

NORTHERN ELECTRIC DISTRIBUTION LIMITED

Registered Number: 2906593

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

DIRECTORS' REPORT

The directors present their report and accounts for the year ended 31 December 2006.

BUSINESS REVIEW OF THE YEAR

The Company serves an area of approximately 14,400 sq km in the north east of England with a resident population of 3.2 million, receives electricity from the National Grid transmission system and distributes it to the 1.6 million customers connected to its electricity distribution network of transformers, switchgear and overhead and underground cables, at voltages of up to 132kV. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. During the 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, as a holder of an electricity distribution licence, is subject to regulation by the Gas and Electricity Markets Authority, which acts through the Office of Gas and Electricity Markets ("Ofgem"). Most of the revenue of the electricity distribution licence holders is controlled by a distribution price control formula set out in the 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. 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 most categories of cost incurred by the Company will have a direct impact on the financial results of the Company.

Following the re-organisation of the way in which the electricity distribution business of the CE Electric UK Funding Company group (the "CE Group") operated, the Company entered into an agreement with Integrated Utility Services Limited ("IUS"), a company in the CE Group, under which the Company purchased the assets and liabilities of IUS which provides connections services and work on and services for the improvement and repair of the Company's electricity distribution network (Note 26). That agreement was effective from 1 April 2006.

Customer service and network performance

During the year, the Company continued to make improvements to the services provided to its customers by taking action to:

- Reduce the overall number of faults and their effects;
- Reduce customer interruptions by targeting overloaded LV feeders;
- Improve under-performing parts of the distribution system by identifying "hot spots" and taking specific action to address the issues in those areas;
- Make best use of new equipment, including fault location devices;
- Invest in new information systems;
- Reduce the average length of time taken to restore supplies in fault situations; and
- Target storm resilience investment and review and amend the major incident plan.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Customer service and network performance (continued)

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

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

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. Guaranteed standards, set for activities such as restoring supplies after unplanned interruptions, measure the level of customer service. Performance against these measures forms part of the Company's regular reporting to Ofgem.

The Company is focusing initiatives on reducing the time taken to restore supplies following faults on the network. Those initiatives include "Power in an Hour", which aims to restore the supplies of as many customers as possible within an hour of the start of an interruption and the use of the latest mobile phone technology to locate and contact the nearest persons able to deal with faults. In addition to this, the Company is continuing with its investment to expand the remote control of the distribution network. The results of this work are starting to show through a reduction in overall average restoration time.

In respect of the key customer service performance indicators and following the investigation referred to on page 8 of this report, the Company's CML performance for the regulatory year to 31 March 2006 was stated as 65.2, compared with the Ofgem target of 71.4, whilst CI performance was stated as 66.1, compared with the Ofgem target of 74.5.

The Company has put a great deal of effort into improving both the speed and usefulness of the information provided to customers through its call centre and, during the regulatory year to 31 March 2006, achieved a cumulative customer satisfaction score of 88.6% for the year and was ranked third in the comparison with other DNOs published by Ofgem. Only one DNO exceeded the Ofgem target of 90%. It is the Company's goal to maintain and then improve on this performance in the future.

System investment and improvement

During the year, £118.8m was invested in the electricity distribution system, including the replacement of assets and continuing network improvements intended to increase the quality of the electricity supply provided to its customers.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

System investment and improvement (continued)

As part of the investment strategy to deliver improvements in an efficient and cost-effective manner, the major projects undertaken during the year included:

- 132/11kV transformer and 11kV switchboard replacement work at Norton;
- Commissioning of new 66/11kV primary substations at Seghill and Birtley Grove;
- Installation of an additional 33/11kV transformer and 33kV switchboard at York University;
- Completion of a project to renew all 66kV and 11kV equipment at Benwell substation;
- Completion of a project to renew all 11kV equipment at Grangetown substation;
- Replacement of 80 units of high voltage outdoor switchgear;
- Replacement of 44 high voltage distribution substations;
- Replacement of 70 units of high voltage indoor switchgear;
- Refurbishment or rebuilding of 70km of high voltage overhead line;
- Refurbishment or rebuilding of 64km of low voltage overhead line; and
- The installation of 150 new sites with remote control facilities and commissioning of an additional 298 remote control units.

In order to deliver its investment strategy, the Company used a mix of its own staff and contractors (including affiliated group companies) to undertake its activities.

Financial Review

Results and dividends

The Company made a profit after tax for the year of £47.7m. An interim dividend totaling £25.0m was paid during the year and the directors recommend that no final dividend be paid in respect of the year, leaving a profit of £22.7m to be transferred to reserves.

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 distribution 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.

Taxation

Full details of the Company's taxation charge are provided in Note 8 to the accounts.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Financial Review (continued)

Generation and use of cash resources

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

Liquidity and maintenance of investment grade ratings

The Company has access to short-term borrowing facilities provided by YE and to committed revolving credit facilities provided by Lloyds TSB Bank plc and Royal Bank of Scotland plc. The Company continues to maintain its investment grade issuer credit rating.

Financial derivatives

As at 31 December 2006 and during the year it was the Company's policy not to hold any derivative financial instruments.

Pensions

The Company is a participating company in the Northern Electric Group of the Electricity Supply Pension Scheme ("ESPS"), a defined benefit scheme. The Company also participates in the Northern Electric Money Purchase Scheme, a defined contribution scheme. Full details of the ESPS pension commitments are provided in Note 23 to the accounts.

Insurance

As part of its insurance and risk strategy, the Company 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 Company 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 in the contribution they make to the elimination or reduction of exposure to such risks.

Income Statement commentary

Profit before tax at £68.1m was £1.0m higher than the previous year. Higher income arising from charges for the use of the Company's distribution network reflecting tariff increases in the year and lower finance costs, (£1.7m) due to the impact of changes in the Company's debt structure during 2005, were partially offset by a full year impact of the pension deficit repair charge which commenced in April 2005.

Cash Flow Statement commentary

Net cash inflow from operating activities

The net cash inflow from operating activities, at £75.5m, was £10.9m higher than the previous year. Favourable working capital movements and lower interest paid were partially offset by an increase in income taxes/group relief paid.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Financial Review (continued)

Cash Flow Statement commentary (continued)

Investing activities

Net cash outflow from investing activities, at £94.3m, was £24.8m higher than in the previous year, reflecting increased capital expenditure partially offset by a net cash inflow of £3.5m in settlement of the net liabilities taken on from IUS (Note 26).

Financing activities

Net cash inflow from financing activities, at £18.8m, was £13.9m higher than in the previous year, due to an increase in loans from Group undertakings and lower equity dividends paid partially offset by the repayment of a short term loan of £6.0m.

Treasury policy

The main risks arising from the Company's financial instruments are interest rate risk and liquidity risk.

Interest rate risk

The Company's primary objective in respect of borrowings is to provide a stable, low cost of financing over time whilst observing approved risk parameters.

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 2006, 69% of the Company's borrowings were at fixed rates and the average maturity for these borrowings was 11 years.

Liquidity risk

The Company's primary 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.

Currently, committed revolving credit facilities are provided by Lloyds TSB Bank plc and Royal Bank of Scotland plc. In addition, short-term borrowing facilities are provided by YE. Such borrowings are on normal commercial terms, are on an arm's length basis and are reflective of an entity with an investment grade issuer credit rating.

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.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Supplier payment policy

The Company complies with the Better Payment Practice Code for the prompt payment of suppliers in accordance with the normal terms of trade. It is Company policy with respect to its suppliers to settle the terms of payment with those suppliers when agreeing the terms of each transaction, to ensure that those suppliers are aware of the terms of payment and to pay in accordance with the Company's contractual and other legal obligations. The number of days purchases in trade payables for the Company at 31 December 2006 was 10 (2005: 8).

Principal risks and uncertainties facing the Company

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 a Corporate Governance Group ("CGG"), consisting of certain directors and senior managers of the CE Group. Key indicators track the number of significant risks actively monitored by the CGG at any one time. As at 31 December 2006 a total of 20 significant risks were registered in this regard. The categories were financial (4), regulatory and legal (3), people (1), commercial (3), technical (4), safety and environment (2), political (1) and physical (2). Other principal categories of risk facing the Company are customer service, corporate reputation and economic.

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 main financial risks facing the Company are outlined under Treasury policy, above.

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

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

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

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Internal control

A rigorous internal control environment exists within the CE Group based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. MidAmerican Energy Holdings Company, 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, an extensive programme to review the company-wide controls took place and resulted in the implementation of various recommended process improvements.

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

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

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

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

Other key features of the internal control system are:

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

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Internal control (continued)

- 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.

Ofgem investigation

Despite the emphasis placed on the internal control environment, certain anomalies in the information reported to Ofgem by the Company under the Quality of Service incentive scheme were identified and investigated internally during the year. The results of those investigations were communicated to Ofgem and, on 3 November 2006, Ofgem announced that it was investigating the possible breach by the Company of standard condition 49 of its licence. This condition requires, inter alia, the licensee to provide Ofgem, or its agent, with certain information pertaining to the number and duration of interruptions in the supply of electricity through the licensee's electricity distribution system and information relating to the number and identity of people who had telephoned the licensee to report a loss of supply.

Although the Company did identify and report the issues to Ofgem itself and none of the Company's customers have paid too much for their electricity as a result, a thorough internal compliance assurance programme was undertaken, which employed significant resource and subjected various internal and external reporting mechanisms to detailed scrutiny. That exercise identified a number of process weaknesses, which required improvement, together with areas of those reporting mechanisms where enhanced verification was required. Remediation projects were allocated to those areas of the business, which either have been or are in the process of being completed.

In addition, as the board has recognised that the issues were not identified by the normal process overseen by the CGG, it has expressed the expectation to management that the enhanced verification measures and risk management processes associated with the CGG should identify such issues and the experience be used to inform and improve the mechanisms for identifying significant risk and control issues in the future.

On 6 June 2007, Ofgem announced that it required a total reduction of £2.1m in the future price control revenues of the Company and Yorkshire Electricity Distribution plc ("YEDL"), an associated CE Group company, after Ofgem's investigation found that the Company and YEDL had misreported performance data and had each breached the condition of their electricity distribution licences requiring them to provide information on the quality of aspects of their services. Of the total reduction of £2.1m, £0.9m is attributable to the Company. Ofgem stated that the decision took into account the voluntary disclosure that the Company and YEDL had misreported data and may have breached their licences and the action taken by the companies. No provision for the reduction of £0.9m has been made in the accounts.

People

An organisational restructure undertaken during the year established a clearly defined leadership team, in which clear roles were identified, so allowing more effective management of the CE Group's business and response to any control weaknesses that may become apparent.

The restructure in the CE Group's electricity distribution business saw the establishment of a single unit for all field operations, a new unit bringing together all of the functions, which relate directly to the Company's customers, an asset management group, which includes engineering design and responsibilities for commercial management, and a function dedicated to performance analysis and innovation.

The information technology, human resources and finance functions were centralised in order to provide those services across the CE Group.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

People (continued)

The Company employed or was responsible for meeting the costs of 952 staff at the end of December 2006 at various locations throughout its distribution services area (2005: 782). Further details are provided in Note 6 to the accounts.

Disabled employees

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

Employee consultation

In line with the Information and Consultation Regulations, the Company has introduced a constitutional framework and 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 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 a monthly newsletter and a quarterly employee magazine.

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 and 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 objective that none of its staff should go home injured. The Company maintained its OHSAS 18001 accreditation and again received a gold award from the Royal Society for the Prevention of Accidents for occupational health and safety performance and provision. The gold status is awarded to recognise the achievement of continued or improving standards of health and safety over at least a four-year period.

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

	2006		2005	
	Target	Actual	Target	Actual
Lost time accidents	0	2	0	0
Medical treatment accidents	0	2	2	0
Operational incidents	4	5	3	4
Preventable vehicle accidents	18	12	15	20

The Company continues to focus on improving safety-related performance through training programmes, on-site audits, regular stand-down briefing sessions away from the workplace and regular safety conferences, which are attended by managers, trade union safety representatives, supervisors and engineers and cover issues such as performance, near misses, learning points and the CE Group's safety action plan.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Environmental Management

A comprehensive policy and strategy, with subordinate operational control procedures and systems, are in place, aimed at ensuring compliance with all environmental requirements. The Company promotes environmental awareness, best practice and legal compliance amongst its staff and contractors and requires strict compliance with its environmental policy.

The Company has operated under the environmental management systems ("EMS") standard ISO 14001 since the late 1990s and has been subjected to regular six-monthly surveillance assessments, which are undertaken by an external certification body, in order to retain United Kingdom Accreditation Service certification status. The most recent surveillance assessment was carried out by Lloyd's Register Quality Assurance in September 2006. Two minor nonconformances were raised for action but the visit report concluded that the EMS continues to operate appropriately in relation to ISO 14001:2004.

Management improvement programmes in support of the Company's environmental policy objectives during the year included:

- A programme to enhance secondary containment and emergency response provision for primary transformer sites to prevent oil leakage;
- Replacement of oil-filled circuit breakers with vacuum and SF6 units at outdoor substations;
- Enhanced monitoring and control measures with regard to the management of fluid-filled underground cable networks;
- Installation of additional engineering controls to improve pollution prevention measures in strategic primary substation sites;
- Installation of underground cables using trenchless technology as opposed to open-cut excavations;
- Monitoring of electrical insulating oil for harmful chemicals and the introduction of special controls and disposal where applicable; and
- The evaluation of waste management provision and minimisation options together with systematic verification of the legal duty of care in connection with waste management activities;

Measurements used to monitor environmental performance include the following categories:

- An annual internal environmental management systems audit programme: (26 audits completed);
- Internal environmental management systems non-conformances: (6 reported and addressed);
- Continual improvement programmes: (7 underway and performing to target);
- Environmental incidents: (29 investigated and remedial action taken, including 10 with related Environment Agency contact);
- Cable fluid loss: (30.0 litres per kilometre);
- EHV transformer oil loss: (zero litres lost), other transformer oil loss: (zero litres lost) and SF6 switch-gear loss: (0.3 kg lost); and

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Environmental Management (continued)

- Environmental customer communications: (288, mainly substation related, regarding graffiti, weeds and fly-tipping).

Actual key performance is provided monthly to MidAmerican, as part of a group-wide monitoring process, and are also made available for scrutiny during six-monthly external environmental management system assessments.

Charitable and political donations

During the year, the Company made charitable donations of £10,539, principally to local charities serving the communities in which the Company operates. No donations were made to political organisations.

Corporate social responsibility

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

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 in developing:

- A novel (super-conducting) fault current limiter, to reduce prospective short-circuit currents. The resultant lower stress on switchgear, if the project succeeds, will permit the connection of more rotating plant (including generation) with lower levels of reinforcement and/or replacement;
- In collaboration with other DNOs, a range of incremental improvements to tools and equipment that, if successful, will further add to overall efficiency improvements; and
- In collaboration with universities and other network operators, a programme of longer-range research that will, if successful, lay the foundation for the development of a wide range of improved products and processes to improve customer service, environmental performance and overall efficiency.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

BUSINESS REVIEW OF THE YEAR (CONTINUED)

Future developments

The Company will continue to operate an electricity distribution business, distributing electricity to customers in the north east of England and North Yorkshire and continue to operate that 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 customers.

DIRECTORS AND THEIR INTERESTS

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

G E Abel	
P E Connor	
R Dixon	
G A Flynn	resigned 15 September 2006
J M France	
N M Gill	appointed 17 November 2006
M J Horsley	resigned 31 October 2006
P A Jones	
K Linge	

Throughout the year, none of the directors was materially interested in any contract in relation to the business of the Company.

AUDITORS

An elective resolution is in place dispensing with the need to appoint auditors annually. Deloitte & Touche LLP have indicated their willingness to continue in office.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS

The directors are responsible for preparing the Annual Report and the financial statements. The directors have elected to prepare financial statements for the Company in accordance with International Financial Reporting Standards ("IFRS"). Company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 1985 and Article 4 of the IAS Regulation.

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.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

DIRECTORS' REPORT (CONTINUED)

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS (CONTINUED)

Directors are also required to:

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

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 1985. 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 s234ZA of the Companies Act 1985.

By order of the board



John Elliott
Company Secretary

22 June 2007

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

We have audited the financial statements of Northern Electric Distribution Limited for the year ended 31 December 2006 which comprise the income statement, the statement of recognised income and expenses, the balance sheet, the cash flow statement and the related notes 1 to 27. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements. In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with those International Financial Reporting Standards as adopted by the European Union, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Separate opinion in relation to IFRS

As explained in Note 2 to the financial statements, the Company, in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board. Accordingly, in our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended.

Deloitte & Touche

Deloitte & Touche LLP
Chartered Accountants & Registered Auditors
Newcastle upon Tyne, England

26 June 2007

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006**

	Notes	2006 £m	2005 £m
Revenue	3	198.1	193.6
Cost of sales		<u>(6.1)</u>	<u>(8.1)</u>
Gross profit		192.0	185.5
Distribution costs		(54.2)	(54.4)
Administrative expenses		<u>(49.7)</u>	<u>(42.3)</u>
Operating profit	5	88.1	88.8
Finance costs	4	<u>(20.0)</u>	<u>(21.7)</u>
Profit before tax		68.1	67.1
Income tax expense	8	<u>(20.4)</u>	<u>(20.2)</u>
Profit from ordinary activities after tax	21	<u>47.7</u>	<u>46.9</u>

All activities relate to continuing operations.

STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 2006

There is no other income or expense other than the profits reported above.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

BALANCE SHEET AS AT 31 DECEMBER 2006

	Notes	2006 £m	2005 £m
Non-current assets			
Property, plant and equipment	10	1,121.4	1,032.2
Intangibles	11	6.2	5.1
		<u>1,127.6</u>	<u>1,037.3</u>
Current assets			
Inventories	13	7.0	7.7
Trade and other receivables	14	37.6	38.3
		<u>44.6</u>	<u>46.0</u>
Total assets		<u>1,172.2</u>	<u>1,083.3</u>
Current liabilities			
Trade and other payables	15	(39.2)	(41.5)
Current income tax liabilities	15	(8.2)	(8.6)
Borrowings	16	(208.4)	(64.6)
Deferred revenue	18	(9.4)	(7.0)
Provisions	19	(1.3)	(1.4)
		<u>(266.5)</u>	<u>(123.1)</u>
Net current liabilities		<u>(221.9)</u>	<u>(77.1)</u>
Non-current liabilities			
Borrowings	16	(147.4)	(247.4)
Deferred income tax liabilities	17	(136.2)	(135.6)
Deferred revenue	18	(327.3)	(305.4)
Provisions	19	(0.9)	(0.6)
		<u>(611.8)</u>	<u>(689.0)</u>
Total liabilities		<u>(878.3)</u>	<u>(812.1)</u>
Net assets		<u>293.9</u>	<u>271.2</u>
Equity			
Share capital	20	200.0	200.0
Retained earnings	21	93.9	71.2
Total equity	21	<u>293.9</u>	<u>271.2</u>

The financial statements were approved by the board of directors and authorised for issue on 22 June 2007 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 2006**

	Notes	2006 £m	2005 £m
Net cash from operating activities	22	<u>75.5</u>	<u>64.6</u>
Investing activities			
Purchase of property, plant and equipment		(127.6)	(103.6)
Purchase of intangible assets		(3.5)	(1.0)
Receipt of customer contributions		33.3	35.1
Acquisition of assets and liabilities	26	<u>3.5</u>	<u>-</u>
Net cash used in investing activities		<u>(94.3)</u>	<u>(69.5)</u>
Financing activities			
Equity dividends paid		(25.0)	(30.0)
New borrowings		-	6.0
Repayment of borrowings		(6.0)	-
Movement in loans from Group undertaking		<u>49.8</u>	<u>28.9</u>
Net cash generated from financing activities		<u>18.8</u>	<u>4.9</u>
Net movement in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of year		<u>-</u>	<u>-</u>
Cash and cash equivalents at end of year		<u>-</u>	<u>-</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006

1 GENERAL INFORMATION

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

The nature of the Company's operations and its principal activities are set out in Note 3 and in the business review of the year on page 1.

2 ACCOUNTING POLICIES

Basis of preparation

The financial statements are prepared in accordance with applicable International Financial Reporting Standards ("IFRS"). The financial statements have also been prepared in accordance with IFRS adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation.

Critical accounting policies

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

The particular policies adopted by the directors are described below. The accounting policies have been applied consistently throughout the year and the preceding year.

Accounting convention

The accounts have been prepared under the historical cost convention. The Company has relied upon Section 228 of the Companies Act 1985 and has presented the accounts for the Company as an individual undertaking only and not as a Group undertaking.

Recently issued accounting pronouncements

At the date of authorisation of these financial statements there were a number of IFRSs and Interpretations in issue but not yet effective. The directors consider that the following may be relevant to the Company in future periods.

IAS 23	Borrowing Costs – Amendments to IAS 23
IFRS 7	Financial Instruments: Disclosure
IFRIC 4	Determining whether an arrangement contains a lease

The directors anticipate that the adoption of these pronouncements in future periods will have no material impact on the financial statements of the Company.

The directors anticipate that the Company will adopt these Standards and Interpretation on their effective dates.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Revenue

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

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

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

Any under or over-recovery of allowed distribution network revenues, as prescribed by Ofgem is not provided for in the financial statements.

Customer contributions towards distribution system assets are included in deferred revenue. The Company's policy is to credit the customer contribution to revenue over 50 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 has been established.

Research costs

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

Operating profit

Operating profit is stated before 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 substantially 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.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Taxation (continued)

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 substantially enacted at the balance sheet date.

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

years

Freehold land is not depreciated.

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

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

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

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

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.

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.

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 profit and loss account 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.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Debt

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. Issue costs are amortised over the period of the related loan.

Borrowing costs are allocated to the income statement as incurred.

Cash and cash equivalents

Loans advanced to the parent company are included within cash and cash equivalents, having a maturity of less than three months.

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 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 ("ESPS"). 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 scheme as if it were a defined contribution scheme. Contributions to the scheme are charged to the income statement or capitalised as appropriate. The capital cost of ex-gratia and supplementary pensions are normally charged to the income statement in the period in which they are granted.

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

3 REVENUE

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

Revenue represents charges made to customers for use of the distribution system, 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

	2006 £m	2005 £m
Interest payable on loans from Group undertakings	<u>20.0</u>	<u>21.7</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

5 OPERATING PROFIT

	2006 £m	2005 £m
This is stated after charging/(crediting):		
Staff costs (Note 6)	33.5	24.6
Research costs	0.2	-
Depreciation of property, plant and equipment	31.4	29.0
Amortisation of deferred revenue	(7.2)	(6.5)
Amortisation of intangibles	2.5	2.8
	<hr/>	<hr/>
Analysis of auditors' remuneration is as follows:	2006	2005
Audit fees	£000	£000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	112	97
	<hr/>	<hr/>

There were no fees payable in relation to non-audit services in 2006 or 2005.

Auditors' remuneration related to the Company is borne by another company in the CE Electric UK Funding Company group (the "CE Group") and is then incurred via a corporate recharge.

6 STAFF COSTS

	2006 £m	2005 £m
Salaries	32.4	27.5
Social security costs	3.1	2.3
Pension costs	22.6	17.1
	<hr/>	<hr/>
	58.1	46.9
Less charged as capital expenditure	(24.6)	(22.3)
	<hr/>	<hr/>
	33.5	24.6
	<hr/>	<hr/>

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

The average monthly number of employees during the year was:

	2006 No.	2005 No.
Technical	222	172
Industrial	419	370
Administration	209	195
Other	62	57
	<hr/>	<hr/>
	912	794
	<hr/>	<hr/>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006

6 STAFF COSTS (CONTINUED)

The increase in staff numbers is due to the acquisition of the assets and liabilities of Integrated Utility Services Limited ("IUS") comprising the provision of connections services and work on and services for the improvement and repair of the Company's electricity distribution network and given that the Company is responsible for meeting the staff costs of CE Electric Services Limited, an associated company in the CE Group, which are attributable to the Company.

CE Electric Services Limited acts as an agent of the Company for the delivery of new connections to the Company's electricity distribution network.

7 DIRECTORS' REMUNERATION

	2006 £	2005 £
<u>Highest Paid</u>		
Short-term employee benefits	57,901	179,687
Compensation for loss of office	247,377	-
Post employment benefits	9,380	46,487
Other long-term benefits	(162,201)	148,654
	<u>152,457</u>	<u>374,828</u>
<u>Total</u>		
Short-term employee benefits	406,225	436,051
Compensation for loss of office	247,377	-
Post employment benefits	77,698	105,185
Other long-term benefits	(31,280)	439,294
	<u>700,020</u>	<u>980,530</u>
Directors who are members of the defined benefit scheme	<u>6</u>	<u>7</u>
Accrued pension benefit relating to highest paid director	<u>89,623</u>	<u>75,739</u>

The directors are also the key personnel of the Company.

Other long-term benefits include credits for amounts previously accrued under the Long Term Incentive Plan.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

8 INCOME TAX EXPENSE

	2006		2005	
	£m	£m	£m	£m
(a) Analysis of charge for the year:				
Corporation tax:				
Corporation tax charge for the year	11.2		10.1	
Payments for use of group losses	9.7		8.6	
Over provision for prior years	(1.1)		(3.1)	
Total current tax charge		19.8		15.6
Deferred tax		0.6		4.6
Tax on profit before tax		<u>20.4</u>		<u>20.2</u>
(b) Reconciliation of income tax expense:				
Profit on ordinary activities before tax		<u>68.1</u>		<u>67.1</u>
Tax on profit before tax at standard rate of corporation tax in United Kingdom of 30%		20.4		20.1
Factors affecting tax charge:				
Under provision for prior years		<u>-</u>		<u>0.1</u>
Tax on profit before tax		<u>20.4</u>		<u>20.2</u>

(c) Factors that may affect future tax charge:

The Chancellor of the Exchequer's Budget of March 2007 announced changes to the rate of corporation tax and to capital allowances to take effect between April 2008 and April 2011. The Company will evaluate the effect of these changes as soon as full details are known.

9 DIVIDENDS

	2006	2005	2006	2005
	Pence per share	Pence per share	£m	£m
Dividend paid	<u>12.5</u>	<u>15.0</u>	<u>25.0</u>	<u>30.0</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

10 PROPERTY, PLANT AND EQUIPMENT

	Distribution system £m	Fixtures and equipment £m	Total £m
COST			
At 1 January 2005	1,015.3	14.5	1,029.8
Additions	106.7	1.6	108.3
Disposals	(1.6)	(0.4)	(2.0)
At 31 December 2005	1,120.4	15.7	1,136.1
Additions	118.8	1.1	119.9
Disposals	(1.7)	(0.2)	(1.9)
Transfers from Group undertakings (Note 26)	-	0.7	0.7
At 31 December 2006	<u>1,237.5</u>	<u>17.3</u>	<u>1,254.8</u>
ACCUMULATED DEPRECIATION			
At 1 January 2005	66.4	10.5	76.9
Charge for the year	27.6	1.4	29.0
Disposals	(1.6)	(0.4)	(2.0)
At 31 December 2005	92.4	11.5	103.9
Charge for the year	29.7	1.7	31.4
Disposals	(1.7)	(0.2)	(1.9)
At 31 December 2006	<u>120.4</u>	<u>13.0</u>	<u>133.4</u>
Net book value at 31 December 2006	<u>1,117.1</u>	<u>4.3</u>	<u>1,121.4</u>
Net book value at 31 December 2005	<u>1,028.0</u>	<u>4.2</u>	<u>1,032.2</u>
Assets in the course of construction included above:			
At 1 January 2005	113.9	-	113.9
Additions	106.1	1.6	107.7
Available for use	(155.2)	(1.6)	(156.8)
At 31 December 2005	64.8	-	64.8
Additions	118.8	1.1	119.9
Available for use	(93.7)	(1.1)	(94.8)
At 31 December 2006	<u>89.9</u>	<u>-</u>	<u>89.9</u>

The Company has entered into contractual commitments in relation to property, plant and equipment of £10.6m (2005 - £5.1m).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****11 INTANGIBLES**

	Software Development Costs £m
COST	
At 1 January 2005	11.0
Additions	1.0
Disposals	(0.9)
At 31 December 2005	11.1
Additions	3.5
Disposals	-
Transfers from Group undertakings (Note 26)	0.1
At 31 December 2006	14.7
AMORTISATION	
At 1 January 2005	4.1
Charge for the year	2.8
Disposals	(0.9)
At 31 December 2005	6.0
Charge for the year	2.5
Disposals	-
At 31 December 2006	8.5
Net book value at 31 December 2006	6.2
Net book value at 31 December 2005	5.1

12 INVESTMENTS

Details of the principal investments of the Company at 31 December 2006 are listed below:

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

The above investments are unlisted. The cost and net book value of the investments are Electralink Limited £62 (2005: £62), Gemserv Limited £1 (2005: £1), MRA Service Company Limited £1 (2005: £1), DCUSA Limited £1 (2005: £nil) and Northern Electric Finance plc £50,000 (2005: £12,500).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****13 INVENTORIES**

	2006 £m	2005 £m
Raw materials and consumables	6.9	7.3
Work in progress	0.1	0.4
	<u>7.0</u>	<u>7.7</u>

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

	2006 £m	2005 £m
Amounts receivable from sale of goods and services	34.9	35.1
Amounts owed by Group undertakings	-	0.1
Prepayments and accrued income	2.7	3.1
	<u>37.6</u>	<u>38.3</u>

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

Credit risk

The Company's principal financial assets are trade and other receivables.

The amounts presented in the balance sheet in relation to trade and other receivables are net of allowances for doubtful receivables of £1.0m (2005: £1.2m).

Approximately 42% (2005: 44%) of the Company's revenues are with one counterparty.

15 OTHER FINANCIAL LIABILITIES**Trade and other payables**

	2006 £m	2005 £m
Payments received on account	6.8	5.4
Trade payables	3.8	2.8
Amounts owed to Group undertakings	5.3	16.4
Other taxes and social security costs	2.1	2.6
Accruals	18.2	8.3
Other payables	3.0	6.0
	<u>39.2</u>	<u>41.5</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

15 OTHER FINANCIAL LIABILITIES (CONTINUED)

Current income tax liabilities

	2006 £m	2005 £m
Corporation Tax	4.7	-
Group Relief	3.5	8.6
	<u>8.2</u>	<u>8.6</u>

The directors consider that the carrying amount of other financial liabilities approximates their fair value.

16 BORROWINGS

	Book value		Fair value	
	2006 £m	2005 £m	2006 £m	2005 £m
Loans	-	6.0	-	6.0
Amounts owed to Group undertakings	355.8	306.0	389.9	352.5
	<u>355.8</u>	<u>312.0</u>	<u>389.9</u>	<u>358.5</u>
The borrowings are repayable as follows:				
On demand or within one year	208.4	64.6	207.4	64.6
In the second year	-	100.0	-	101.3
After five years	147.4	147.4	182.5	192.6
	<u>355.8</u>	<u>312.0</u>	<u>389.9</u>	<u>358.5</u>
Analysis of borrowings:				
Short term loan	-	6.0	-	6.0
Inter-company working capital loan	108.4	58.6	108.4	58.6
Yorkshire Electricity Group plc 2007 – 4.75%	100.0	100.0	99.0	101.3
Northern Electric Finance plc 2020 – 8.875%	100.0	100.0	129.8	137.9
Northern Electric Finance plc 2035 - £50m 5.125%	47.4	47.4	52.7	54.7
	<u>355.8</u>	<u>312.0</u>	<u>389.9</u>	<u>358.5</u>

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

Interest on the inter company working capital and short term loans is charged at a floating rate of interest, thus exposing the Company to cash flow interest rate risk. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

The loans are non-secured.

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****16 BORROWINGS (CONTINUED)**

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

The Company's Senior Total Net Debt as at 31 December 2006 totalled £358.4m. Using the RAV value as at March 2007, as outlined by Ofgem in its Final Proposals for Distribution Prices published in November 2004, and up rating for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at December 2006 of £748.0m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 48%.

At 31 December 2006, the Company had available £52.0m (2005: £46.0m) 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 2005	131.4	(0.4)	131.0
Charge/(credit) to income	4.7	(0.1)	4.6
At 31 December 2005	136.1	(0.5)	135.6
Charge/(credit) to income	0.7	(0.1)	0.6
At 31 December 2006	136.8	(0.6)	136.2

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

18 DEFERRED REVENUE

	Customer Contributions £m
At 1 January 2005	285.2
Additions	33.7
Amortisation	(6.5)
	<hr/>
At 31 December 2005	312.4
Additions	31.5
Amortisation	(7.2)
	<hr/>
At 31 December 2006	<u>336.7</u>
	2006 £m
	2005 £m
Included in current liabilities	9.4
Included in non-current liabilities	327.3
	<hr/>
	<u>336.7</u>
	<hr/>
	<u>312.4</u>

19 PROVISIONS

	Claims £m	Other £m	Total £m
At 1 January 2006	1.1	0.9	2.0
Transfers from Group undertakings (Note 26)	0.1	-	0.1
Utilised/paid in the year	(0.5)	(0.3)	(0.8)
Charged to the income statement	0.7	0.2	0.9
	<hr/>	<hr/>	<hr/>
At 31 December 2006	<u>1.4</u>	<u>0.8</u>	<u>2.2</u>
	2006 £m	2005 £m	
Included in current liabilities	1.3	1.4	
Included in non-current liabilities	0.9	0.6	
	<hr/>	<hr/>	
	<u>2.2</u>	<u>2.0</u>	

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

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated biphenyls (PCBs) and for an amount to cover claims made under section 74 of the new Road and Street Works Act 1991.

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

20 SHARE CAPITAL

	2006 No./£	2005 No./£
Ordinary shares of £1 each		
Authorised	300,000,000	300,000,000
Allotted, called up and fully paid	<u>200,000,100</u>	<u>200,000,100</u>

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

21 MOVEMENT ON RESERVES AND RECONCILIATION OF MOVEMENTS IN TOTAL EQUITY

	Share Capital £m	Retained Reserves £m	Total Equity £m
At 1 January 2005	200.0	54.3	254.3
Profit for the year	-	46.9	46.9
Dividends paid	-	(30.0)	(30.0)
At 31 December 2005	200.0	71.2	271.2
Profit for the year	-	47.7	47.7
Dividends paid	-	(25.0)	(25.0)
At 31 December 2006	<u>200.0</u>	<u>93.9</u>	<u>293.9</u>

22 NET CASH FROM OPERATING ACTIVITIES

	2006 £m	2005 £m
Operating profit	88.1	88.8
Depreciation and amortisation	33.9	31.8
Amortisation of deferred revenue	(7.2)	(6.5)
Increase/(decrease) in provisions	0.1	(2.4)
Operating cash flows before movements in working capital	114.9	111.7
Decrease/(increase) in inventories	0.8	(3.0)
Decrease/(increase) in receivables	0.3	(1.8)
Decrease in payables	(0.3)	(5.2)
Cash generated by operations	115.7	101.7
Income taxes paid	(5.4)	(6.9)
Group relief paid	(14.8)	(6.6)
Interest paid	(20.0)	(23.6)
Net cash from operating activities	<u>75.5</u>	<u>64.6</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

23 PENSION COMMITMENTS

The Company has two types of retirement benefit scheme.

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 Scheme are held in a separate trustee-administered fund. The Northern Electric Group of the ESPS (the "Northern Group") was closed to staff commencing employment on or after 23 July 1997. The Northern Electric Money Purchase Scheme, a defined contribution scheme, was made available to new employees from that date.

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 Northern Group's share of the ESPS was carried out by Hewitt, Bacon and Woodrow, consulting actuaries, as at 31 March 2004. The projected unit method was used for the valuation. The principal actuarial assumptions were that the investment return would exceed salary increases by 1.6% per annum (inclusive of merit awards) and exceed future pension increases by 2.0% per annum.

The total market value of the assets of Northern Group at the date of the actuarial valuation was £678.8m.

For the Northern Group the valuation showed that the actuarial value of the assets represented 85.3% of the actuarial value of the accrued benefits. 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, but without allowing for future salary increases. This represented a funding deficiency of £116.6m. Allowing for the effect of future salary increases then the actuarial value of the assets was 78.1% of the accrued benefits, representing a deficiency of £190.3m.

The CE Group reached agreement during 2005 with the Independent Trustee and Group Trustees to repair the scheme deficit. The agreement comprises monthly cash payments of £1.9m (£23.1m per annum) that started in April 2005. Of these annual payments £17.7m will be paid by the Company. These payments address the funding deficiency of £116.6m over six years and the deficit of £190.3m over 12 years subject to movements in actuarial assumptions adopted in the triennial valuation as at 31 March 2004.

The ESPS is a defined benefit plan that share's 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 ESPS contribution rates in addition to the deficit repair contributions mentioned above for 2006 were 60.7% for certain senior management and 20.6% for other employees. The agreed ESPS contribution rates for 2007 are 60.7% for certain senior management and 20.6% for other employees.

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

The Company defined contribution pension cost for the year ended 31 December 2006 was £22.6m (2005: £17.1m).

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****23 PENSION COMMITMENTS (CONTINUED)**

Disclosures in relation to the Northern Group are:

Principal assumptions:

	2006 Projected unit	2005 Projected unit
Valuation method		
Discount rate	5.20%	4.75%
Inflation rate	3.00%	2.50%
Increase to pensions	3.00%	2.50%
Increase to deferred benefits	3.00%	2.50%
Salary increases	3.25%	2.75%

The mortality assumptions are based on a mortality experience investigation carried out at the time of the 2004 actuarial valuation and allow for future improvements in mortality, in addition to those already encompassed within standard mortality tables. The assumption used for these disclosures implies that a member who retires in 2007 at age 60 will live for a further 23 years after retirement, if he is male, and for a further 26 years after retirement, if she is female.

These assumptions are determined in accordance with International Accounting Standard 19, "Employee Benefits", (IAS 19) and do not reflect the assumptions used by the independent actuary in the triennial valuation as at 31 March 2004, which determined the Northern Group's contribution rate for future years.

For closed schemes under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

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

	2006 £m	2005 £m
Opening defined benefit obligation	906.0	819.0
Current service cost	10.0	8.4
Interest cost	42.2	42.0
Contributions from employees	3.4	3.4
Actuarial losses	2.1	70.1
Benefits paid	(37.8)	(36.9)
Closing defined benefit obligation	<u>925.9</u>	<u>906.0</u>

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

	2006 £m	2005 £m
Opening fair value of plan assets	821.6	708.4
Expected returns	57.5	49.4
Actuarial gains	32.4	66.5
Contributions by employer	35.7	30.8
Contribution from employees	3.4	3.4
Benefits paid	(37.8)	(36.9)
Closing fair value of plan assets	<u>912.8</u>	<u>821.6</u>

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****23 PENSION COMMITMENTS (CONTINUED)**

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

	Long term rates of return expected at		Value	
	2006 %	2005 %	2006 £m	2005 £m
Equities	8.7	8.7	473.6	422.7
Gilts	4.5	4.5	334.4	304.7
Cash	4.0	4.5	3.0	5.0
Property	7.7	7.7	101.8	89.2
Total fair value of scheme assets			<u>912.8</u>	<u>821.6</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 Group at 31 December 2006.

The CE Group expects to contribute approximately £35.9m to its defined benefit plan in 2007.

24 OPERATING LEASE ARRANGEMENTS

	2006 £m	2005 £m
Minimum lease payments under operating leases recognised in the year	<u>6.0</u>	<u>5.3</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:

	2006 £m	2005 £m
Within one year	3.8	3.2
In the second to fifth year inclusive	12.5	10.0
After five years	<u>22.6</u>	<u>21.2</u>
	<u>38.9</u>	<u>34.4</u>

Leases consist of rent payable in respect of operational sub station sites and vehicle leases both primarily from related parties.

NORTHERN ELECTRIC DISTRIBUTION LIMITED**REGISTERED NUMBER 2906593****NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)****25 RELATED PARTY TRANSACTIONS**

The Company has received loans from companies in the CE Group. The total interest included in finance costs in the income statement for the year ended 31 December 2006 was £20.0m (2005: £21.7m). Included within borrowings is £355.8m as at 31 December 2006 (2005: £306.0m) and within trade and other payables £4.8m as at 31 December 2006 (2005: £4.8m) in respect of these loans.

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

In addition to the transaction referred to in Note 26, the Company entered into transactions, in the ordinary course of business, with other CE Group companies. Transactions entered into and trading balances outstanding were as follows:

Related Party	Sales to Related Party £m	Purchases from Related Party £m	Amounts Owed by Related Party (Note 14) £m	Amounts Owed to Related Party (Note 15) £m
2006:				
CE Insurance Services Limited	-	0.6	-	-
Integrated Utility Services Limited	0.4	8.6	-	-
Northern Electric plc	0.6	4.2	-	0.1
Northern Electric Properties Limited	0.0	0.8	-	0.1
Yorkshire Electricity Distribution plc	6.2	4.9	-	-
Vehicle Lease and Service Limited	-	3.2	-	0.3
2005:				
CE Insurance Services Limited	-	0.8	-	-
Integrated Utility Services Limited	2.0	32.2	-	11.1
Northern Electric plc	0.2	4.5	-	0.1
Northern Electric Properties Limited	-	0.8	-	0.1
Yorkshire Electricity Distribution plc	4.2	2.6	0.1	-
Vehicle Lease and Service Limited	-	3.0	-	0.3

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

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

NORTHERN ELECTRIC DISTRIBUTION LIMITED

REGISTERED NUMBER 2906593

NOTES TO THE ACCOUNTS - 31 DECEMBER 2006 (CONTINUED)

26 ACQUISITION OF ASSETS AND LIABILITIES

With effect from 1 April 2006, the Company entered into an agreement with IUS, a member of the CE Group, to purchase the assets and liabilities of IUS comprising the provision of connections services and work on and services for the improvement and repair of the Company's electricity distribution network for a cash inflow of £3.5m.

Net liabilities acquired were:

	£m
Property, plant and equipment	0.7
Intangibles	0.1
Inventories	0.1
Trade and other payables	(4.3)
Provisions	(0.1)
	<hr/>
Total cash consideration received	(3.5)

The directors do not believe any fair value adjustments are required on acquisition.

27 ULTIMATE HOLDING COMPANY

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.