REPORT OF THE DIRECTORS AND

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

FOR

NORTHERN ELECTRIC DISTRIBUTION LIMITED

CONTENTS OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

COMPANY INFORMATION
FOR THE YEAR ENDED 31 DECEMBER 2010

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REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

The directors present the annual report and accounts of Northern Electric Distribution Limited (the "Company") for the year ended 31 December 2010, which includes the business review and audited financial statements for that year. Pages 2 to 19 inclusive of this annual report comprise a directors' report that has been drawn up and presented in accordance with the Companies Act 2006.

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.

PRINCIPAL ACTIVITY
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 with a resident population of 3.2 million, which extends from North Northumberland south to York and west to the Pennines. The Company's distribution system receives electricity from the National Grid's transmission system and distributes it, at voltages of up to 132kV, to approximately 1.6 million customers connected to its network of transformers, switchgear and overhead and underground cables. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State.

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

Principle	Strategy	Indicator
Financial strength	Effective stewardship of the Company's financial resources, investing in assets and focusing on long-term opportunities, which contribute to the Company's future strength.	Profitability, cash flow and maintenance of investment grade credit ratings.
Customer service	Delivering reliability, fair prices and exceptional service.	Improving network resilience and performance, measured by:- customer minutes lost, customer interruptions and customer satisfaction.
Operational excellence	Setting high standards for the Company's operations and system investment, operation and maintenance.	Effective asset management, managing commercial risk and improving network resilience and performance.
Employee commitment	Equipping employees with the resources and skills they need to operate successfully and in a safe and rewarding environment.	Leading safety performance, engaging employees and effective leadership.
Environmental respect	Using natural resources wisely and protecting the environment, where it is impacted by the Company's operations.	Reducing environmental impact and promoting and pursuing long-term sustainability.
Regulatory integrity	Adhering to a policy of strict compliance with appropriate standards, policies and legislation.	Strong internal controls, regulatory engagement and industry influence.

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

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

REVIEW OF BUSINESS

The Company made a promising start to the Distribution Price Control Review 5 ("DPCR5") period, which took effect on 1 April 2010 for a five-year period and followed the Company's agreement to the required modifications to its electricity distribution licence. A change to the tariff charging methodology, introduced during the year, has resulted in an increase in revenue compared to the prior year.

Based on the DPCR5 final proposals, together with a rebalancing of distribution charges between customer groups, the Company's charges made in relation to the distribution of electricity to domestic customers increased by 2.8% on 1 April 2010, which was equivalent to about 0.4% on their electricity bills. Changes to the Company's charges made in relation to non-domestic customers varied more widely between the different types of non-domestic customers.

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

During the year, the CE Group was successful in winning funding under the Low Carbon Network Fund arrangements for its customer-led network revolution project, received an award under the electricity distribution customer service reward scheme, implemented the new guaranteed standards of performance in the network connections area of its business and achieved a significant reduction in the number of failures recorded against the various guaranteed standards of performance so that it recorded its best ever performance in that respect. Further details are given in the sustainability section within Core Principles below.

There were some disappointing aspects to the Company's health and safety performance for the year, with the Company missing its internal targets in respect of lost time accidents and operational incidents. However, the number of preventable vehicle accidents experienced was better than target and also reduced in comparison to the year ended 31 December 2009.

DIVIDENDS

During the year, an interim dividend of £20,000,000 (10p per ordinary share) was paid.

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, on which the Company invested £586,000 (Note 5 to the accounts), 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;

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

- Development of a successful competitive bid to the newly established Low Carbon Networks Fund, second tier. This project, which is being delivered in collaboration with several key UK technology providers, will trial novel technologies and approaches to the installation and use of low carbon technologies likely to be seen on the network in the near future and to explore the impact of such technologies on network planning, design and operation;

- Building on the successful, and still ongoing, field trials of newly developed superconducting fault limiters. A new project funded though the Low Carbon Networks Fund first tier has been instigated to implement this new technology at higher voltages and thus provide further technology options as alternatives to traditional engineering solutions for network constraints;

- Continuing to develop a suite of asset indices for improved asset management alongside a new integrated database and expert system to allow better decision making and improved exploitation of information gathered in previous projects;

- Having completed a project at Durham University to assess electrical network risk with the objective of improving decision making for network reinforcement and operation the Company has successfully obtained further funding through the Knowledge Transfer Partnership programme to embed the learning developed within the organisation to ensure maximum business impact for the investment already made; and

- A new project, investigating demand side management impacts on network risk, which will also support the low carbon network activities is now underway.

FUTURE DEVELOPMENTS

The financial position of the Company, as at 31 December 2010, is shown in the statement of financial position on page 23.

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

DIRECTORS

The directors shown below have held office during the whole of the period from 1 January 2010 to the date of this report.

R Dixon
T E Fielden
J M France
N M Gill
P A Jones

COMPANY'S POLICY ON PAYMENT OF CREDITORS

The Company complies with the Better Payment Practice Code for the prompt payment of suppliers in accordance with the normal terms of trade. It is Company policy with respect to its suppliers to settle the terms of payment with those suppliers when agreeing the terms of each transaction, to ensure that those suppliers are aware of the terms of payment and to pay in accordance with the Company's contractual and other legal obligations. The number of days purchases in trade creditors for the Company at 31 December 2010 was 24 (2009: 9).

POLITICAL AND CHARITABLE CONTRIBUTIONS

During the year, charitable donations of £25,452 were made (2009: £29,313), principally to local charities serving the communities in which the Company operates. No contributions were made to political organisations (2009: nil).

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

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

- continues to generate value over the long-term;

- invests in and manages its electricity distribution network in an efficient and effective manner;

- provides its customers with an excellent standard of service;

- engages with its employees so that they feel rewarded and recognised as part of a team that sets and achieves increasingly high standards of performance; and

- is viewed as being a leader in terms of shaping the future direction of the electricity distribution network sector in the United Kingdom.

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

CORE PRINCIPLES
Financial strength

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

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

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

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

Revenue
The Company's revenue at £257,595,000 was £33,042,000 higher than the prior year mainly due to an increase in units distributed and also a change in the tariff charging methodology which was introduced during the year.

Operating profit
The Company's operating profit at £ 121,912,000 was £32,380,000 higher than the previous year reflecting the increase in revenues in the year.

Finance costs and investments
Finance costs net of investment income at £24,730,000 were £1,365,000 higher than the prior year reflecting higher rates of interest being charged on short term borrowings from Group undertakings.

Taxation
The effective tax rate in the current year is 23%. Details are provided in Note 6 to the accounts.

Results and dividends
The Company made a profit after tax for the year of £75,183,000. An interim dividend of £20,000,000 was paid during the year and the directors recommend that no final dividend be paid in respect of the year.

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

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

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

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

Movements in cash flows were as follows:

Operating activities: Cash flow from operating activities at £105,653,000 was £26,565,000 higher than the previous year reflecting higher profitability in the year.

Investing activities: Net cash used in investing activities at £82,240,000 was £18,785,000 lower than the previous year, reflecting lower net capital expenditure compared to the prior year.

Financing activities: The net cash used in financing activities at £23,413,000 represents a £40,121,000 adverse variance compared to the previous year, mainly due to the repayment of short term loans which were outstanding at 31 December 2009.

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

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

In addition, the Company has access to further short-term borrowing facilities provided by YEG, and a £2m overdraft facility provided by Lloyds TSB Bank plc, which is renewable annually.

The directors do not consider there to be any doubt over the Company's ability to raise appropriate levels of finance in the future, given its investment grade issuer credit rating and the fundamental financial strength and nature of its business.

Interest rate risk
The Company is financed by long-term borrowings at fixed rates and has access to short-term borrowing facilities at floating rates of interest. As at 31 December 2010, 73% of the Company's borrowings were at fixed rates and the average maturity for these borrowings was 22 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 2010 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 immediate parent company and the Principal Employer of the Scheme, was engaged with the Group Trustees in the triennial actuarial valuation process, as at 31 March 2010, in order to determine the funding position of the Scheme and the associated deficit repair arrangements. Those discussions are continuing as at the date of these accounts.

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

As the actual repair period for each scheme is a matter for the trustees of that scheme to agree with its sponsoring employer, which, in the Company's case, is Northern Electric plc, 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.

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

Customer service

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

Those improvements included:

- building on the introduction of the interactive voice response system in the call centre. The system takes advantage of the latest developments in automatic messaging and enables the provision of an improved service, including text and voice-message updates, to customers during loss of supply incidents;

- improving the accuracy of the times estimated for the restoration of supply during network faults that are communicated to customers;

- continuing to improve under-performing parts of the distribution network by identifying "hot spots" and taking specific action to address the issues in those areas;

- maintaining the priority services register so that the Company is aware of people with disabilities or special needs, who may be affected by interruptions to the electricity supply, and can take appropriate action to assist those people in such circumstances;

- undertaking a programme to reduce the number of instances in which the Company fails to meet an electricity guaranteed standard of performance; and

- improving customer service by resolving in excess of 95% of enquiries at the initial point of contact.

The Company achieved a customer satisfaction score of 91.2% (2009: 89.2%) for the regulatory year ended 31 March 2010 and intends to build on the telephony system mentioned above in order to more effectively integrate its other customer facing processes to improve the service provided. Continued development of the Company's customer service improvement plan will include increasing focus on excellence in customer service in order to achieve a customer satisfaction score of greater than 90%.

The Company formally implemented the new electricity connections guaranteed standards of performance in October 2010 following a successful audit, which confirmed compliance with Ofgem's requirements. Performance was positive throughout the opening quarter following the implementation of those new guaranteed standards, with the Company achieving a success rate of 99.88%.

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

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

- The number of interruptions to supply;

- The duration of interruptions to supply; and

- Customer satisfaction.

Customer minutes lost ("CML") and customer interruptions ("CI") are the key performance indicators used by the Company to measure the quality of supply and system performance. CML measure the average number of supply minutes lost for every connected customer due to faults and planned outages that last for three minutes or longer. CI measure the average number of supply interruptions for every 100 connected customers due to faults and planned outages that last for three minutes or longer.

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

In respect of the key customer service performance indicators, the Company's reported performance for the regulatory year to 31 March 2010, against the targets determined by Ofgem, was as follows:

	Actual	Target
CML:	68.8 (2009: 76.3)	67.4 (2009: 68.4)
CI:	62.3 (2009: 64.2)	74.5 (2009: 74.5)
Customer Satisfaction	91.2% (2009: 89.2%)	90% (2009: 90%)

Performance in the regulatory year to 31 March 2010 showed an improvement in each category and was better than Ofgem's target for both customer satisfaction and CI, although CML slightly missed target. The Company continues to anticipate that the customer service improvement actions mentioned above and the various improvement actions in respect of the network's resilience will continue to support improvements in performance.

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 four ("DPCR4") settlement. The customer service targets were not adjusted to take account of the effects of the representations made by the Company and accepted by Ofgem. Instead, the benefits arising from that decision were reflected in a favourable adjustment to the Company's base allowed revenue. That position continued until 31 March 2010 and the implementation of DPCR5 with effect from 1 April 2010.

Operational excellence

The Company's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the year, £125,670,000 was invested in the improvement of the distribution network, including the replacement of assets and continuing network improvements intended to increase the quality of the electricity supply provided to customers.

Operational activity

The Company's investment strategy is designed to deliver improvements in an efficient and cost-effective manner in order to improve the network's resilience by minimising the number of faults that occur, reducing the average number of customers affected by a fault and providing a quicker restoration service in the event of a fault.

The Company's Field Operations structure is designed to provide the best possible foundation for optimum operational performance and is based on six individual business units for the operation of the network, 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; and

- Operational Services includes contract management, business controls and administration, supply chain management, training and health and safety services.

This operating structure enabled the focus in the year to continue to be on delivering the core operational programmes and assisted the Company in identifying the priorities it needs to deliver in order to enhance its performance. Those priorities were identified as including a reduction in the average level of fault repair work in progress, the introduction of improvements in field response and supply restoration times and in the management of intermittent faults, the implementation of enhanced controls for outage risk management and a more robust approach to the control of operations on the low voltage network.

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

- Continuation of the 132kV switchgear replacement project at Tynemouth in North Tyneside and of a new 33/11kV substation to provide improved voltage regulation in the Wensleydale area of North Yorkshire and completion of a new 20kV capacitor switch station in the North Northumberland area;

- Refurbishment of 3km of 66kV overhead line and the refurbishment or rebuilding of 47km of high voltage overhead line and 17km of low voltage overhead line;

- Replacement of 56 units of high voltage outdoor switchgear, 34 high voltage distribution substations and 93 units of high voltage indoor switchgear;

- The upgrade and reinforcement of 15 sites to address the quality of supply performance issues relating to those circuits; and

- The installation and commissioning of 290 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, an affiliated company registered in the Republic of Ireland, to undertake its activities.

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

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

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.

In 2010, the Company received its fifth successive Gold Medal 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 in 2010 and is eligible in 2011 for the Royal Society for the Prevention of Accidents' President's Award, for ten or more successive Gold Awards.

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

	2010		2009	
	Target	**Actual**	Target	Actual
Lost time accidents	**0**	**4**	0	1
Restricted duty accidents	**1**	**1**	1	1
Medical treatment accidents	**3**	**2**	3	2
Operational incidents	**3**	**6**	3	4
Preventable vehicle accidents	**10**	**5**	10	13

Although safety performance relative to the internal targets was disappointing in certain areas during 2010, performance levels continue to benchmark very well against others in the sector. The Company continues to implement a safety improvement plan that targets delivery of continuous improvement. As part of that plan, the Company introduced a number of safety initiatives in order to prevent slips, trips and falls, which proved successful during the severe wintry weather conditions experienced both at the beginning and end of the year. These initiatives included the use of "Spikey Plus" ice cleats for use over other safety footwear and the increased availability of grit salt for use on site works.

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

Management structure

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

Employees
The challenging external economic environment continued throughout 2010 and the Company continued to implement its programme of cost mitigation, which included the control of headcount and salary cost allocation.

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

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

The Company employed 968 staff at the end of December 2010. (2009: 953).

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

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

The CE Group is committed to maintaining and improving effective communication with employees, principally through regular staff briefs on current issues, meetings with staff and their representatives and the issue of an employee publication. During the year, the President and Chief Operating Officer of the CE Group delivered regular broadcast briefings using telephone conference call facilities in order to provide employees with updates such as on the performance of the CE Group, financial, organisational and safety issues and customer service performance.

Environmental respect

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

The Company has operated a United Kingdom Accreditation Service scheme since the late 1990s, certified to the environmental management systems standard ISO 14001 and is subject to regular six-monthly assessments by an accredited external certification body in order to retain that status. The most recent assessments were carried out by Lloyd's Register Quality Assurance in April and September 2010. There were no major non-conformances noted and the assessment reports concluded that the main management system elements were seen to be effective and well maintained and continual improvement was demonstrated.

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

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

- Replacing selected fluid-filled cable sections with non-fluid polymeric equivalents;

- Replacing oil-filled circuit breakers with vacuum and sulphur hexafluoride gas filled units at outdoor substations to reduce the potential for oil leakage;

- Installing underground cables using trenchless technology as opposed to open-cut excavations;

- A depot energy efficiency improvement programme; and

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

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

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

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

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

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

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

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

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

Regulatory integrity

The Company manages its business to the highest behavioural standards and adheres to a policy of strict compliance with all relevant standards, legislation and regulatory conditions. The Governance and Risk Management Group ("GRMG") monitored and managed 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 1,781 regulatory obligations contained within the compliance database is currently assigned to 55 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 Regulation Manager reports to the board of directors on the outcome of each quarter's exercise.

During the year, a revenue-related issue arose in that the adjustment of settlements data by certain suppliers had the effect of distorting the apparent performance of the Company under the losses incentive scheme for the regulatory year ended 31 March 2010. The Company devoted a significant effort to investigating the complexities of the settlement system data flows and presented its findings to Ofgem, which agreed to the restatement of losses information for the regulatory year ended 31 March 2010 on a revised basis proposed by the Company. Ofgem's agreement to this restatement covered only the data flows relating to the regulatory year ended 31 March 2010 and resulted in an under-recovery being generated in respect of the Company's maximum permitted revenue for that year of £2,171,000, to be recognised as revenue over the 2011/12 regulatory period, as opposed to the previously anticipated over-recovery.

Although this restatement is a favourable outcome and a significant step towards resolving the overall commercial impact of supplier activity on allowed revenues associated with the losses incentive, the issue remains subject to the closing out the DPCR4 losses rolling retention mechanism. In addition, the impact of the DPCR4 period performance on the DPCR5 final losses targets remains uncertain and is still to be resolved. Discussions with Ofgem in respect of those issues are continuing as at the date of approval of this annual report and accounts and the Directors anticipate that those discussions will be concluded by the end of 2011.

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

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

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

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

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

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

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

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

Financial risk
As a holder of an electricity distribution licence, the Company is subject to regulation by the Gas and Electricity Markets Authority ("GEMA"), which acts through Ofgem.

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

It has been the practice of Ofgem to review and reset the formula at five-year intervals, although the formula has been, and may be, reviewed at other times at the discretion of Ofgem. The current five-year price control period became effective on 1 April 2010 and has set the Company's revenues through to 31 March 2015. 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 Company's financial results.

The Company operates under a price control that determines the maximum permitted revenue for each regulatory year. Where the Company recovers more, or less, than this maximum the difference is carried forward, with interest, into the entitlement for the following year. In respect of the regulatory year to 31 March 2010, the Company was forecast to exceed the maximum permitted under the price control mainly as a result of late changes in the volumes of sales reported by the electricity suppliers that had an impact on the Company's entitlement under the electrical losses incentive of its price control formula. The Company entered into a dialogue with Ofgem in respect of this issue and proposed certain adjustments to the relevant data for the regulatory year to 31 March 2010, which Ofgem confirmed were necessary to restore the Company's allowed revenue position to an appropriate level. This issue is discussed further on page 14.

The other financial risks facing the Company are outlined in the Treasury section on page 6 of this report.

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

- Counter-party security, with credit cover arrangements being in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism;

- Severe weather incidents, which impact on the distribution network's performance and are addressed through a robust major incident management plan;

- The demand for copper, a key component in the construction of distribution network assets, which has resulted in inflated prices and an increased risk of unauthorised access to the Company's sites for the purpose of theft;

- Public safety and network security issues, particularly relating to the theft of copper; and

- The potential for the failure of major circuits, which would put a significant number of customers at risk of losing supply.

Risk Management

The CE Group operates a structured and disciplined approach to the management of risk, as part of the overall risk management approach. Risks are assessed with due regard to probability and impact and the risk environment is reviewed continually in order that new or emerging potential risks are identified. Those risks assessed to be significantly high are logged within a risk register that the GRMG reviews regularly and key indicators track the number of significant risks, which are actively monitored by the GRMG at any one time.

Risk mitigation and loss control plans are prepared in response to strategic risks in order that the directors can be assured that appropriate mitigating actions are in place and are being implemented. These plans are monitored through to implementation and reviewed to determine whether the level of residual, mitigated risk is within an acceptable level of tolerance.

The CE Group identifies and assesses risks associated with the achievement of its strategic objectives, including those of an environmental and social nature. Any key actions needed to further enhance the control environment are identified, along with the person responsible for the management of the specific risk. A regular review of the key risks, controls and action plans is undertaken.

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

The risk management programme includes regular review of crisis management and disaster recovery plans which are periodically tested. In 2010 activities included a review of the CE Group's major incident plan for operational systems, participation in exercises with local authorities to review the planned response to major events and a disaster recovery test simulating the loss of a non-operational office and support systems.

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

- Processes and procedures to operate under the Occupational Health and Safety Assessment Series ("OHSAS") standard OHSAS 18001, which is subject to external certification and regular assessment;

- An external obligations programme, which provides a robust approach to, compliance with financial, legal and regulatory obligations;

- Centralised treasury operations that operate within defined limits and are subject to regular reporting requirements and audit reviews; and

- Established procedures for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by in the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the Company and of the profit or loss of the Company for that period. In preparing these financial statements, International Accounting Standard 1 requires the directors to:

- Properly select and apply accounting policies;
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- Make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2010

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

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

- The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;

- The Company is profitable with strong underlying cash flows and holds investment grade credit ratings; and

- The Company is financed by long-term borrowings with an average maturity of 22 years and has access to borrowing facilities provided by Lloyds TSB Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc. On 2 July 2010 the Company entered into an agreement with EIB under which EIB provides the Company with a £119m loan facility. As at 28 February 2011, that facility was fully drawn.

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.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS
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.

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.

ON BEHALF OF THE BOARD:

J Elliott
Secretary

18 March 2011

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF NORTHERN ELECTRIC DISTRIBUTION LIMITED

We have audited the financial statements of Northern Electric Distribution Limited for the year ended 31 December 2010 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's 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 auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 18, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

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 2010 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 Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

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.

Christopher Powell FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountant and Statutory Auditor
Newcastle upon Tyne

29 March 2011

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010 £'000	2009 £'000
CONTINUING OPERATIONS			
Revenue	3	**257,595**	224,553
Cost of sales		**(7,009)**	(6,002)
GROSS PROFIT		**250,586**	218,551
Operating expenses	8	**(128,674)**	(129,019)
OPERATING PROFIT		**121,912**	89,532
Other gains		**243**	199
Finance costs		**(24,730)**	(23,365)
PROFIT BEFORE INCOME TAX	5	**97,425**	66,366
Income tax	6	**(22,242)**	(18,560)
PROFIT FOR THE YEAR		**75,183**	47,806

The notes form part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2010

	2010 £'000	2009 £'000
PROFIT FOR THE YEAR	75,183	47,806
OTHER COMPREHENSIVE INCOME	-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	75,183	47,806

The notes form part of these financial statements

NORTHERN ELECTRIC DISTRIBUTION LIMITED (REGISTERED NUMBER: 2906593)

STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2010

	Notes	2010 £'000	2009 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	11	**4,011**	4,639
Property, plant and equipment	12	**1,479,740**	1,399,919
Investments	13	**50**	50
		1,483,801	1,404,608
CURRENT ASSETS			
Inventories	14	**7,777**	7,175
Trade and other receivables	15	**48,741**	45,710
		56,518	52,885
TOTAL ASSETS		**1,540,319**	1,457,493
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	16	**200,000**	200,000
Retained earnings	17	**228,162**	172,979
TOTAL EQUITY		**428,162**	372,979
LIABILITIES			
NON-CURRENT LIABILITIES			
Trade and other payables	18	**417,504**	397,552
Borrowings	19	**347,443**	347,559
Deferred tax	21	**133,133**	136,401
Provisions	20	**1,034**	1,045
		899,114	882,557
CURRENT LIABILITIES			
Trade and other payables	18	**67,556**	59,214
Borrowings	19	**130,624**	133,644
Tax payable		**13,165**	7,900
Provisions	20	**1,698**	1,199
		213,043	201,957
TOTAL LIABILITIES		**1,112,157**	1,084,514
TOTAL EQUITY AND LIABILITIES		**1,540,319**	1,457,493

The financial statements were approved by the Board of Directors on 18 March 2011 and were signed on its behalf by:

P A Jones
Director

The notes form part of these financial statements

NORTHERN ELECTRIC DISTRIBUTION LIMITED (REGISTERED NUMBER: 2906593)

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	Called up share capital £'000	Retained earnings £'000	Total equity £'000
Balance at 1 January 2009		200,000	145,173	345,173
Changes in equity				
Dividends	7	-	(20,000)	(20,000)
Total comprehensive income		-	47,806	47,806
Balance at 31 December 2009		200,000	172,979	372,979
Changes in equity				
Dividends	7	-	(20,000)	(20,000)
Total comprehensive income		-	75,183	75,183
Balance at 31 December 2010		200,000	228,162	428,162

The notes form part of these financial statements

NORTHERN ELECTRIC DISTRIBUTION LIMITED (REGISTERED NUMBER: 2906593)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010 £'000	2009 £'000
Cash flows from operating activities			
Cash generated from operations	25	**150,314**	116,488
Finance costs paid		**(24,417)**	(23,335)
Group relief paid		**(12,682)**	(7,010)
Tax paid		**(7,562)**	(7,055)
Net cash from operating activities		**105,653**	79,088
Cash flows from investing activities			
Purchase of intangible fixed assets		**(943)**	(319)
Purchase of tangible fixed assets		**(119,445)**	(131,302)
Sale of tangible fixed assets		**243**	199
Receipt of customer contributions		**37,905**	30,397
Net cash used in investing activities		**(82,240)**	(101,025)
Cash flows from financing activities			
Movement in borrowings in the year		**(33,734)**	9,086
Loans from Group undertakings		**30,321**	27,622
Equity dividends paid		**(20,000)**	(20,000)
Net cash (used in)/from financing activities		**(23,413)**	16,708
Decrease in cash and cash equivalents		-	(5,229)
Cash and cash equivalents at beginning of year		-	5,229
Cash and cash equivalents at end of year		-	-

The notes form part of these financial statements

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 Report of the Directors 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.

Judgments in applying accounting policies and key sources of estimation uncertainty
Many of the amounts included in the financial statements involve the use of judgement and/or estimation. These judgements 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 judgements 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 judgement 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.

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

Standards affecting presentation and disclosure;

IFRS 8 Operating Segments - Amendments to IFRS 8

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

Standards affecting the reported results and the financial position;

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

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

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

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

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

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

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

Customer contributions towards distribution system assets are included in deferred revenue. The Company's policy is to credit the customer contribution to revenue over 15 - 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.

Operating profit
Operating profit is stated before investment income and finance costs.

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.

2. **ACCOUNTING POLICIES - continued**

Property, plant and equipment and depreciation

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

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

Distribution system assets	45 years
Distributed generation	15 years
Metering equipment included in distribution system assets	up to 6 years
Information technology equipment included in distribution system assets	up to 10 years
Non-operational assets:	
Buildings - freehold	up to 60 years
Buildings - leasehold	lower of lease period or 60 years
Fixtures and equipment	up to 10 years

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 judgement 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 judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make judgement concerning the cash flows, growth rates and discount rates for the cash-generating units under review.

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.

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.

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.

2. ACCOUNTING POLICIES - continued

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

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.

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.

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 judgement 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.

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 and are held 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.

3. SEGMENTAL REPORTING

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief 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.

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.

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. EMPLOYEES AND DIRECTORS

	2010	2009
	£'000	£'000
Salaries	**37,439**	36,234
Social security costs	**3,270**	3,124
Defined benefit pension costs	**28,385**	28,086
Defined contribution pension costs	**204**	281
	69,298	67,725
Less charged to property, plant and equipment	**(31,669)**	(29,491)
	37,629	38,234

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

The average monthly number of employees during the year was:

	2010	2009
	No.	No.
Technical	**235**	242
Industrial	**468**	463
Administration	**201**	195
Other	**64**	60
	968	960

4. EMPLOYEES AND DIRECTORS - continued

DIRECTORS' REMUNERATION

	2010 £'000	2009 £'000
Highest Paid:		
Short-term employee benefits	**125**	131
Post employment benefits	**9**	11
Other long-term benefits	**146**	59
	280	201
Total:		
Short-term employee benefits	**347**	439
Post employment benefits	**73**	107
Other long-term benefits	**275**	154
	695	700
Directors who are members of the defined benefit scheme	**3**	3
Accrued pension benefit relating to highest paid director	**-**	-

OTHER KEY PERSONNEL REMUNERATION

	2010 £'000	2009 £'000
Total:		
Short-term employee benefits	**299**	272
Post employment benefits	**69**	74
Other long-term benefits	**102**	25
	471	371

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.

5. PROFIT BEFORE INCOME TAX

The profit before income tax is stated after charging/(crediting):

	2010 £'000	2009 £'000
Depreciation - owned assets	**46,884**	43,902
Profit on disposal of fixed assets	**(243)**	(199)
Software development costs amortisation	**1,571**	1,498
Research costs	**586**	431
Amortisation of deferred revenue	**(12,416)**	(11,712)
Impairment of trade and other receivables	**49**	12

5. PROFIT BEFORE INCOME TAX - continued

Analysis of auditors' remuneration is as follows:

	2010 £'000	2009 £'000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	**109**	105
Other assurance services	**5**	-
Total fees payable to the Company's auditors	**114**	105

6. INCOME TAX

Analysis of the tax charge

	2010 £'000	2009 £'000
Current tax:		
Tax	**25,510**	16,419
Deferred tax	**(3,268)**	2,141
Total tax charge in income statement	**22,242**	18,560

Factors affecting the tax charge

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

	2010 £'000	2009 £'000
Profit on ordinary activities before tax	**97,425**	66,366
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2009 - 28%)	**27,279**	18,582
Effects of:		
Changes in tax rates	**(4,931)**	-
Over provision for prior years	**(102)**	(22)
Non taxable income net of permanent disallowances	**(2)**	-
Receipt under service level agreement	**(2)**	-
Total income tax	**22,242**	18,560

6. INCOME TAX - continued

	2010	2009
	£'000	£'000
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	7,927	7,437
Payment for use of group losses	17,600	8,809
Under provision for prior years	(17)	173
Total current tax charge	25,510	16,419
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	1,663	2,141
Effect of changes in tax rates	(4,931)	-
Total deferred tax (credit)/charge	(3,268)	2,141
Tax on profit before tax	22,242	18,560

The Finance Act 2010 includes a provision that the standard rate of corporation tax in the United Kingdom will reduce from 28% to 27% from April 2011. Accordingly, this rate has been applied when calculating deferred tax assets and liabilities throughout the CE Group as at 31 December 2010.

7. DIVIDENDS

	2010	2009
	£'000	£'000
Interim dividend at 10.0p per share	20,000	20,000

8. OPERATING EXPENSES

Operating expenses comprise:

	2010	2009
	£'000	£'000
Distribution costs	74,088	71,053
Administrative expenses	54,586	57,966
	128,674	129,019

9. OPERATING LEASE COMMITMENTS

	2010	2009
	£'000	£'000
Minimum lease payments under operating leases recognised in the year	**5,444**	6,605

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:

	2010	2009
	£'000	£'000
Within one year	**4,468**	4,130
In the second to fifth year	**13,488**	12,994
After five years	**19,757**	21,601
	37,713	38,725

10. FINANCE COSTS

Finance costs in 2010 and 2009 comprise interest payable on amounts owed to Group undertakings.

11. INTANGIBLE ASSETS

	Software development costs
	£'000
COST	
At 1 January 2010	**17,824**
Additions	**943**
At 31 December 2010	**18,767**
AMORTISATION	
At 1 January 2010	**13,185**
Amortisation for year	**1,571**
At 31 December 2010	**14,756**
NET BOOK VALUE	
At 31 December 2010	**4,011**

11. INTANGIBLE ASSETS - continued

	Software development costs £'000
COST	
At 1 January 2009	17,505
Additions	319
At 31 December 2009	17,824
AMORTISATION	
At 1 January 2009	11,687
Amortisation for year	1,498
At 31 December 2009	13,185
NET BOOK VALUE	
At 31 December 2009	4,639

12. PROPERTY, PLANT AND EQUIPMENT

	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST			
At 1 January 2010	1,624,056	20,788	1,644,844
Additions	125,670	1,035	126,705
Disposals	(3,885)	(1,077)	(4,962)
At 31 December 2010	1,745,841	20,746	1,766,587
DEPRECIATION			
At 1 January 2010	227,615	17,310	244,925
Charge for year	45,360	1,524	46,884
Eliminated on disposal	(3,885)	(1,077)	(4,962)
At 31 December 2010	269,090	17,757	286,847
NET BOOK VALUE			
At 31 December 2010	1,476,751	2,989	1,479,740

12. **PROPERTY, PLANT AND EQUIPMENT - continued**

	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST			
At 1 January 2009	1,506,316	19,049	1,525,365
Additions	122,538	1,866	124,404
Disposals	(4,798)	(127)	(4,925)
At 31 December 2009	1,624,056	20,788	1,644,844
DEPRECIATION			
At 1 January 2009	190,016	15,932	205,948
Charge for year	42,397	1,505	43,902
Eliminated on disposal	(4,798)	(127)	(4,925)
At 31 December 2009	227,615	17,310	244,925
NET BOOK VALUE			
At 31 December 2009	1,396,441	3,478	1,399,919

Assets in the course of construction included above:

At 1 January 2010	**46,958**	**-**	**46,958**
Additions	**125,670**	**1,035**	**126,705**
Available for use	**(113,441)**	**(1,035)**	**(114,476)**
At 31 December 2010	**59,187**	**-**	**59,187**

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £15,412,000 (2009: £13,040,000).

13. **INVESTMENTS**

Details of the principal investments of the Company at 31 December 2010 are listed below:

Name of Company	**Country of Registration**	**Holding of Ordinary Shares**	**Proportion**	**Nature of Business**
Electralink Limited	England and Wales	619 at 10p	6.7%	Data transfer network operator
MRA Service Company Limited	England and Wales	1 at £1	1.0%	Governance of the electricity industry's Master Registration Agreement
DCUSA Limited	England and Wales	1 at £1	1.0%	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 (2009: £62), MRA Service Company Limited £1 (2009: £1), DCUSA Limited £1 (2009: £1) and Northern Electric Finance plc £50,000 (2009: £50,000).

14. INVENTORIES

	2010	2009
	£'000	£'000
Raw materials and consumables	**7,601**	6,957
Work-in-progress	**176**	218
	7,777	7,175

15. TRADE AND OTHER RECEIVABLES

	2010	2009
	£'000	£'000
Current:		
Distribution use of system receivables	**42,504**	34,508
Amounts receivable from sale of goods and services	**1,204**	8,055
Prepayments and accrued income	**5,033**	3,147
	48,741	45,710

15. TRADE AND OTHER RECEIVABLES - continued

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

Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 30% of distribution revenues in 2010 (2009: 32%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account. Included within other payables are customer deposits of £1,530,000 as at 31 December 2010 (2009: £1,523,000).

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 £3,000, which have been placed into administration and have therefore been provided in full at the year end (2009: £17,000)

Amounts receivable from sale of goods and services

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

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

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £720,000 (2009: £1,164,000) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £349,000 (2009: £435,000) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 304 days (2009: 347 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £500,000 (2009: £328,000) which are past due at the reporting date and for which 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 (2009: 60 days).

Ageing of past due but not impaired receivables

	2010 **£'000**	2009 £'000
30-60 days	**358**	246
60-120 days	**129**	65
120-210 days	**13**	17
Total	**500**	328

15. TRADE AND OTHER RECEIVABLES - continued

Movement in the allowance for doubtful debts

	2010 £'000	2009 £'000
At 1 January	452	548
Amounts utilised/written off in the year	(149)	(108)
Amounts recognised in income statement	49	12
At 31 December	352	452

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 £242k (2009: £239k) 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.

Categories of financial asset

	2010 £'000	2009 £'000
Loans and receivables at amortised cost	43,708	42,563
Total financial assets	43,708	42,563
Non current assets	1,483,801	1,404,608
Inventories	7,777	7,175
Prepayments and accrued income	5,033	3,147
Total non-financial assets	1,496,611	1,414,930
Total assets	1,540,319	1,457,493

16. CALLED UP SHARE CAPITAL

	2010 No./£	2009 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.

17. RESERVES

	Retained earnings £'000
At 1 January 2010	**172,979**
Profit for the year	**75,183**
Dividends	**(20,000)**
At 31 December 2010	**228,162**

18. TRADE AND OTHER PAYABLES

	2010 £'000	2009 £'000
Current:		
Payments on account	**23,802**	20,624
Trade creditors	**6,464**	3,382
Amounts owed to Group undertakings	**401**	280
Social security and other taxes	**4,948**	3,724
Other creditors	**1,449**	1,680
Deferred revenue	**13,431**	13,807
Accrued expenses	**17,061**	15,717
	67,556	59,214

	2010 £'000	2009 £'000
Non-current:		
Deferred revenue	**417,504**	397,552

18. TRADE AND OTHER PAYABLES - continued

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the 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.

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

	Less than 3 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2010:					
Non-interest bearing	**30,323**	**-**	**-**	**-**	**30,323**
Variable interest rate liability	**126,892**	**-**	**-**	**-**	**126,892**
Fixed interest rate liability	**-**	**22,463**	**89,850**	**688,175**	**800,488**
	157,215	**22,463**	**89,850**	**688,175**	**957,703**
2009:					
Non-interest bearing	24,783	-	-	-	24,783
Variable interest rate liability	133,594	-	-	-	133,594
Fixed interest rate liability	-	22,463	89,850	710,638	822,951
	158,377	22,463	89,850	710,638	981,328

18. **TRADE AND OTHER PAYABLES - continued**

Categories of financial liabilities

	2010 £'000	2009 £'000
Loans and payables at amortised cost	**(486,381)**	(486,545)
Total financial liabilities	**(486,381)**	(486,545)
Payments received on account	**(23,802)**	(20,624)
Income tax liabilities	**(146,298)**	(144,301)
Other taxes and social security	**(4,948)**	(3,724)
Accruals	**(17,061)**	(15,717)
Deferred Revenue	**(430,935)**	(411,359)
Provisions	**(2,732)**	(2,244)
Total non financial liabilities	**(625,776)**	(597,969)
Total liabilities	**(1,112,157)**	(1,084,514)

Deferred Revenue

	2010 £'000	2009 £'000
At 1 January	**(411,359)**	(398,005)
Additions	**(31,992)**	(25,033)
Amortisation	**12,416**	11,679
At 31 December	**(430,935)**	(411,359)

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

19. BORROWINGS

The directors' consideration of liquidity, interest rate and foreign currency risk is described in detail in the Report of the Directors.

	Book Value		Fair Value	
	2010	2009	**2010**	2009
	£'000	£'000	**£'000**	£'000
Loans	**-**	33,500	**-**	33,500
Amounts owed to Group undertakings	**478,067**	447,703	**508,929**	455,648
	478,067	481,203	**508,929**	489,148
The borrowings are repayable as follows:				
On demand or within one year	**130,624**	133,644	**130,624**	133,594
After five years	**347,443**	347,559	**378,305**	355,554
	478,067	481,203	**508,929**	489,148
Analysis of borrowings:				
Short term loan	**-**	33,500	**-**	33,500
Inter-company short term loan	**126,892**	96,658	**126,892**	96,608
Northern Electric Finance plc 2020 - 8.875%	**101,848**	101,785	**133,249**	123,623
Northern Electric Finance plc 2035 - 5.125%	**49,297**	49,193	**47,530**	44,920
Yorkshire Electricity Group plc 2037 - 5.9%	**100,016**	100,022	**106,033**	100,494
Northern Electric Finance plc 2037 - 5.125%	**100,014**	100,045	**95,225**	90,003
	478,067	481,203	**508,929**	489,148

The fair value of the external borrowings is determined with reference to quoted market prices. The directors' estimates of the fair value of internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments. The fair value of short-term borrowings is equal to their book value. All loans are non-secured and are denominated in sterling.

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 1.5%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £0.3m 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 covenants associated with the 2035 bonds issued by Northern Electric Finance plc, a wholly-owned subsidiary of the Company, include restrictions on the issuance of new indebtedness and the making of distributions dependent on the scale of the ratio of Senior Total Net Debt to Regulatory Asset Value ("RAV"). The definition of Senior Total Net Debt excludes any subordinated debt and any debt incurred on a non-recourse basis. In addition, it excludes interest payable, any fair value adjustments and unamortised issue costs.

The Company's Senior Total Net Debt as at 31 December 2010 totalled £475.2m. Using the RAV value as at March 2011, as outlined by Ofgem in its Final Proposals for Distribution Prices published in December 2009, and up rating for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at December 2010 of £951.2m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 50%.

At 31 December 2010, the Company had available £196.0m (2009: £18.6m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

20. PROVISIONS

	2010	2009
	£'000	£'000
Provisions	**2,732**	2,244
Analysed as follows:		
Current	**1,698**	1,199
Non-current	**1,034**	1,045
	2,732	2,244

	Claims	**Other**	**Total**
	£'000	**£'000**	**£'000**
At 1 January 2010	**1,160**	**1,084**	**2,244**
Utilised/paid in the year	**(817)**	**(517)**	**(1,334)**
Charged to income statement	**1,484**	**338**	**1,822**
At 31 December 2010	**1,827**	**905**	**2,732**

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

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

21. DEFERRED TAX

	Accelerated Tax Depreciation	Other	Total
	£'000	£'000	£'000
At 1 January 2010	**136,691**	**(290)**	**136,401**
(Credit)/Charge to income statement	**(3,330)**	**62**	**(3,268)**
At 31 December 2010	**133,361**	**(228)**	**133,133**

	£'000	£'000	£'000
At 1 January 2009	134,669	(409)	134,260
Charge to income statement	2,022	119	2,141
At 31 December 2009	136,691	(290)	136,401

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

22. EMPLOYEE BENEFIT OBLIGATIONS

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 triennial 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 current valuation is ongoing. The projected unit method was used for the 2007 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.

The CE Group reached agreement during March 2008 with the Group Trustees to repair this deficit. The agreement comprised 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 was paid by the Company. These payments aimed 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 current triennial valuation process.

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

The Company pension cost for the year ended 31 December 2010 was £28.6m (2009: £28.4m).

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

Principal assumptions:

	2010	2009
	Projected	Projected
Valuation method	**unit**	unit
Discount rate	**5.50%**	5.70%
Inflation rate	**3.20%**	3.20%
Increase to pensions	**3.20%**	3.20%
Increase to deferred benefits	**3.20%**	3.20%
Salary increase	**3.20%**	2.75%*

* 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 28 years, if he is male, and for a further 28 years, if she is female. Life expectancy at age 60 for non-pensioners (currently aged 45) is assumed to be 29 years, if they are male, and 30 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.

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

	2010	2009
	£m	£m
Opening defined benefit obligation	**1,021.9**	855.3
Current service costs	**10.0**	7.5
Interest cost	**57.4**	53.7
Contributions from employees	**3.0**	3.0
Actuarial losses	**12.5**	145.7
Benefits paid	**(43.7)**	(43.3)
Closing defined benefit obligation	**1,061.1**	1,021.9

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

Opening fair value of plan assets	**938.4**	801.4
Expected returns	**60.4**	(54.6)
Actuarial gains	**41.9**	78.6
Contributions by employer	**43.7**	44.1
Contributions from employees	**3.0**	3.0
Benefit paid	**(43.7)**	(43.3)
Closing fair value of plan assets	**1,043.7**	938.4

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

	Long term rates of return expected at		Value	
	2010	2009	**2010**	2009
	%	%	**£m**	£m
Equities	**8.50**	8.50	**346.9**	340.5
Gilts	**4.60**	5.10	**602.0**	516.0
Cash	**4.20**	4.50	**0.8**	0.5
Property	**8.40**	8.50	**94.0**	81.4
Total fair value of scheme assets			**1,043.7**	938.4

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 directors are currently in negotiation with the scheme trustees in relation to the contributions to be made to the defined benefit plan in 2011 as part of concluding on the March 2010 triennial valuation. Until those negotiations are concluded, it is not possible to state the value of the contributions to be made during 2011.

23. RELATED PARTY DISCLOSURES

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 2010 was £24,009,000 (2009: £23,058,000). Included within borrowings is £478,067,000 as at 31 December 2010 (2009: £447,703,000).

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

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

Related Party	Sales to related parties £'000	Purchases from related parties £'000	Amounts owed to related parties £'000
2010:			
CE Insurance Services Limited	-	**460**	-
Integrated Utility Services Limited	**479**	**36**	-
Integrated Utility Services Limited (registered in Eire)	-	**1,070**	**70**
Northern Electric plc	**162**	**4,820**	-
Northern Electric Properties Limited	-	**662**	-
Yorkshire Electricity Distribution plc	**13,558**	**7,563**	-
Vehicle Lease and Service Limited*		**3,131**	**331**
2009:			
CE Insurance Services Limited	-	629	-
Integrated Utility Services Limited	423	32	-
Integrated Utility Services Limited (registered in Eire)	-	1,199	-
Northern Electric plc	169	5,496	-
Northern Electric Properties Limited	-	928	-
Yorkshire Electricity Distribution plc	12,674	7,643	-
Vehicle Lease and Service Limited*	-	3,205	280

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 and no impairment charges were recorded in relation to amounts owed by related parties in the current or the prior year.

* Vehicle Lease and Service Limited is a joint venture in which Northern Electric plc has a 50% non-controlling interest.

24. ULTIMATE 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.

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

	2010 £'000	2009 £'000
Profit before income tax	**97,425**	66,366
Depreciation charges	**48,455**	45,400
Profit on disposal of fixed assets	**(243)**	(199)
Amortisation of deferred revenue	**(12,416)**	(11,679)
Increase/(Decrease) in provisions	**488**	(236)
Finance costs	**24,730**	23,365
	158,439	123,017
(Increase)/Decrease in inventories	**(602)**	1,016
Increase in trade and other receivables	**(9,596)**	(6,643)
Increase/(Decrease) in trade and other payables	**2,073**	(902)
Cash generated from operations	**150,314**	116,488