

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**REPORT & ACCOUNTS  
TO 31 DECEMBER 2009**

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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**REPORT AND ACCOUNTS TO 31 DECEMBER 2009**

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# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

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

## DIRECTORS' REPORT

### **Cautionary statement regarding forward-looking statements**

This annual report has 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. This annual report contains certain forward-looking statements, which can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, business prospects, the availability of financing to the Company and anticipated cost savings are forward-looking statements.

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

The directors present the annual report and accounts of Northern Electric Distribution Limited (the "Company") for the year ended 31 December 2009, which includes the business review and audited financial statements for that year. Pages 1 to 22 inclusive of this annual report comprise a directors' report that has been drawn up and presented in accordance with the Companies Act 2006.

### **PRINCIPAL ACTIVITIES**

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

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

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

<b><u>Principle</u></b>	<b><u>Strategy</u></b>	<b><u>Indicator</u></b>
Financial strength	Effective stewardship of the Company's financial resources, investing in assets and focusing on long term opportunities, which contribute to the Company's future strength.	Profitability. Cash flow. Maintenance of investment grade credit ratings.
Customer service	Delivering reliability, fair prices and exceptional service.	Improving network resilience and performance, measured by: Customer minutes lost; Customer interruptions; and Customer satisfaction.

## NORTHERN ELECTRIC DISTRIBUTION LIMITED

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### DIRECTORS' REPORT (CONTINUED)

#### PRINCIPAL ACTIVITIES (continued)

<u>Principle</u>	<u>Strategy</u>	<u>Indicator</u>
Operational excellence	Setting high standards for the Company's operations and system investment, operation and maintenance.	Effective asset management. Managing commercial risk. Improving network resilience and performance.
Employee commitment	Equipping employees with the resources and skills they need to operate successfully and in a safe and rewarding environment.	Leading safety performer. Engaging employees. Effective leadership.
Environmental respect	Using natural resources wisely and effectively protecting the environment, where it is impacted by the Company's operations.	Reducing environmental impact. Promoting and pursuing long term sustainability.
Regulatory integrity	Adhering to a policy of strict compliance with appropriate standards, policies and legislation.	Strong internal controls. Regulatory engagement. Industry influence.

The Company continues to put plans in place to deliver its objectives against the strategy based on the Core Principles, executes on those plans across a range of activities, measures its progress and introduces corrective action wherever required. Adherence to its strategy and Core Principles enabled the Company to deliver a pleasing financial performance against the challenging economic environment, which persisted throughout 2009 and which included the highest reduction in the number of units distributed across its network for a number of years.

### BUSINESS REVIEW

#### Review of the year

The Company continued to make good progress in many areas of its business during the year, with financial performance meeting the challenges of the year, assisted by a strong cost control and mitigation exercise, customer service performance improving in the call centre with the introduction of a new inter-active voice recognition system and a significant reduction being achieved in the relation to the work in progress to repair faults on the distribution network. Disappointingly, the Company failed to meet its targets in respect of lost time accidents, preventable vehicle accidents and operational incidents. In addition, a single network fault early in 2009 resulted in the Company's guaranteed standards of performance failures being in excess of those experienced in 2008.

During 2009, the Company was fully engaged with the Office of Gas and Electricity Markets ("Ofgem") in the Distribution Price Control 5 ("DPCR5") process, which culminated on 7 December 2009 with Ofgem publishing its final proposals in respect of the price control formula that will take effect for the five-year period commencing 1 April 2010. That process involved submission of the Company's detailed business plans in February 2009, the publication by Ofgem of an initial set of proposals on 3 August 2009 and continuing subsequent dialogue between the Company and Ofgem throughout the remainder of the year. Following detailed analysis, the Company advised Ofgem, on 23 December 2009, that it was accepting its final proposals.

Under its final proposals for DPCR5, Ofgem set a 4.7 per cent 'vanilla' weighted average cost of capital, which equates to 5.6 per cent pre-tax, in order to allow the Company to fund its cost of debt and equity. The Company was disappointed at the low level of the return on capital allowed but pleased that Ofgem recognised the Company as one of the more efficient distribution network operators ("DNOs").

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

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

##### **Review of the year (continued)**

The Company was also pleased to see the focus in DPCR5 on rewarding DNOs for delivering high standards of customer service and providing the opportunity for outperforming Ofgem's baseline expenditure and performance targets. In addition, Ofgem has set out the "outputs" it expects the Company to achieve and, as an incentive to provide better customer service, will introduce new, statutory guaranteed standards of performance in respect of connections to the Company's network, more challenging targets for network reliability and a new measure of customer satisfaction with the service provided.

The Company's charges based on the DPCR5 final proposals, together with a rebalancing of distribution charges between customer groups, mean that, on 1 April 2010, the Company's charges made in relation to the distribution of electricity to domestic customers will increase by about 2.8%, or equivalent to about 0.4% on their electricity bills. Changes to the charges made in relation to non-domestic customers will vary more widely between different types of non-domestic customers.

##### **Strategic objectives**

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

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

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

# **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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

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

#### **Review of the year (continued)**

#### **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 strength:**

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

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

The other financial strength risks facing the Company are outlined in the Treasury section on page 9 below.

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### DIRECTORS' REPORT (CONTINUED)

#### Principal risks and uncertainties (continued)

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

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

<u>Risk</u>	<u>Issue</u>	<u>Mitigation</u>
Counter-party security (Financial Strength)	A counter-party with which the Company trades may go bankrupt causing loss of invested funds or amounts owing.	The treasury function has strict controls in respect of the counter-parties with which it deals, including the use of credit ratings and appropriate limits. Credit cover arrangements are in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism, if good debt control practices continue to be followed.
Potential flooding and other weather related events. (Operational Excellence and Customer Service)	Recent weather patterns suggest a heightened risk of flooding of 'at risk areas' and the potential for increased occurrence of damage to the overhead network.	A robust major incident management plan is in place. The Company's critical property unit plan assesses those properties most at risk and a flood mitigation plan is in place, including the erection of permanent and temporary defences.
BT ESP analogue circuits (Operational Excellence)	Potential withdrawal of service puts existing communication arrangements at risk.	The Company is represented on the Energy Networks Association's working group, which is working with BT, the Cabinet Office, Ofgem and Ofcom to consider the issues. Options include retaining the equivalent service, potentially at higher than current cost or utilising an alternative solution.
Network risk posed by cables through the Tyne Tunnel (Operational Excellence and Environmental Respect)	The 66kV fluid-filled cables in the tunnel are aging with increased risk of failure, leading to a requirement for the substantial use of generating units and potential guaranteed standards failures and incentive penalties.	The Company's Primary Engineering Projects team has implemented a solution and the new configuration is due to be commissioned in mid-2010.
Motor accident management (Employee Commitment and Regulatory Integrity)	Any significant road traffic accident involving a Company vehicle may create a liability, which the Company has to meet, and involve injury to employees and/or third parties.	The inclusion of road risk related issues in the CE Group's Safety Improvement Plan and the appointment of a dedicated road risk manager, together with improved reporting routines, has increased the focus on road safety.

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### DIRECTORS' REPORT (CONTINUED)

#### Principal risks and uncertainties (continued)

##### **Operational risk (continued):**

<u>Risk</u>	<u>Issue</u>	<u>Mitigation</u>
Electricity Safety, Quality and Continuity Regulations 2002 (Employee Commitment and Regulatory Integrity)	The regulations impose various statutory obligations, non-compliance with which could lead to incidents, prosecution and claims.	A full site inspection and risk assessment regime is in place designed to ensure compliance.
Shortage of supply and increased demand for copper (Operational Excellence)	The global demand for copper has impacted the availability and cost of a number of core products and increased the risk of theft.	Improved and more efficient procurement processes have been introduced and security at all sites where copper products are stored has been reviewed and enhanced where required.
Influenza pandemic (Employee Commitment and Operational Excellence)	A pandemic may occur, substantially impacting on normal business operations.	A pandemic group was established and an action plan incorporated into the Company's existing crisis management and business continuity plans, which included information and practice obtained from liaison with government agencies, health professionals and occupational health experts.

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

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

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

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



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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

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

##### **Operational risk (continued)**

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

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

##### **Internal control**

A rigorous internal control environment exists within the CE Group based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. MidAmerican Energy Holdings Company ("MidAmerican"), a parent company of the Company, requires a quarterly control risk self-assessment to be undertaken by all senior managers as part of its programme for compliance with the requirements of the Sarbanes-Oxley Act. During the year, the annual, extensive programme to review the company-wide controls was completed and opportunities to enhance control arrangements, identified by that review, have been implemented.

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

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

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

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

Other key features of the internal control system are:

- Comprehensive business planning and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- Regular review of key performance indicators to assess progress towards objectives;
- A range of policies, codes of practice and more detailed instructions that define the processes to be followed;
- A strong internal audit function to provide independent scrutiny of internal control systems and risk management procedures, including the standards required by the Sarbanes-Oxley Act;
- On-going health and safety performance reviews carried out by in-house safety professionals in addition to the regime of routine health and safety risk assessment and management processes carried out within each of the operating units;

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

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

- Processes and procedures to operate under the Occupational Health and Safety Assessment Series ("OHSAS") standard OHSAS 18001, which is subject to external certification and regular assessment;
- An external obligations programme, which provides a robust approach to, and compliance with, financial, legal and regulatory obligations;
- Centralised treasury operations that operate within defined limits and are subject to regular reporting requirements and audit reviews; and
- Established procedures for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

#### **Financial strength**

During 2009, the Company continued to improve its management of routine financial performance, implemented tighter expenditure controls through a wide-ranging cost mitigation exercise, enhanced the reporting of management information and embedded the culture of continuous financial improvement in all areas of its operations.

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

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

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

#### **Revenue**

Revenue at £224.6m was £9.7m higher than the previous year as a result of a tariff increase in the year, partly offset by a reduction in units distributed over the network.

#### **Operating profit**

Operating profit at £89.7m was £7.8m higher than the previous year as a result of increased revenue combined with a stable cost base.

#### **Finance costs**

Finance costs at £23.4m were broadly in line with the previous year, reflecting the fact that the majority of the Company's debt is at fixed rates of interest.

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

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

##### **Taxation**

The effective tax rate in the current year is 27.9%. The Company's taxation charge in 2008 was affected by changes in tax legislation. Details are provided in Note 8 to the accounts.

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

The Company made a profit after tax for the year of £47.8m. An interim dividend of £20.0m was paid during the year and the directors recommend that no final dividend be paid in respect of the year.

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

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

##### **Dividend policy**

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

##### **Cash flow**

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

Movements in cash flows were as follows:

- *Operating activities:* Cash flow from operating activities at £79.4m was £6.1m higher than 2008, mainly due to an increase in cash profits of £9.9m and a reduction in interest paid of £4.3m, offset by adverse movements on working capital.
- *Investing activities:* Net cash used in investing activities at £101.1m was broadly in line with the prior year and reflects a reduction in capital expenditure being offset by a reduction in the receipt of customer contributions.
- *Financing activities:* The net cash generated by financing activities at £16.5m was £13.7m lower than the prior year reflecting a reduction in the amount of capital raised from new borrowings.

##### **Treasury**

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

The main risks are liquidity and interest rate risk.

##### **Liquidity risk**

The Company has access to short-term borrowing facilities provided by YEG and a £50m committed revolving credit facility provided by Lloyds TSB Bank plc and Royal Bank of Scotland plc. Although the revolving credit facility is due to expire in April 2010, the Company has commitments in place to increase those facilities to £75m with Lloyds TSB Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc, part of the Banco Santander group, for a three year period. An additional overdraft facility of £2m is provided by Lloyds TSB Bank plc, which is renewed on an annual basis.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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

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

##### **Treasury (continued)**

##### **Interest rate risk**

The Company is financed by long-term borrowings at fixed rates and has access to short-term borrowing facilities at floating rates of interest. As at 31 December 2009, 73% of the Company's borrowings were at fixed rates and the average maturity for these borrowings was 23 years.

##### **Currency risk**

No material currency risks are faced by the Company.

##### **Trading risk**

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

##### **Financial derivatives**

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

##### **Pensions**

The Company is a participating employer in the Northern Electric Group of the Electricity Supply Pension Scheme (the "Scheme"), a defined benefit scheme. Full details of the Company's commitments to the Scheme and the associated deficit repair payments are provided in Note 22 to the accounts. During 2010, Northern Electric plc, the Company's parent company and the Principal Employer of the Scheme, will be engaged with the Group Trustees in the triennial actuarial valuation process, which is to take place as at 31 March 2010, in order to determine the funding position of the Scheme and the associated deficit repair arrangements.

Ofgem recognises that pensions, particularly with respect to the current deficit positions of various schemes, represent a significant cost to the DNOs and, as part of the DPCR5 process, undertook a review of the pension principles it established in 2003. That review included the issue of three consultation documents and the holding of three seminars for interested parties and, as a result, Ofgem confirmed that the DNOs would be allowed to recover the full value of the deficits attributable to the licensee's distribution business that were in existence as at 31 March 2010, via their regulated revenues. However, given the regulated nature of the DNOs' businesses, Ofgem took the view that there is not the same risk or urgency as in other sectors of the economy to ensure that those deficits are repaired as soon as possible and, therefore, set a notional repair period of 15 years for the purpose of assessing the DNOs' allowed revenues in respect of pension costs over the DPCR5 period. As the actual repair period for each scheme is a matter for the trustees of that scheme to agree with its sponsoring employer, Ofgem recognised that there is the potential for there to be a difference between the repair period so agreed and the 15 year notional repair period used in DPCR5. Noting this position, Ofgem commented in the DPCR5 final proposals that, should shorter deficit repair periods be agreed between trustees and sponsoring employers, the DNOs allowed revenues over the remaining portion of the 15 years will be adjusted so that the DNOs suffer no detriment on a net present value basis.

The Company also participates in the Northern Electric Money Purchase Scheme, which is a defined contribution scheme.

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

#### **Insurance**

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

#### **Customer service**

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

- implementing a new interactive voice response system into the Company's front line call centre, which takes advantage of the latest developments in automatic messaging, in order to assist in the handling of customer loss of supply calls;
- improving the accuracy of network fault estimated restoration times inputted to the trouble management system and, consequently, communicated to customers;
- implementing a new complaint handling process to ensure robust compliance with the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 and to meet the target of in excess of 90% of complaints being resolved at the initial point of contact;
- continuing to improve under-performing parts of the distribution system by identifying "hot spots" and taking specific action to address the issues in those areas;
- extending the priority services register so that the Company is aware of people with disabilities or special needs, who may be affected by interruptions to the electricity supply and can take appropriate action to assist those people in such circumstances; and
- undertaking a programme to reduce the number of instances by 5%, in which the Company fails to meet an electricity guaranteed standard of performance.

The Company's customer service satisfaction scores continued to show an improving trend through the year and in excess of 97% of complaints were resolved at the first time of asking. In that respect, developing the new telephony system for other customer facing processes will form a significant part of the customer service improvement plan in order to meet the target of a customer satisfaction score of greater than 90%.

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

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

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### DIRECTORS' REPORT (CONTINUED)

#### Customer service (continued)

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

In respect of the key customer service performance indicators, the Company's performance for the regulatory year ended 31 March 2009 showed that the Company achieved the target for customer interruptions but failed on customer minutes lost, whilst just failing to achieve the customer satisfaction target, as follows:

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

At the time the above targets were set, no account was taken of the customer service impact arising from additional vegetation management obligations, which were not allowed for in the distribution price control 4 settlement. The customer service targets were not adjusted to take account of the effects of the representations made by the Company and accepted by Ofgem, which are noted on page 8. Instead, the benefits arising from that decision were reflected in a favourable adjustment to the Company's base allowed revenue. That position will continue until 31 March 2010.

#### Operational excellence

The Company's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the year, £122.5m was invested in the improvement of the distribution system, including the replacement of assets and continuing network improvements intended to increase the quality of the electricity supply provided to customers.

#### **Operational activity**

The investment strategy is designed to deliver improvements in an efficient and cost-effective manner by minimising the number of faults that occur, reducing the average number of customers affected by a fault and providing a quicker restoration service in the event of a fault. Such actions are expected to have a positive impact on future CI and CML performance. The focus in 2009 was on delivering the core operational programmes, in particular the installation of remote control units and improving the lead times for fault repair work-in-progress.

That focus was designed to support the Company's goals in the area of operational excellence and to ensure that the distribution network is operated as well as possible. To that end, the Company's priorities are to deliver an underlying improvement in the network's resilience, deal appropriately with any risks as and when they arise, plan its operational activity so as to operate within the planning assumptions for pre-arranged system unavailability and, while doing so, to pay close attention to the underlying cost. Consequently, the Company has established five targets to enhance its performance in terms of operational excellence:

- Deliver enhancements to the network by adding intelligent reconfiguration capability, which includes the commissioning of additional rural and urban remote control units on the high voltage system and auto-sectionalisers in rural area;
- Minimise abnormal running arrangements by maintaining a routine service level for fault repair work-in-progress on the high voltage network, building on the success in that respect during 2009;

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### DIRECTORS' REPORT (CONTINUED)

#### Operational excellence (continued)

- Minimise the impact on costs and customer service by pursuing a "fix-first-time" approach on the low voltage network, which will further improve the level of fault repair work-in-progress;
- Enhance the operational availability of the installed remote control units by improving the level of work-in-progress of failure investigations, which will have a consequential benefit in respect of the successful operation of those units; and
- Complete the capital and maintenance work programmes, along with repair, connection and diversion work, within the pre-arranged interruption target.

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

- The completion of a project to replace existing 66kV and 11kV switchgear and reinforce the existing 66/11kV primary substation at Amberton Road in Hartlepool;
- The completion of a project to establish a new 66/11kV primary substation at Melrosegate in York;
- The completion of a project to replace the 66kV transformers at Carville substation in Newcastle;
- The completion of a project to reinforce system security at Bedale substation by undertaking 33kV circuit modifications and connecting a new 33kV outlet at Lemming Bar in North Yorkshire;
- The completion of the underground cables works associated with the final stage of the refurbishment of the Spennymoor to Skernside 66kV circuit in Durham;
- The completion of a major 33kV reinforcement project in Newcastle designed to meet demand growth and provide further system security in the area;
- The initiation of a major 132kV switchgear replacement project at Tynemouth in North Tyneside;
- Replacement of 35 units of high voltage outdoor switchgear;
- Replacement of 38 high voltage distribution substations;
- Replacement of 80 units of high voltage indoor switchgear;
- Refurbishment or rebuilding of 55km of high voltage overhead line;
- Refurbishment or rebuilding of 33km of low voltage overhead line;
- The upgrade and reinforcement of 5.3km of overhead line to address the quality of supply performance issues relating to those circuits; and
- The installation and commissioning of 300 new remote control sites.

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

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

Operational excellence (continued)

#### **Enduring Operating Model**

During the year, a significant project was undertaken by the senior Field Operations team to reorganise the operating structure within that area of the Company's business in order to provide the best possible foundation for optimum operational performance into the future. The management structure within Field Operations is based on seven individual business units, as follows:

- Network Operations provides the day-to-day and reactive management of the distribution network at all voltages and includes activities such as network performance, emergency planning and restoration activities associated with network faults;
- Service Delivery has responsibility for the control and management of the craft-based staff, direct labour and the provision of this resource to the other business units and is structured across two geographic zones;
- Network Repairs focuses on core repair activities and significant cost control initiatives in respect of expenditure on the repair of faulted assets;
- Connections Delivery undertakes non-discretionary, customer-driven work and is structured across two geographic zones;
- Programme Delivery has a functional bias to its activities and includes primary engineering projects, overhead programme delivery, asset programme delivery and protection and technical services;
- Operational Services includes contract management, business controls and administration and supply chain management; and
- Field Standards provides training, quality assurance, services standards and health and safety services across Field Operations.



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

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

##### **Commercial risk**

Managing commercial risk in the context of the difficult economic and financial trading conditions, which continued throughout 2009, was and will continue to be of key importance to the Company's operations. In that respect, the Company has, throughout the year, focused on ensuring strict adherence to the CE Group's policies for credit checking, payment terms, payment performance tracking and debt management.

During 2009, the CE Group completed the process of putting in place contracts in the commercially significant areas of IT facilities management and cable engineering services. A number of major IT suppliers responded to the tender for IT facilities management services and, following an extensive evaluation process, the new contract was awarded to Logica and will be effective from 1 April 2010 until 31 March 2015. Following a similar tender exercise, contracts for the provision of cable engineering services were awarded to Balfour Beatty Utility Solutions, Clancy Docwra, the Freedom group of companies, J Murphy & Sons, Morrison Utility Services and Murphy Limited and are effective for the five year period to June 2014.

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

#### **Employee commitment**

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

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

The Company received its fourth successive Gold Medal award from the Royal Society for the Prevention of Accidents, for occupational health and safety performance and provision, to recognise the achievement of continued or improving standards of health and safety over a sustained period. The Gold Award is the highest achievement award and the Gold Medal is presented for receiving five or more successive Gold Awards. The Company continued to maintain its OHSAS 18001 certification.

The main key performance indicators used by the Company to monitor safety performance are as follows:

	2009		2008	
	Target	Actual	Target	Actual
Lost time accidents	0	1	0	2
Medical treatment accidents	3	2	3	1
Operational incidents	3	4	3	8
Preventable vehicle accidents	10	13	10	18

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

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

Although safety performance against target was disappointing in certain areas during 2009, the Company is not complacent and continues to rigorously implement, review and adjust the safety improvement plan accordingly to deliver continuous improvement. In terms of preventable vehicle accidents the performance has been unacceptable and focus continues heavily on this area with implementation of a robust assessment and training plan aimed at changing behaviour and improving concentration skills. It is expected that this, together with the zero tolerance approach, should continue to deliver improvements in safety performance.

#### **Management structure**

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

#### **Employees**

2009 was a particularly challenging year. The external economic environment and a tougher than expected DPCR5 final settlement have driven tight controls on a number of key activity programmes. Internal programmes of cost containment have been a key theme across the business and these have extended to the control of headcount and salary cost allocation with improved management processes being introduced in the first quarter of the year. Those improvements included enhanced control over external recruitment, the targeting of that recruitment at key hires and all such appointments being subject to the approval of the President and Chief Operating Officer of the CE Group.

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

Given the demographics of the Company's workforce, the increasing investment in the distribution network and in order to encourage investment in a sustainable workforce, Ofgem provided an allowance, in its DPCR5 final proposals, in order to fund the Company's plans for workforce renewal across the DPCR5 period. Ofgem has stated that the allowance is on a "use it or lose it" basis and the Company will need to demonstrate that it has used that allowance appropriately and efficiently to recruit and train new staff or for other means of renewing its workforce and report annually on its progress in that respect.

The Company employed 953 staff at the end of December 2009 at various locations throughout its distribution services area (2008: 959).

#### **Disabled employees**

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

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

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

##### **Employee consultation**

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

The Company is committed to maintaining and improving effective communication with employees, principally through regular staff briefs on current issues, meetings with staff and their representatives and the issue of an employee publication. During 2009, the Company introduced an additional means of communication in the form of regular broadcast briefings by the President and Chief Operating Officer of the CE Group using telephone conference call facilities. The broadcast briefings were used to provide employees with updates such as on the performance of the Company and the CE Group, progress in respect of DPCR5, organisational restructures and safety issues and performance.

#### **Environmental respect**

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

The Company has operated a United Kingdom Accreditation Service accredited scheme to the environmental management systems ("EMS") standard ISO 14001 since the late 1990s that is subject to regular six-monthly assessments by an external certification body in order to retain that status. The 2009 assessment was carried out by Lloyd's Register Quality Assurance in September with no major or significant non-conformances raised. The report concluded that a sound approach to the implementation, maintenance and improvement of a mature EMS had been demonstrated.

The Company delivered its targeted improvement in the key area of fluid-filled cable leakage, was compliant against the required streetworks performance standards under the Traffic Management Act and was fully compliant with all required Environmental Agency reporting obligations.

Improvements in support of the Company's environmental policy objectives during the year included:

- A programme to enhance secondary containment provision for primary transformer sites to prevent oil leakage;
- A programme to enhance emergency response provision for primary transformer sites to mitigate oil leakage;
- Replacement of oil-filled circuit breakers with vacuum and sulphur hexafluoride (SF6) gas filled units at outdoor substations to reduce gas leakage;
- Improved monitoring and response measures with regard to the management of fluid-filled underground cable networks and the reduction of leakages;
- Installation of additional engineering controls where required to improve pollution prevention at strategic sites;
- Installation of underground cables using trenchless technology as opposed to open-cut excavations; and

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

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

- Environmental awareness training for all new start personnel and contractors, complemented by periodic refresher training for all staff.

#### **Sustainability**

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

The Company measures and publishes its own carbon footprint and has set a target of a reduction in its carbon footprint of 20 per cent by 2020. Actions taken during the course of the year to assist in meeting this target include fitting speed limiters to about a third of its vehicle fleet, the procurement of building energy management systems for its major office sites and a pilot project to recycle office waste at one of its non-operational sites.

In addition, Ofgem will be looking to the Company to contribute to the sustainability agenda through more detailed reporting on the carbon footprint of its business, considering the use of better demand side management techniques to address network constraints and by the provision of simpler information to those parties interested in connecting local, embedded generation to the network.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

#### **Regulatory integrity**

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

As has been the case for some years, breaches by a DNO of its licence conditions could lead to financial penalties, which Ofgem has stated "will have a proportionate impact on shareholder returns". In order to assure compliance with its licence and other regulatory obligations, the Company operates a regulatory compliance affirmation process, under which ownership of the approximately 1,170 regulatory obligations contained within the compliance database is currently assigned to some 49 owners in the CE Group. Those owners are required, on a quarterly basis, to review compliance with their relevant obligations and report on any perceived risks to the compliance process, which are then addressed. The Company's Regulation Manager reports to the board of directors on the outcome of each quarter's exercise.

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

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

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

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

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

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

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

During the year, charitable donations of £50,301 were made (2008: £34,649), principally to local charities serving the communities in which the Company operates. No contributions were made to political organisations (2008: £nil).

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

#### **Research and development**

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

- Active participation in programmes of national significance in collaboration with other DNOs and academic institutions to make significant technological progress for utilisation by the industry as a whole;
- Continuing to support collaboration with other DNOs, both through industry associations and on a multilateral basis, on a range of incremental improvements to tools and equipment that, if successful, will further add to overall efficiency improvements;
- Contributing to the ongoing development of eligibility for and governance of the new Low Carbon Networks Fund, initiated by Ofgem, as a part of DPCR5. The Low Carbon Networks Fund is intended to encourage innovation in terms of the technology used and the commercial and operational environments, in which the DNOs undertake their activities in order to contribute towards achieving a low or zero carbon position in the industry. The Company will, therefore, be looking to develop its programme of research and development in order to provide opportunities to access that fund;
- Initial field trials of newly developed superconducting fault limiters have been successfully undertaken;
- The network deployment of a fault passage indicator system, reducing reaction time to network faults and minimising customer impact;
- Further developing a suite of health indices, for improved asset management, completing EHV cables and commencing work on poles and substations; and
- Continuing to support a project at Durham University to assess electrical network risk with the objective of improving decision making on network reinforcement and operation. A follow up project, investigating demand side management impacts on network risk, has also been developed.

#### **Supplier payment policy**

The Company complies with the Better Payment Practice Code for the prompt payment of suppliers in accordance with the normal terms of trade. It is CE Group policy with respect to its suppliers to settle the terms of payment with those suppliers when agreeing the terms of each transaction, to ensure that those suppliers are aware of the terms of payment and to pay in accordance with the CE Group's contractual and other legal obligations. The number of days purchases in trade creditors for the Company at 31 December 2009 was 9 (2008: 11).

#### **Future Developments**

The financial position of the Company, as at the year end, is shown in the balance sheet on page 27, there have been no significant events since the year end and the directors intend to develop the business in a manner that concentrates on its core skills of electricity distribution by continuing to operate its business with the goal of out-performing the allowances in the distribution price control, while efficiently investing in the electricity distribution system with the aim of improving the quality of supply provided to its customers.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

#### **Directors**

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

G E Abel	resigned 16 October 2009
P E Connor	resigned 16 October 2009
R Dixon	Non-Executive Director
T E Fielden	Finance Director, CE Electric UK (appointed 16 October 2009)
J M France	Regulation Director, CE Electric UK
N M Gill	Field Operations Director, CE Electric UK
P A Jones	President and Chief Operating Officer, CE Electric UK
K Linge	resigned 16 October 2009

Details of the directors' emoluments are included in note 7 to the accounts.

#### **Auditors**

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

#### **Going Concern**

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

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

- a) The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance their activities, which are the subject of obligations under Part 11 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- b) The Company is profitable with strong underlying cash flows and has investment grade credit ratings; and
- c) The Company has considerable financial resources, in the form of short-term borrowings made available by YEG and committed revolving credit facilities from Lloyds TSB Bank plc and Royal Bank of Scotland plc. Those facilities will be renewed before the expiry of the existing facility and will be provided by Lloyds TSB Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc, part of the Banco Santander group, for a three year period.

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

#### **Responsibility of directors for the preparation of the report and accounts**

The directors are responsible for preparing the Annual Report and the financial statements and are required to prepare financial statements for the Company in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union. Company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 2006 and Article 4 of the IAS Regulation.

## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

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

#### **Responsibility of directors for the preparation of the report and accounts (continued)**

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

Directors are also required to:

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report which complies with the requirements of the Companies Act 2006. The directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

#### **Audit of the accounts**

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

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

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

By order of the board



John Elliott  
Company Secretary

19 March 2010



## **NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

### **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NORTHERN ELECTRIC DISTRIBUTION LIMITED**

We have audited the financial statements of Northern Electric Distribution Limited (the "Company") for the year ended 31 December 2009 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Balance Sheet and the Cash Flow Statement and the related notes 1 to 26. 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 an auditors' report 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 auditors**

As explained more fully in the Directors' Responsibilities Statement, 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 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 (APB'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.

#### **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 2009 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 the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

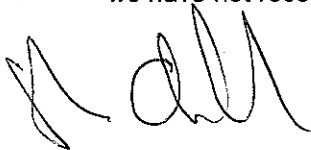
**REGISTERED NUMBER 2906593**

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NORTHERN ELECTRIC DISTRIBUTION LIMITED (CONTINUED)**

**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.



John Charlton  
(Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditors  
Newcastle upon Tyne, England  
23 March 2010

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009**

	Notes	2009 £m	2008 £m
Revenue	3	224.6	214.9
Cost of sales		<u>(6.0)</u>	<u>(5.9)</u>
<b>Gross profit</b>		218.6	209.0
Distribution costs		(71.4)	(66.7)
Administrative expenses		<u>(57.5)</u>	<u>(60.4)</u>
<b>Operating profit</b>	5	89.7	81.9
Finance costs	4	<u>(23.4)</u>	<u>(24.1)</u>
<b>Profit before tax</b>		66.3	57.8
Income tax expense	8	<u>(18.5)</u>	<u>(22.7)</u>
<b>Profit for the financial year</b>		<u>47.8</u>	<u>35.1</u>

All activities relate to continuing operations.

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009**

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2009**

	<b>Share Capital £m</b>	<b>Retained Reserves £m</b>	<b>Total Equity £m</b>
At 1 January 2008	200.0	130.1	330.1
Comprehensive income for the year	-	35.1	35.1
Dividends paid	-	(20.0)	(20.0)
	<hr/>	<hr/>	<hr/>
At 31 December 2008	200.0	145.2	345.2
Comprehensive income for the year	-	47.8	47.8
Dividends paid	-	(20.0)	(20.0)
	<hr/>	<hr/>	<hr/>
At 31 December 2009	<hr/> 200.0	<hr/> 173.0	<hr/> 373.0


**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**BALANCE SHEET AS AT 31 DECEMBER 2009**

	Notes	2009 £m	2008 £m
<b>Non-current assets</b>			
Property, plant and equipment	10	1,399.9	1,319.4
Intangibles	11	4.6	5.8
		<u>1,404.5</u>	<u>1,325.2</u>
<b>Current assets</b>			
Inventories	13	7.2	8.2
Trade and other receivables	14	45.7	34.9
Cash and cash equivalents	14	-	5.2
		<u>52.9</u>	<u>48.3</u>
<b>Total assets</b>		<u>1,457.4</u>	<u>1,373.5</u>
<b>Current liabilities</b>			
Trade and other payables	15	(45.4)	(43.7)
Current income tax liabilities	15	(7.9)	(5.6)
Borrowings	16	(133.5)	(96.8)
Deferred revenue	18	(13.8)	(12.5)
Provisions	19	(1.2)	(1.9)
		<u>(201.8)</u>	<u>(160.5)</u>
<b>Net current liabilities</b>		<u>(148.9)</u>	<u>(112.2)</u>
<b>Non-current liabilities</b>			
Borrowings	16	(347.6)	(347.5)
Deferred income tax liabilities	17	(136.4)	(134.2)
Deferred revenue	18	(397.6)	(385.5)
Provisions	19	(1.0)	(0.6)
		<u>(882.6)</u>	<u>(867.8)</u>
<b>Total liabilities</b>		<u>(1,084.4)</u>	<u>(1,028.3)</u>
<b>Net assets</b>		<u>373.0</u>	<u>345.2</u>
<b>Equity</b>			
Share capital	20	200.0	200.0
Retained earnings		<u>173.0</u>	<u>145.2</u>
<b>Total equity</b>		<u>373.0</u>	<u>345.2</u>

The financial statements were approved by the board of directors and authorised for issue on 19 March 2010 and were signed on its behalf by:



P A Jones  
Director

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009**

	Notes	2009 £m	2008 £m
<b>Net cash from operating activities</b>	21	<u>79.4</u>	<u>73.3</u>
<b>Investing activities</b>			
Purchase of property, plant and equipment		(131.3)	(144.2)
Purchase of intangible assets		(0.4)	(0.7)
Proceeds from disposals of property, plant and equipment		0.2	0.3
Receipt of customer contributions		<u>30.4</u>	<u>46.3</u>
<b>Net cash used in investing activities</b>		<u>(101.1)</u>	<u>(98.3)</u>
<b>Financing activities</b>			
Equity dividends paid		(20.0)	(20.0)
New borrowings		5.4	17.0
Movement in loans from Group undertaking		<u>31.1</u>	<u>33.2</u>
<b>Net cash generated from financing activities</b>		<u>16.5</u>	<u>30.2</u>
<b>Net (decrease)/increase in cash and cash equivalents</b>		(5.2)	5.2
<b>Cash and cash equivalents at beginning of year</b>		<u>5.2</u>	<u>-</u>
<b>Cash and cash equivalents at end of year</b>		<u>-</u>	<u>5.2</u>

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009

### 1 GENERAL INFORMATION

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

The nature of the Company's operations and its principal activities are set out in the Business Review, in the Director's Report and in Note 3.

### 2 ACCOUNTING POLICIES

#### **Accounting convention and basis of preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation and with those parts of the Companies Act 2006 (the "Act") that are applicable to companies reporting under IFRS.

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

#### **Going Concern**

The directors have, at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements. Further detail is contained within the Directors Report on page 21.

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

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

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

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

#### **Critical accounting policies**

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

## NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

### NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

#### 2 ACCOUNTING POLICIES (CONTINUED)

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

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

##### Standards affecting presentation and disclosure

IAS 1	Presentation of Financial Statements – Amendments to IAS 1
IFRS 8	Operating Segments
IFRS 7	Financial Instrument Disclosure – Amendments to IFRS 7

IAS 1 has introduced a number of changes in the format of the financial statements. No third balance sheet has been presented in these financial statements as no changes in accounting policy have been adopted retrospectively.

IFRS 8 is a disclosure Standard that redefines the process for measuring segmental information in the notes to the accounts. In practice however, the adoption of this Standard has not led to any change in the disclosures contained within these financial statements. Further detail can be found in note 3 to the accounts.

The amendments to IFRS 7 expand the disclosures required in respect of fair value measurement and liquidity risk. In practice these amendments have had no material impact on these financial statements.

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

IAS 23	Borrowing Costs – Amendments to IAS 23
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The principal change to IAS 23 was to eliminate the option to expense all borrowing costs when incurred. From 1 January 2009, all borrowing costs relating to qualifying assets have therefore been capitalised. The impact on these financial statements has been less than £0.1m.

##### Standards and Interpretations approved by not yet effective

At the date of authorisation of these financial statements the following Interpretation was in issue but not yet effective and has therefore not yet been applied. The directors consider that the adoption of this Interpretation may be relevant to the Company in future periods.

IFRIC 18	Transfer of Assets from Customers
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The directors anticipate that the Company will adopt this Interpretation on the date on which it is endorsed by the European Union. The directors are currently considering the impact of the adoption of this Interpretation, which is still unclear.

##### **Revenue**

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

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



## NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

### NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

#### 2 ACCOUNTING POLICIES (CONTINUED)

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

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

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

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

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

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

##### **Research costs**

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

##### **Operating profit**

Operating profit is stated before investment income and finance costs.

##### **Taxation**

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

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

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

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

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

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 2 ACCOUNTING POLICIES (CONTINUED)

#### **Property, plant and equipment and depreciation**

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

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

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

Freehold land is not depreciated.

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

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

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

#### **Software development costs**

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

#### **Investments**

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**2 ACCOUNTING POLICIES (CONTINUED)**

**Inventories**

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

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

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

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

**Provisions**

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

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

**Leases**

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

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

**Trade receivables**

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

**Trade payables**

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

**Borrowings**

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

**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**2 ACCOUNTING POLICIES (CONTINUED)**

**Financial instruments**

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

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

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

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

**Financial liabilities and equity**

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

**Pensions**

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

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

**3 REVENUE**

The Company has voluntarily adopted IFRS 8 Operating Segments with effect from 1 January 2009. 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 Operating Officer of the CE Electric UK Funding Company group of companies (the "CE Group") to allocate resources to these segments and to assess their performance.

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 3 REVENUE (CONTINUED)

In practice, the President and Chief Operating Officer allocates resources and assesses performance based upon the aggregate results of the Company and Yorkshire Electricity Distribution plc, another distribution network operator in the CE Group, suggesting that no segmental reporting is required. Therefore, the adoption of IFRS 8 does not impact these financial statements.

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, the recharge of costs incurred on behalf of related parties, amortisation of customer contributions and other services and is included net of value added tax.

### 4 FINANCE COSTS

	2009 £m	2008 £m
Interest payable on loans from Group undertakings	<u>23.4</u>	<u>24.1</u>

### 5 OPERATING PROFIT

	2009 £m	2008 £m
This is stated after charging/(crediting):		
Staff costs (Note 6)	38.2	42.3
Research costs	0.4	0.5
Depreciation of property, plant and equipment	43.9	40.2
Amortisation of deferred revenue	(11.7)	(10.6)
Amortisation of intangibles	1.5	1.7
Impairment loss on trade and other receivables	<u>-</u>	<u>0.3</u>
Analysis of auditors' remuneration is as follows:	£000	£000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	<u>105</u>	<u>110</u>

There were no fees payable in relation to non-audit services in 2009 or 2008.

### 6 STAFF COSTS

	2009 £m	2008 £m
Salaries	36.2	35.3
Social security costs	3.1	3.1
Defined benefit pension costs	28.3	30.8
Defined contribution pension costs	<u>0.1</u>	<u>0.1</u>
	67.7	69.3
Less charged to property, plant and equipment	<u>(29.5)</u>	<u>(27.0)</u>
	<u>38.2</u>	<u>42.3</u>

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 6 STAFF COSTS (CONTINUED)

The majority of the Company's employees are members of the Northern Electric Group of the ESPS, details of which are given in Note 22.

The average monthly number of employees during the year was:

	2009 No.	2008 No.
Technical	242	250
Industrial	463	449
Administration	195	202
Other	60	64
	<u>960</u>	<u>965</u>

### 7 DIRECTORS' & KEY PERSONNEL REMUNERATION

DIRECTORS' REMUNERATION	2009 £	2008 £
<u>Highest Paid</u>		
Short-term employee benefits	130,745	103,612
Post employment benefits	10,569	9,767
Other long-term benefits	<u>59,454</u>	<u>101,708</u>
	<u>200,768</u>	<u>215,087</u>
<u>Total</u>		
Short-term employee benefits	438,683	403,641
Post employment benefits	106,934	117,051
Other long-term benefits	<u>153,903</u>	<u>325,208</u>
	<u>699,520</u>	<u>845,900</u>
Directors who are members of the defined benefit scheme	<u>3</u>	<u>6</u>
Accrued pension benefit relating to highest paid director	<u>-</u>	<u>-</u>
 OTHER KEY PERSONNEL REMUNERATION	 2009 £	 2008 £
<u>Total</u>		
Short-term employee benefits	272,090	282,281
Post employment benefits	73,620	70,179
Other long-term benefits	<u>24,906</u>	<u>88,588</u>
	<u>370,616</u>	<u>441,048</u>

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

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**8 INCOME TAX EXPENSE**

	2009	2008
	£m	£m
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	8.3	5.2
Payments for use of group losses	7.8	9.4
Under provision for prior years	<u>0.2</u>	<u>0.2</u>
Total current tax charge	16.3	14.8
Deferred tax:		
Deferred tax expense relating to the origination and reversal of temporary differences	2.2	1.5
Effect of changes in legislation	<u>-</u>	<u>6.4</u>
Total deferred tax charge	<u>2.2</u>	<u>7.9</u>
Tax on profit before tax	<u>18.5</u>	<u>22.7</u>
The total charge can be reconciled to the accounting profit as follows:		
Profit before tax	<u>66.3</u>	<u>57.8</u>
Tax on profit before tax at standard rate of corporation tax in United Kingdom of 28% (2008: 28.5%)	18.6	16.5
Effect of changes in legislation	-	6.4
Over provision for prior years	<u>(0.1)</u>	<u>(0.2)</u>
Tax on profit before tax	<u>18.5</u>	<u>22.7</u>

The tax rates used are the UK corporate rate of 30% until 31 March 2008 and 28% from 1 April 2008, time apportioned for 2008.

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

**9 DIVIDENDS**

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**10 PROPERTY, PLANT AND EQUIPMENT**

	Distribution system £m	Fixtures and equipment £m	Total £m
<b>COST</b>			
At 1 January 2008	1,363.9	17.9	1,381.8
Additions	146.4	1.3	147.7
Disposals	(4.0)	(0.2)	(4.2)
At 31 December 2008	1,506.3	19.0	1,525.3
Additions	122.5	1.9	124.4
Disposals	(4.8)	(0.1)	(4.9)
At 31 December 2009	<u>1,624.0</u>	<u>20.8</u>	<u>1,644.8</u>
<b>ACCUMULATED DEPRECIATION</b>			
At 1 January 2008	155.5	14.4	169.9
Charge for the year	38.5	1.7	40.2
Disposals	(4.0)	(0.2)	(4.2)
At 31 December 2008	190.0	15.9	205.9
Charge for the year	42.4	1.5	43.9
Disposals	(4.8)	(0.1)	(4.9)
At 31 December 2009	<u>227.6</u>	<u>17.3</u>	<u>244.9</u>
Net book value at 31 December 2009	<u>1,396.4</u>	<u>3.5</u>	<u>1,399.9</u>
Net book value at 31 December 2008	<u>1,316.3</u>	<u>3.1</u>	<u>1,319.4</u>
<b>Assets in the course of construction included above:</b>			
At 1 January 2008	87.3	-	87.3
Additions	146.4	-	146.4
Available for use	(154.5)	-	(154.5)
At 31 December 2008	79.2	-	79.2
Additions	122.5	1.9	124.4
Available for use	(154.7)	(1.9)	(156.6)
At 31 December 2009	<u>47.0</u>	<u>-</u>	<u>47.0</u>

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £13.0m (2008: £6.7m).



# NORTHERN ELECTRIC DISTRIBUTION LIMITED

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## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 11 INTANGIBLES

	Software Development Costs £m
<b>COST</b>	
At 1 January 2008	16.7
Additions	0.8
	<hr/>
At 31 December 2008	17.5
Additions	0.3
	<hr/>
At 31 December 2009	17.8
	<hr/>
<b>AMORTISATION</b>	
At 1 January 2008	10.0
Charge for the year	1.7
	<hr/>
At 31 December 2008	11.7
Charge for the year	1.5
	<hr/>
At 31 December 2009	13.2
	<hr/>
Net book value at 31 December 2009	4.6
	<hr/>
Net book value at 31 December 2008	5.8
	<hr/>

### 12 INVESTMENTS

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

Name of Company	Country of Registration	Holding of Ordinary Shares	Proportion	Nature of Business
Electralink Limited	England and Wales	619 at 10p	6.7%	Data transfer network operator
MRA Service Company Limited	England and Wales	1 at £1	1.0%	Governance of the electricity industry's Master Registration Agreement
DCUSA Limited	England and Wales	1 at £1	2.0%	Management and governance of the Distribution Connection and Use of System Agreement
Northern Electric Finance plc	England and Wales	50,000 at £1	100%	Finance company

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

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

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## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 13 INVENTORIES

	2009 £m	2008 £m
Raw materials and consumables	7.0	8.0
Work in progress	0.2	0.2
	<u>7.2</u>	<u>8.2</u>

### 14 OTHER FINANCIAL ASSETS

#### Trade and other receivables

	2009 £m	2008 £m
Distribution use of system receivables	34.5	26.3
Amounts receivable from sale of goods and services	8.1	4.8
Prepayments and accrued income	3.1	3.8
	<u>45.7</u>	<u>34.9</u>

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

#### Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 32% of distribution revenues in 2009 (2008: 36%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account. Included within other payables are customer deposits of £1.5m as at December 2009 (2008: £1.6m).

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £nil, which have been placed into administration and have therefore been provided in full at the year end (2008: £0.4m)

#### 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 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.

# NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 14 OTHER FINANCIAL ASSETS (CONTINUED)

#### Amounts receivable from sale of goods and services (continued)

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £1.2m (2008: £0.3m) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.5m (2008: £0.1m) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 347 days (2008: 640 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.3m (2008: £1.0m). 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 60 days (2008: 90 days).

#### Ageing of past due but not impaired receivables

	2009 £m	2008 £m
30-60 days	0.2	0.5
60-120 days	0.1	0.2
120-210 days	-	0.3
Total	<u>0.3</u>	<u>1.0</u>

#### Movement in the allowance for doubtful debts

	£m
At 1 January 2009	0.5
Amounts utilised/written off in the year	0.1
Amounts recognised in income statement	<u>(0.1)</u>
At 31 December 2009	<u>0.5</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 £0.2m (2008: £0.4m) which have been placed in administration. The impairment represents the difference between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

#### Cash and cash equivalents

Cash and cash equivalents comprise cash held at bank. The fair value of cash and cash equivalents is equal to their book value.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

**REGISTERED NUMBER 2906593**

**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**14 OTHER FINANCIAL ASSETS (CONTINUED)**

**Categories of financial assets**

	2009 £m	2008 £m
Cash and bank balances	-	5.2
Loans and receivables at amortised cost	42.6	31.1
<b>Total financial assets</b>	<b>42.6</b>	<b>36.3</b>
Non current assets	1,404.5	1,325.2
Inventories	7.2	8.2
Prepayments and accrued income	3.1	3.8
<b>Total non-financial assets</b>	<b>1,414.8</b>	<b>1,337.2</b>
<b>Total Assets</b>	<b>1,457.4</b>	<b>1,373.5</b>

**15 OTHER FINANCIAL LIABILITIES**

**Trade and other payables**

	2009 £m	2008 £m
Payments received on account	20.6	13.6
Trade payables	3.4	3.2
Amounts owed to Group undertakings	0.3	0.4
Other taxes and social security costs	3.7	3.1
Accruals	15.7	21.7
Other payables	1.7	1.7
	<b>45.4</b>	<b>43.7</b>

**Current income tax liabilities**

	2009 £m	2008 £m
Corporation Tax	7.1	5.6
Group relief	0.8	-
	<b>7.9</b>	<b>5.6</b>

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

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**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**15 OTHER FINANCIAL LIABILITIES (CONTINUED)**

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities included in Notes 15 and 16. 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 £m	3 months To 1 year £m	1 to 5 years £m	5+ Years £m	Total £m
2009:					
Non-interest bearing	24.8	-	-	-	24.8
Variable interest rate liability	133.5	-	-	-	133.5
Fixed interest rate liability	-	22.5	89.9	710.6	823.0
	<u>158.3</u>	<u>22.5</u>	<u>89.9</u>	<u>710.6</u>	<u>981.3</u>
2008:					
Non-interest bearing	30.1	-	-	-	30.1
Variable interest rate liability	93.2	-	-	-	93.2
Fixed interest rate liability	-	22.5	89.9	733.1	845.5
	<u>123.3</u>	<u>22.5</u>	<u>89.9</u>	<u>733.1</u>	<u>968.8</u>

**Categories of financial liabilities**

	2009 £m	2008 £m
Loans and payables at amortised cost	<u>486.5</u>	<u>449.6</u>
Total financial liabilities	<u>486.5</u>	<u>449.6</u>
Payments received on account	20.6	13.6
Income tax liabilities	144.3	139.8
Other taxes and social security	3.7	3.1
Accruals	15.7	21.7
Deferred Revenue	411.4	398.0
Provisions	2.2	2.5
	<u>597.9</u>	<u>578.9</u>
Total liabilities	<u>1,084.4</u>	<u>1,028.5</u>

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**16 BORROWINGS**

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

	Book value		Fair value	
	2009	2008	2009	2008
	£m	£m	£m	£m
Loans	33.5	28.1	33.5	28.1
Amounts owed to Group undertakings	447.6	416.2	455.6	409.6
	<u>481.1</u>	<u>444.3</u>	<u>489.1</u>	<u>437.7</u>
The borrowings are repayable as follows:				
On demand or within one year	133.5	96.8	133.5	96.8
After five years	347.6	347.5	355.6	340.9
	<u>481.1</u>	<u>444.3</u>	<u>489.1</u>	<u>437.7</u>
Analysis of borrowings:				
Short term loan	33.5	28.1	33.5	28.1
Inter-company short term loan	96.6	65.2	96.6	65.2
Northern Electric Finance plc 2020 – 8.875%	101.8	101.8	123.6	122.6
Northern Electric Finance plc 2035 - £50m 5.125%	49.2	49.2	44.9	43.5
Yorkshire Electricity Group plc 2037 – 5.9%	100.0	100.0	100.5	94.2
Northern Electric Finance plc 2037 – 5.125%	100.0	100.0	90.0	84.1
	<u>481.1</u>	<u>444.3</u>	<u>489.1</u>	<u>437.7</u>

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

Interest on the inter-company short-term loan is charged at base rate and on short-term loans is charged at a floating rate of interest at LIBOR plus 0.25%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £1.3m per year. This is considered to be an acceptable level of risk. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

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

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 ELECTRIC DISTRIBUTION LIMITED

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## NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

### 16 BORROWINGS (CONTINUED)

The Company's Senior Total Net Debt as at 31 December 2009 totalled £479.9m. Using the RAV value as at March 2010, as outlined by Ofgem in its Final Proposals for Distribution Prices published in December 2009, and up rating for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at December 2009 of £870.3m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 55%.

At 31 December 2009, the Company had available £18.6m (2008: £24.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

### 17 DEFERRED TAX

	Accelerated Tax Depreciation £m	Other £m	Total £m
At 1 January 2008	126.7	(0.4)	126.3
Charge to income statement	7.9	-	7.9
At 31 December 2008	134.6	(0.4)	134.2
Charge to income statement	2.1	0.1	2.2
At 31 December 2009	136.7	(0.3)	136.4

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

### 18 DEFERRED REVENUE

	£m	
At 1 January 2008	360.9	
Additions	47.7	
Amortisation	(10.6)	
At 31 December 2008	398.0	
Additions	25.1	
Amortisation	(11.7)	
At 31 December 2009	411.4	
	2009 £m	2008 £m
Included in current liabilities	13.8	12.5
Included in non-current liabilities	397.6	385.5
	411.4	398.0

Deferred revenue represents contributions from customers made in advance towards distribution system assets. This income is released to the income statement over 45 years on a straight line basis, in line with the useful economic life of the distribution system assets. Management have reviewed their assumptions regarding deferred revenue in the year, meaning that on average, contributions are transferred from payments on account to deferred revenue more quickly. If this change had been in place in the prior year, the impact on the deferred revenue balance would have been £8.0m.

**NORTHERN ELECTRIC DISTRIBUTION LIMITED**

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**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 CONTINUED)**

**19 PROVISIONS**

	Claims £m	Other £m	Total £m
At 1 January 2008	1.4	1.0	2.4
Utilised/paid in the year	(1.0)	(0.1)	(1.1)
Charged to the income statement	0.9	0.3	1.2
At 31 December 2008	1.3	1.2	2.5
Utilised/paid in the year	(0.6)	(0.2)	(0.8)
Charged to income statement	0.5	-	0.5
At 31 December 2009	1.2	1.0	2.2
		2009 £m	2008 £m
Included in current liabilities		1.2	1.9
Included in non-current liabilities		1.0	0.6
		2.2	2.5

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

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and for an amount to cover claims made under section 74 of the New Road and Street Works Act 1991. Costs are expected to be incurred over the next 20 years.

**20 SHARE CAPITAL**

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

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



**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)****21 NET CASH FROM OPERATING ACTIVITIES**

	2009 £m	2008 £m
Operating profit	89.7	81.9
Depreciation and amortisation	45.4	41.9
Amortisation of deferred revenue	(11.7)	(10.6)
Increase in provisions	(0.2)	0.1
	<hr/>	<hr/>
Operating cash flows before movements in working capital	123.2	113.3
Decrease in inventories	1.0	0.1
(Increase)/decrease in receivables	(6.6)	7.0
(Decrease)/increase in payables	(0.8)	(2.1)
	<hr/>	<hr/>
Cash generated by operations	116.8	118.3
Income taxes paid	(14.0)	(8.1)
Group relief paid	-	(9.3)
Dividends received	-	0.1
Interest paid	(23.4)	(27.7)
	<hr/>	<hr/>
Net cash from operating activities	79.4	73.3

**22 PENSION COMMITMENTS**

The Company has two retirement benefit schemes.

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

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

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

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

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

## NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

### NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)

#### 22 PENSION COMMITMENTS (CONTINUED)

The CE Group reached agreement during March 2008 with the Group Trustees to repair this deficit. The agreement comprises monthly cash payments of £2.4m (£28.8m per annum) backdated to commence in April 2007 in addition to the normal employer contributions. Of these annual payments, £21.9m will be paid by the Company. These payments aim to remove the shortfall of £95.1m by December 2010 subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2007 being borne out in practice.

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

The contribution rates to the Northern Electric Group of the ESPS, in addition to the deficit repair contributions mentioned above, for 2009 were 44.7% for certain senior management and 26.3% for other employees. These rates will remain in place until a time as a new schedule of contributions is agreed between the trustees of the Northern Electric Group of the ESPS and the Company as part of the triennial valuation process.

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

The Company pension cost for the year ended 31 December 2009 was £28.4m (2008: £30.9m).

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

Principal assumptions:

	2009	2008
Valuation method	Projected unit	Projected unit
Discount rate	5.70%	6.40%
Inflation rate	3.20%	3.00%
Increase to pensions	3.20 %	3.00%
Increase to deferred benefits	3.20%	3.00%
Salary increases	2.75%*	3.25%

\* 2.75% per annum for ten years then 3.0% thereafter

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

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

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**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**22 PENSION COMMITMENTS (CONTINUED)**

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

	2009 £m	2008 £m
Opening defined benefit obligation	855.3	917.2
Current service cost	7.5	10.3
Interest cost	53.7	53.0
Contributions from employees	3.0	3.1
Actuarial gains/(losses)	145.7	(87.3)
Benefits paid	(43.3)	(41.0)
Closing defined benefit obligation	<u>1,021.9</u>	<u>855.3</u>

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

	2009 £m	2008 £m
Opening fair value of plan assets	801.4	956.6
Expected returns	54.6	66.2
Actuarial gains/(losses)	78.6	(231.4)
Contributions by employer	44.1	47.9
Contribution from employees	3.0	3.1
Benefits paid	(43.3)	(41.0)
Closing fair value of plan assets	<u>938.4</u>	<u>801.4</u>

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

	Long term rates of return expected at		Value	
	2009 %	2008 %	2009 £m	2008 £m
Equities	8.50	8.90	340.5	322.2
Gilts	5.10	5.35	516.0	404.7
Cash	4.50	3.25	0.5	(4.8)
Property	8.50	7.90	81.4	79.3
Total fair value of scheme assets			<u>938.4</u>	<u>801.4</u>

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

The CE Group expects to contribute approximately £44.6m to its defined benefit plan in 2010, including £28.4m of pension deficit repair costs.

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**NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)**

**23 OPERATING LEASE ARRANGEMENTS**

	2009 £m	2008 £m
Minimum lease payments under operating leases recognised in the year	<u>6.6</u>	<u>6.7</u>

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

	2009 £m	2008 £m
Within one year	4.1	4.1
In the second to fifth year inclusive	13.0	13.3
After five years	<u>21.6</u>	<u>18.7</u>
	<u>38.7</u>	<u>36.1</u>

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

**24 RELATED PARTY TRANSACTIONS**

The Company has received loans from other companies in the CE Group. The total interest included in finance costs in the income statement for the year ended 31 December 2009 was £23.4m (2008: £24.1m). Included within borrowings is £447.6m as at 31 December 2009 (2008: £416.2m).

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

**NORTHERN ELECTRIC DISTRIBUTION LIMITED****REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2009 (CONTINUED)****25 RELATED PARTY TRANSACTIONS (CONTINUED)**

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

Related Party	Sales to Related Party  £m	Purchases from Related Party  £m	Amounts Owed to Related Party (Note 15) £m
2009:			
CE Insurance Services Limited	-	0.7	-
Integrated Utility Services Limited(registered in Eire)	-	1.0	0.1
Northern Electric plc	0.2	5.5	-
Northern Electric Properties Limited	-	1.0	-
Yorkshire Electricity Distribution plc	12.7	7.9	-
Vehicle Lease and Service Limited	-	3.2	0.2
2008:			
CE Insurance Services Limited	-	0.7	-
Integrated Utility Services Limited (registered in Eire)	-	1.0	0.2
Northern Electric plc	0.3	4.8	-
Northern Electric Properties Limited	-	1.0	-
Yorkshire Electricity Distribution plc	9.8	6.1	-
Vehicle Lease and Service Limited	-	2.7	0.2

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

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

**26 IMMEDIATE PARENT UNDERTAKING AND CONTROLLING PARTY**

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

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