December	<u>583,228</u>	<u>546,590</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 over 45 years on a straight line basis (except for distribution generation which is released over 15 years on a straight line basis), in line with the useful economic life of the distribution system assets.

18. BORROWINGS

The directors' consideration of liquidity, interest rate and foreign currency risk are described in the Strategic Report.

	Book Value		Fair Value	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Loans	243,534	243,551	261,388	249,963
Amounts owed to Group undertakings	<u>418,632</u>	<u>415,691</u>	<u>554,770</u>	<u>501,463</u>
	<u>662,166</u>	<u>659,242</u>	<u>816,158</u>	<u>751,426</u>
The borrowings are repayable as follows:				
On demand or within one year	75,217	72,391	75,217	72,391
Between one and five years	218,925	218,900	256,576	257,034
After five years	<u>368,024</u>	<u>368,951</u>	<u>484,365</u>	<u>422,001</u>
	<u>662,166</u>	<u>659,242</u>	<u>816,158</u>	<u>751,426</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

18. BORROWINGS - continued

Analysis of borrowings:

	Book Value		Fair Value	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Short-term loan	11	53	11	53
Inter-company short-term loan	67,042	64,174	67,042	64,174
Northern Electric Finance plc 2020 - 8.875%	101,849	101,849	130,276	130,560
Northern Electric Finance plc 2035 - 5.125%	49,711	49,638	69,168	60,154
Yorkshire Electricity Group plc 2037 - 5.9%	100,016	100,016	150,277	128,934
Northern Electric Finance plc 2037 - 5.125%	100,014	100,014	138,007	117,641
European Investment Bank 2018 - 4.065%*	41,419	41,410	42,974	43,632
European Investment Bank 2019 - 4.241%*	41,481	41,472	44,655	44,683
European Investment Bank 2020 - 4.386%*	40,495	40,488	44,990	44,478
European Investment Bank 2027 - 2.564%	120,128	120,128	128,758	117,117
	<u>662,166</u>	<u>659,242</u>	<u>816,158</u>	<u>751,426</u>

The fair value is determined with reference to quoted market prices. The directors' estimates of the fair value of bank loans and 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 value of short-term borrowings is equal to their book value. All loans are non-secured and are denominated in sterling.

The valuation of liabilities set out above 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 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 on inter-company short-term loans is charged at a floating rate of interest at LIBOR plus 0.35%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £0.6m 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 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.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

18. BORROWINGS - continued

The Company's Senior Total Net Debt as at 31 December 2016 totalled £654.5 million. Using the RAV value as at March 2016, as outlined by Ofgem in its electricity distribution price control financial model published in November 2015, and adjusting for the effects of movements in the value of the Retail Prices Index ("RPI") gives an approximation for the RAV value as at December 2016 of £1,295.0 million. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 50.5% (2015: 52.3%).

At 31 December 2016, the Company had available £94.0 million (2015: £94.0 million) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

19. LEASING AGREEMENTS

Minimum lease payments under non-cancellable operating leases fall due as follows:

	2016 £'000	2015 £'000
Within one year	5,235	5,235
Between one and five years	14,008	14,773
In more than five years	<u>3,131</u>	<u>3,251</u>
	<u>22,374</u>	<u>23,259</u>

	2016 £'000	2015 £'000
Minimum lease payments under operating leases recognised in the year	<u>7,070</u>	<u>6,601</u>

Leases primarily relate to the hire of fleet vehicles and the rental of operational land. The vehicle leases have terms between 2 and 7 years. The Company does not have the option to purchase the vehicles at the end of the lease term.

The operational land leases are between 10 and 999 years, but in the majority are between 20 and 60 years. As the leases are regarded as a business tenancy, the Company has the option to renew the lease under the 1954 Landlord and Tenant Act unless a landlord is to redevelop or has grounds to recover land as prescribed under the Act, and may acquire the freehold at any time by agreement. The Company also has the ability to compulsory purchase the freehold.

20. PROVISIONS

	2016 £'000	2015 £'000
Other provisions	<u>728</u>	<u>1,129</u>
Analysed as follows:		
Current	630	867
Non-current	<u>98</u>	<u>262</u>
	<u>728</u>	<u>1,129</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2016

20. PROVISIONS - continued

	Claims	Other	Total
	£'000	£'000	£'000
At 1 January 2016	444	685	1,129
Utilised/paid in the year	(850)	(576)	(1,426)
Charged to statement of profit or loss	<u>623</u>	<u>402</u>	<u>1,025</u>
At 31 December 2016	<u>217</u>	<u>511</u>	<u>728</u>

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

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and for an amount to cover claims made under section 74 of the New Road and Street Works Act 1991. Costs are expected to be incurred over the next 15 years.

21. DEFERRED TAX

	Accelerated Tax Depreciation	Other	Total
	£'000	£'000	£'000
At 1 January 2016	92,815	(218)	92,597
Credit to statement of profit or loss	<u>(2,994)</u>	<u>(84)</u>	<u>(3,078)</u>
At 31 December 2016	<u>89,821</u>	<u>(302)</u>	<u>89,519</u>

	Accelerated Tax Depreciation	Other	Total
	£'000	£'000	£'000
At 1 January 2015	100,686	(210)	100,476
Credit to statement of profit or loss	<u>(7,871)</u>	<u>(8)</u>	<u>(7,879)</u>
At 31 December 2015	<u>92,815</u>	<u>(218)</u>	<u>92,597</u>

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

22. EMPLOYEE BENEFIT OBLIGATIONS

Introduction

The Company contributes to two pension schemes, which it operates 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.

No other post-retirement benefits are provided to members of the DB Scheme.

Unless otherwise stated, disclosures within this note are representative of the Northern Powergrid Group as a whole and not the Company on an individual basis as the Company accounts for the DB Scheme as if it were a defined contribution scheme.

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 interests of all relevant beneficiaries and are responsible in particular for the asset investment strategy plus the day-to-day administration of the benefits payable. They also are 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 actuarial valuation of the DB scheme was carried out by the Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2013. Such valuations are required by law to take place at intervals of no more than three years. 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 October 2014 with the Trustees to repair the funding deficit of £286.4m as at 31 March 2014 over the 11 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2013 being borne out in practice. The agreement includes cash payments of £34.9m 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	£28.6m p.a.
1 April 2016 to 31 March 2025	£18.4m p.a.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

All contributions set out above are in 2014/15 prices and will be increased each year in line with increases in RPI over the period until they fall due.

The contributions payable by the Northern Powergrid Group to the DB Scheme in respect of future benefits, which are accruing, are 34.2% of pensionable pay. These contributions were determined as part of the 31 March 2013 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 2016. In addition, the Northern Powergrid Group pays 3.0% of pensionable pay to the DB Scheme to cover the expenses of running the DB Scheme.

The next funding valuation is on-going and expected to be concluded by the end of June 2017.

The Northern Powergrid Group's total contributions to the DB Scheme for the next financial year are expected to be £36.7 million.

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.

Pensions' 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;
- promote and to improve understanding of good administration;
- reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund ("PPF"); and
- minimise any adverse impact on the sustainable growth of an employer.

The Pensions Regulator has various powers including the power 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 contributions where there has been a detrimental action against the scheme.

Profile of the DB Scheme

The Defined Benefit Obligation ("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 results of the 31 March 2013 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

Broadly, about 40% of the liabilities are 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).

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Risks associated with the DB Scheme

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

Risk	Description	Mitigation
Volatile asset returns	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 aims to hold a significant proportion (48%) of its assets in return-seeking assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term.	The allocation to return-seeking assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from return-seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation.
Changes in bond yields	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 (61%) as bonds, which provide a hedge against falling bond yields (falling yields which increase the DBO will also increase the value of the bond assets). 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.
Inflation risk	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).
Currency risk	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.
Life expectancy	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 DB Scheme regularly reviews actual experience of its membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption.

The Northern Powergrid Group and Trustees have agreed a long-term strategy for reducing investment risk as and when appropriate. This includes the use of Liability Driven Investment (LDI) from October 2016 to more closely match the nature and duration of the DB Scheme's liabilities through the use of derivatives such as swaps and repurchase agreements. The portfolio is designed to hedge a proportion of the interest rate and inflation risk inherent in the Scheme's liabilities. The target hedging level is currently 60% of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

The Trustees insure certain benefits payable on death before retirement.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Other risks

There are a number of other risks associated with 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 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 the 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.

Reporting at 31 December 2016

For the purposes of this disclosure, the current and future pension costs of the Northern Powergrid Group have been assessed by Aon Hewitt, a qualified independent actuary, using the assumptions set out below, which the actuary has confirmed represent a reasonable best estimate of those costs. This review has been based on the same membership and other data as at 31 March 2013. The board of Northern Powergrid Holdings Company has accepted the advice of the actuary and formally approved the use of these assumptions for the purpose of calculating the pension cost of the Northern Powergrid Group.

The results of the latest funding valuation at 31 March 2013 have been adjusted to 31 December 2016. Those adjustments take account of experience over the period since 31 March 2013, changes in market conditions, and differences in the financial and demographic assumptions. The present value of 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 DB Scheme approach retirement.

The Company's total pension cost for the year ended 31 December 2016 was £24.6m (2015: £30.6m).

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

Main financial assumptions	2016 % p.a.	2015 % p.a.
RPI Inflation	3.00	2.90
Rate of long-term increase in salaries	3.00	2.90
Pension increases	2.90	2.80
Discount rate for scheme liabilities	2.70	3.70

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

Main demographic assumptions	2016	2015
Life expectancy for a male currently aged 60	27.1	27.0
Life expectancy for a female currently aged 60	28.8	28.7
Life expectancy at 60 for a male currently aged 45	28.6	28.5
Life expectancy at 60 for a female currently aged 45	30.6	30.4
Proportion of pension exchanged for additional cash at retirement	10%	10%

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued **FOR THE YEAR ENDED 31 DECEMBER 2016**

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

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

Asset allocation	2016	2015
	£m	£m
Developed market equity	338.6	331.0
Emerging market equity	12.9	11.2
Property	91.4	146.0
Reinsurance	71.3	68.2
Listed infrastructure	99.2	90.1
Investment grade corporate bonds	366.9	375.5
Other debt	30.3	38.7
Fixed interest gilts	52.4	24.9
Index-linked gilts	3.1	453.7
Liability driven investments	581.2	-
Cash	107.1	22.0
Total	1,754.4	1541.3

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 December 2016, the fair value of the DB Scheme's assets, which related to self-investment, amounted to less than Nil% (2015: Nil%).

Changes to the present value of the DBO during the year	2016	2015
	£m	£m
Opening DBO	1453.2	1463.2
Current service cost	14.9	15.9
Interest expense on defined benefit obligation	53.0	52.0
Contributions by DB Scheme participants	1.0	1.5
Actuarial gains on DB Scheme liabilities arising from changes in demographic assumptions	-	(12.4)
Actuarial losses/(gains) on DB Scheme liabilities arising from changes in financial assumptions	311.5	(1.9)
Actuarial gains on DB Scheme liabilities arising from experience	(25.9)	(5.6)
Net benefits paid out	(84.8)	(59.5)
Closing DBO	1,722.9	1453.2

Changes in the fair value of DB Scheme assets during the year	2016	2015
	£m	£m
Opening fair value of DB Scheme assets	1541.3	1516.1
Interest income on DB Scheme assets	56.7	54.5
Re-measurement gains/(losses) on DB Scheme assets	200.9	(20.3)
Contributions by the employer	40.5	50.2
Contributions by DB Scheme participants	1.0	1.5
Net benefits paid out	(84.8)	(59.5)
Administration costs incurred	(1.2)	(1.2)
Closing fair value of DB Scheme assets	1,754.4	1,541.3

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Actual return on DB Scheme assets	2016	2015
	£m	£m
Interest income on DB Scheme assets	56.7	54.5
Re-measurement gain/(loss) on DB Scheme assets	200.9	(20.3)
Actual return on DB Scheme assets	257.6	34.2

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 Group. The sensitivity of the results to these assumptions is as follows.

	Changes in DBO £m	Revised DBO £m
Current Figures	1,722.9	
Following a 10 bps decrease in the discount rate	33.8	1,756.7
Following a 10 bps increase in the discount rate	(33.2)	1,689.7
Following a 10 bps increase in the inflation assumption	30.0	1,752.9
Following a 10 bps decrease in the inflation assumption	(29.6)	1,693.3
Following a 1 year increase in life expectancy	67.1	1,790.0
Following a 1 year decrease in life expectancy	(67.0)	1,655.9

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.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued **FOR THE YEAR ENDED 31 DECEMBER 2016**

23. RELATED PARTY DISCLOSURES

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:

	Sales to related parties £'000	Purchases from related parties £'000	Amounts owed to related parties £'000	Finance cost/income to related parties £'000	Borrowings from related parties £'000
Related Party					
2016					
Integrated Utility Services Limited	402	2,112	-	-	-
Integrated Utility Services Limited (registered in Eire)	7	1,387	165	-	-
Northern Electric plc	35	3,885	-	-	-
Northern Electric Finance plc	-	-	-	17,027	251,574
Northern Powergrid Insurance Services Limited	-	-	-	-	-
Northern Powergrid Metering Limited	94	-	-	-	-
Northern Powergrid (Yorkshire) plc	17,348	10,841	-	55	-
Vehicle Lease and Service Limited	37	3,895	418	-	-
Yorkshire Electricity Group	-	-	-	6,326	166,664
	<u>17,923</u>	<u>22,120</u>	<u>583</u>	<u>23,298</u>	<u>418,238</u>
2015					
Integrated Utility Services Limited	339	1,505	-	-	-
Integrated Utility Services Limited (registered in Eire)	7	1,515	82	-	-
Northern Electric plc	52	4,419	-	-	-
Northern Electric Finance plc	-	-	-	17,023	251,501
Northern Powergrid Insurance Services Limited	-	356	-	-	-
Northern Powergrid Metering Limited	85	-	-	-	-
Northern Powergrid (Yorkshire) plc	17,887	9,294	-	-	-
Vehicle Lease and Service Limited	37	3,718	417	-	-
Yorkshire Electricity Group plc	-	-	-	6,347	164,190
	<u>18,407</u>	<u>20,807</u>	<u>499</u>	<u>23,370</u>	<u>415,691</u>

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

Interest on loans from Northern Powergrid Group companies is charged at a commercial rate. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of amounts owed by related parties

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

24. RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS

	2016	2015
	£'000	£'000
Profit before income tax	121,381	133,356
Depreciation charges	77,916	73,759
Profit on disposal of fixed assets	(400)	(474)
Amortisation of deferred revenue	(19,342)	(22,203)
Decrease in provisions	(401)	(709)
Finance costs	29,082	26,478
Finance income	(482)	(126)
	207,754	210,081
Decrease/(increase) in inventories	721	(1,063)
(Increase)/decrease in trade and other receivables	(1,487)	6,037
Increase/(decrease) in trade and other payables	1,646	(6,132)
Cash generated from operations	<u>208,634</u>	<u>208,923</u>

25. ULTIMATE 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 UK, can both be obtained from the Company Secretary, Northern Powergrid Holdings Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.