

REGISTERED NUMBER: 02906593 (England and Wales)

REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018
FOR
NORTHERN POWERGRID (NORTHEAST) LIMITED

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

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COMPANY INFORMATION FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

DIRECTORS:

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T H France
N M Gill
P A Jones
A J MacLennan
A R Marshall
P C Taylor

COMPANY SECRETARY:

J C Riley

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Newcastle upon Tyne
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REGISTERED NUMBER:

02906593 (England and Wales)

AUDITOR:

Deloitte LLP
Statutory Auditor
Newcastle upon Tyne
United Kingdom

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2018







The directors present the annual reports and financial statements for the Regulatory Year ended 31 March 2018 of Northern Powergrid (Northeast) Limited (the "Company"). The Regulatory Accounts have been prepared in accordance with Part A of standard condition 44 (Regulatory Accounts) of the electricity distribution license granted to the Company by the Secretary of State (the "License").

BUSINESS MODEL

The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. As a distribution network operator ("DNO"), the Company distributes electricity to approximately 1.6 million customers connected to its electricity distribution network within its distribution services area in the northeast of England, which extends from North Northumberland, south to York and west to the Pennines.

The Company's distribution network includes over 41,000 kilometres of overhead and underground cables and more than 27,000 substations. Electricity is received from National Grid's transmission system and from generators connected directly to the network, and then distributed at voltages of up to 132 kilovolts ("kV").

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

| Core Principle | | Strategic objective | Key Performance Indicators ("KPI") |
|---|------------------------|---|---|
|  | Financial strength | Strong finances that enable improvement and growth. | <ul style="list-style-type: none">• Operating profit• Maintenance of investment grade credit ratings• Cash flow |
|  | Customer service | Delivering exceptional customer service. | <ul style="list-style-type: none">• Broad measure of customer satisfaction• Stakeholder Engagement rank |
|  | Operational excellence | High-quality, efficient operators running a smart reliable energy system. | <ul style="list-style-type: none">• Customer Minutes Lost• Customer Interruptions• Network investment• High voltage restoration time |
|  | Employee commitment | High-performing people doing rewarding jobs in a safe and secure workplace. | <ul style="list-style-type: none">• Occupational Safety and Health Administration Rate• Preventable Vehicle Accidents• Lost time accidents• Restricted duty accidents• Medical treatment accidents• Operational incidents• Absence rate |
|  | Environmental respect | Leaders in environmental respect and low carbon technologies. | <ul style="list-style-type: none">• Total Oil/Fluid Lost• SF6 Gas discharges• Environmental Incidents• Carbon Footprint |
|  | Regulatory integrity | Trustworthy, fair and balanced, creating win-win outcomes. | <ul style="list-style-type: none">• Quarterly certification |


The core principles set out the basis on which the Company generates value over the longer term and are defined by a number of strategic objectives. Throughout the report, the strategic focus of each principle sets out the way in which each objective is to be achieved through the delivery of both financial and non-financial KPIs.

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REVIEW OF THE REGULATORY YEAR

|  Strategic objective Strong finances that enable improvement and growth. | FINANCIAL STRENGTH | | |
|--|-----------------------------------|-------------------------|------------------|
| | KPI | 2017/18 | 2016/17 |
| | Operating Profit | £128.7 million | £153.4 million |
| | Credit Rating (Standard & Poor's) | A | A |
| | Cash Flow | | |
| | Operating activities | £138.8 million | £182.9 million |
| | Investing activities | £(146.2) million | £(155.8) million |

Strategic focus: To provide the financial resources to support long-term corporate stability.

Performance during the Regulatory Year: The Company continued to maintain good control in respect of both its capital and operating costs by effectively managing the financial risks that could have had an adverse impact on its business. The ED1 price control has been set for eight years which provides the Company with some stability in terms of its income until 31 March 2023.

Revenue: The Company's revenue at £327.9 million was £8.5 million lower than the prior year primarily due to the profile of allowed revenues over the ED1 price control period and reduced units distributed.

Operating profit and position at the Regulatory Year-end: The Company's operating profit of £128.7 million was £24.7 million less than the previous Regulatory Year, primarily reflecting lower revenues, higher depreciation charges, increased business rates and pension costs. The statement of financial position on page 30 shows that, as at 31 March 2018, the Company had total equity of £998.8 million. The directors consider the Company to have a strong financial position which, when coupled with the preference of its parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy"), for operating with lower levels of debt than equivalent companies in the sector, creates a stable base for continued strong performance during the ED1 period.

Finance costs and Investments: Finance costs net of investment income at £28.6 million remains unchanged from prior year.

Taxation: The effective tax rate in the Regulatory Year was 19.7%. Corporation tax of £19.3 million was paid in the Regulatory Year, this was higher than the prior Regulatory Year of £3.8 million due to the conclusion of a tax claim with HMRC in 2017. Details of the income tax expense are provided in Note 9 to the financial statements.

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

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

Cash flow: The Company aims to collect from customers and pay suppliers within contracted terms. Any surplus cash held is remitted to Yorkshire Electricity Group plc ("YEG"), a company in the Northern Powergrid Group, and invested accordingly, generating a market rate of return for the Company. Movements in cash flows were as follows:

- | | |
|------------------------|--|
| - Operating activities | Cash flow from operating activities at £138.8 million was £44.1 million lower than the previous Regulatory Year, mainly due to lower profits, higher tax paid and adverse working capital movements. |
| - Investing activities | Net cash used in investing activities at £146.2 million was £9.6 million lower than the previous Regulatory Year, reflecting lower capital expenditure and lower customer contributions. |
| - Financing activities | The net cash from financing activities at £7.4 million was £34.5 million higher than prior Regulatory Year outflow of £27.1 million reflecting the increase in loans from Group undertaking offset by repayment of external bonds/loans. |

Pensions: The Company is a participating employer in the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "DB Scheme"), a defined benefit scheme. Further details of the Company's commitments to the DB Scheme and the associated deficit repair payments are provided in Note 24 to the financial statements. The Company also participates in the Northern Powergrid Pension Scheme, which is a defined contribution scheme.


Insurance: As part of its insurance and risk strategy, the Northern Powergrid Group has in place insurance policies, which cover risks associated with employees, third party motor and public liability. The Northern Powergrid Group carries appropriate excesses on those policies and is effectively self-insured up to the level of those excesses. Consequently, risk management is extremely important, given the contribution it makes to the elimination or reduction of exposure to those risks.

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

|  | CUSTOMER SERVICE | | |
|---|--|---------|---------|
| | KPI | 2017/18 | 2016/17 |
| Strategic objective Delivering exceptional customer service. | BMCS | 87.2% | 86.8% |
| | BMCS Power Cuts | 87.7% | 88.1% |
| | BMCS General Enquiries | 90.5% | 90.1% |
| | BMCS Connections | 85.5% | 84.8% |
| | SECV rank (combined with Northern Powergrid (Yorkshire) plc) | 3 | 5 |

Strategic focus: To improve the service delivered to customers.

Performance during the Regulatory Year: Under the broad measure of customer satisfaction ("BMCS"), an independent market research company carried out telephone surveys with the Company's customers to find out how satisfied they were with services related to unplanned or planned power cuts, quotations and subsequent connections, and general enquiries. At the end of the Regulatory Year, the Company recorded an overall satisfaction score (an internal metric comprising a blend of the power cuts, general enquiries and connections BMCS scores) of 87.2%, which was comparable to the prior Regulatory Year (86.8%). To further enhance the service provided to customers, a number of initiatives from the Company's customer experience improvement plan were implemented. This included the continued development of the customer relationship management system and enhancing the self-service offerings available to customers.

Throughout the Regulatory Year, further improvements were made to the way in which the Contact Centre operates. The Quality Framework, which supports Contact Centre employees in delivering exceptional customer service, was extended to the connections business. In addition, the Contact Centre was restructured to introduce a metering defect customer support team, designed to effectively support customers during the government's smart meter roll-out programme.

Connections to the network

Strategic focus: To reduce routine, small works end-to-end connections lead times by 30% during the ED1 period, actively facilitate the development of competition from independent connections providers ("ICPs") and deliver the major works service improvement plan as part of the Office for Gas and Electricity Markets ("Ofgem") Incentive on Connections Engagement ("ICE").

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

Performance during the Regulatory Year: Within connections services (the performance of which is measured by the BMCS connections KPI), work to improve the level of customer services within the small works connections business continued. In support of this, the processes implemented during 2017, which introduced a single point of customer contact for the delivery of small works connections and the online service alteration quotation facility, were further embedded.

The Company continued to encourage competition in connections from ICPs by providing dual quotations, enabling ICPs to self-determine and approve points of connection to the network, and simplifying the authorisation process for ICPs' operational staff.

In relation to the Company's ICE commitments, the 26 actions included in the service improvement plan were successfully delivered during the Regulatory Year. To further enhance service levels, 17 additional actions (initiated from customer feedback) were incorporated into the service improvement plan.

Corporate responsibility

Strategic focus: To build effective relationships with stakeholders whilst maximising the value of contact with customers, especially those who are vulnerable and hard to reach.

Performance during the Regulatory Year: The Company continued to work closely with key partners such as the Environment Agency, local authorities and local resilience forums, particularly during periods of severe weather. Collaboration with stakeholders in the wider energy industry included the continued promotion of the national '105' number and participation in the January 2018 overhead line safety campaign, an Energy Networks Association initiative, supported by DNOs.

In May 2017, the Company, together with its affiliate Northern Powergrid (Yorkshire) plc, put forward its Stakeholder engagement ("SECV") submission to Ofgem in respect of work undertaken during the previous Regulatory Year. The submission provided an overview of activities, including, the work of the Social Issues Expert Group (whose remit is to enhance the services available to vulnerable customers), the increased focus on data quality which had resulted in cleansing the Company's Priority Services Register, and the strengthening of relationships with partners who deliver key services to customers. Following the submission to Ofgem's panel, the position of the Company in the context of the wider DNO group increased from fifth place to third. The improvement demonstrated the effectiveness of the revised stakeholder engagement strategy launched in 2016.


Throughout the Regulatory Year, the Northern Powergrid Group continued to support several charitable organisations and sponsor both the "Safety Champions" initiative, which is aimed at enhancing safety performance, and the Cub Home Safety Activity Badge, which has been designed to teach Cub Scouts about safety in and around the home. A number of tailored education and safety programmes were also delivered, including, 'Look up – It's live', a campaign to promote safety messages to the rural community, Make the Grade in Energy, an education, skills and employability programme, Energy Heroes, targeted at the primary school pupils to promote awareness of energy costs and ways of saving energy, and attendance at The Big Bang Fair, which encourages young people to pursue science, technology, engineering and maths subjects.

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STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

REVIEW OF THE REGULATORY YEAR (CONTINUED)

|  | OPERATIONAL EXCELLENCE | | | | |
|---|---|----------------|--------|----------------|--------|
| | KPI | 2017/18 | | 2016/17 | |
| Strategic objective | | Actual | Target | Actual | Target |
| High-quality, efficient operators running a smart reliable energy system. | Customer Minutes Lost | 44.6 | <61.9 | 45.0 | <64.1 |
| | Customer Interruptions | 51.8 | <62.1 | 53.3 | <62.7 |
| | KPI | 2017/18 | | 2016/17 | |
| | | Actual | | Actual | |
| | Network investment | £173.9 million | | £189.6 million | |
| | High voltage restoration time (minutes) | 57.8 | 53.0 | 55.7 | 51.0 |

Strategic focus: To enhance the reliability of the network in support of the commitment to achieve 8% fewer unplanned power cuts and reduce the average length of unplanned power cuts by 20% during the ED1 period.

Performance during the Regulatory Year: Customer minutes lost ("CML") and customer interruptions ("CI") are the KPIs set by Ofgem and used by the Company to measure the quality of supply and system performance. CML measures the average number of supply minutes lost for every connected customer due to both planned and unplanned power cuts that last for three minutes or longer. CI measures the average number of supply interruptions per every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer. Performance during the Regulatory Year was better than Ofgem's target for both CML and CI.

The Company invested £173.9 million during the Regulatory Year through its approved network investment strategy (2017: £189.6 million), which has been designed to deliver improvements and increase the network's resilience. Various major projects were undertaken to reinforce the primary network, refurbish transformers, rebuild overhead lines, remove and replace oil-filled cables, change deteriorated poles, replace switchgear and install and commission new remote control points.

Enhancements to the network also continued through investment in the use of technology. This included the deployment of over 1,400 smart fuses to restore supplies in under three minutes to customers affected by intermittent faults, and the roll out of 300 (to increase to 600) next generation innovative low-voltage technology devices to perform multiple restorations of customers' supplies, again in under three minutes. In addition, the Company continued to further expand the automated power restoration system, designed to restore power to the network in a safe manner in under three minutes. In relation to the Company's high-voltage restoration performance during the Regulatory Year averaged some 57.8 minutes (2017: 55.7 minutes), after allowing for severe weather incidents and other exemptions, which was below the target level of 53 minutes.


The Company aims to respond effectively to the needs of customers and local communities and to achieve the guaranteed standard for the restoration of supply: restoration within 12 hours of a power cut occurring under normal weather conditions. During the Regulatory Year over 99.8% of customers' supplies were restored within this target.

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

| | | | | | |
|---|---|--------|--------|--------|--------|
|  | EMPLOYEE COMMITMENT | | | | |
| Strategic objective | KPI (Calendar year) | 2018 | | 2017 | |
| | | Actual | Target | Actual | Target |
| High-performing people doing rewarding jobs in a safe and secure workplace. | Occupational Safety and Health Administration Rate (Northern Powergrid Group) | 0.44 | 0.26 | 0.30 | 0.30 |
| | Preventable Vehicle Accidents | 12 | 13 | 11 | 10 |
| | Lost time accidents | 2 | 1 | 1 | 1 |
| | Restricted duty accidents | 1 | 0 | 0 | 1 |
| | Medical treatment accidents | 0 | 1 | 1 | 1 |
| | Operational incidents | 2 | 5 | 3 | 5 |
| | Northern Powergrid Group Absence rate | 2.9% | | 2.9% | |

Health and Safety

Strategic focus: To deliver a comprehensive safety and health improvement plan ("SHIP") and achieve the Northern Powergrid Group commitment of halving its accident rate during the ED1 period.

Performance during the Regulatory Year: In common with the Berkshire Hathaway Energy group, the Northern Powergrid Group measures its safety performance in terms of the Occupational Safety and Health Administration ("OSHA") rate, which is a measure used in the United States ("US") to capture safety incidents down to minor levels of medical treatment. The Northern Powergrid Group missed the OSHA rate of 0.26 (2017: 0.30) recording a total of ten recordable incidents against a target of six. Whilst the outcome was disappointing, the Company's long term safety record suggests that it is one of the safest in its sector. This has been recognised in the form of a Gold President's Award from the Royal Society for the Prevention of Accidents for the achievement of 14 consecutive Gold Awards. The Company failed to meet both the restricted duty accidents and lost time accident targets. The failure to meet these targets was primarily the result of a series of relatively minor driving incidents and trips, slips and falls. The Company continues to take action to seek to minimise these lower level risks.

Improving safety performance remains a priority and the way in which this is achieved is set out in the Company's SHIP. The SHIP focuses on leadership engagement, supervisory oversight, and workplace risk management. These three areas are supported by driver training, operational safety seminars, stand-down briefings and regular safety reports and newsflashes.

The health and wellbeing of staff, is a key priority of the Northern Powergrid Group and forms an integral part of the SHIP. Existing support includes the availability of an independent employee assistance service, which is a confidential, self-referral counselling and information service to assist with personal or work-related problems and access to services including counselling and physiotherapy referrals. A number of new initiatives focused specifically on mental health and wellbeing were launched during the Regulatory Year. These included the recruitment of mental health first aid volunteers, providing mental health awareness training and a series of mental health campaigns in conjunction with the United Kingdom ("UK") mental health awareness week.

The Company's OHSAS 18001 health and safety management systems successfully retained certification.

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

Employees

Strategic focus: To emphasise the importance of leadership and high standards of performance by engaging, collaborating and working with employees and their trade union representatives.

Performance during the Regulatory Year: The Northern Powergrid Group conducted an externally facilitated employee survey to benchmark the level of employee engagement against top performing organisations and to identify areas for improvement. In response to feedback from the most recent survey, a number of commitments were made in respect of communication and to enhance the quality and quantity of time spent discussing personal objectives and development.

During the Regulatory Year, 68 new recruits (2017: 71) joined the Northern Powergrid Group workforce renewal programme, including, for the first time, two Cyber Apprentices. In addition, 19 trainees graduated from their training programmes.

The Company has adopted the Berkshire Hathaway Energy code of business conduct, which details the commitment to ethics and compliance with the law, provides reporting mechanisms for known or suspected ethical or legal violations, and establishes minimum standards of behaviour expected of all employees. In support of this, a "speaking up" process is in place enabling all employees to raise concerns of unethical acts, malpractice or impropriety (including bribery or corruption), and an anonymous help line operated by an independent company is also available.

At 31 March 2018, the Company employed 1,107 employees (2017: 1,052). Further information concerning how the Northern Powergrid group is supporting gender diversity in the energy industry can be found in the Northern Powergrid gender pay gap report via the Northern Powergrid corporate website.

| | 2017/18 | | | 2016/17 | | |
|------------------------------|---------|--------|-------|---------|--------|-------|
| | Male | Female | All | Male | Female | All |
| Directors | 6 | 1 | 7 | 8 | 1 | 9 |
| Senior Managers ¹ | 26 | 4 | 30 | 32 | 6 | 38 |
| Total Number of Employees | 884 | 223 | 1,107 | 862 | 190 | 1,052 |


¹ The criteria for categorising the population of senior managers was made more stringent during the 2017/18 Regulatory Year which is reflected in the reduction in the total number

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

|  | ENVIRONMENTAL RESPECT | | | | |
|---|-------------------------------|--------|--------|--------|--------|
| Strategic objective | KPI | 2018 | | 2017 | |
| | | Actual | Target | Actual | Target |
| Leaders in environmental respect and low carbon technologies. | Total Oil/Fluid Lost (litres) | 12,124 | 12550 | 18,641 | 16,006 |
| | SF6 Gas discharges (kg) | 36.13 | 34 | 14.17 | 28 |
| | Environmental Incidents | 1 | <3 | 4 | <6 |
| | Carbon Footprint (tonnes) | 17,745 | 24,063 | 22,339 | 19,944 |

Strategic focus: Deliver Environmental "RESPECT" (Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training) and in doing so reduce oil and fluid loss by 15% and our business carbon footprint by 10% during the ED1 period.

Performance during the Regulatory Year: The Company has operated a UK Accreditation Service scheme for environmental management since the late 1990s and is certified to the environmental management systems standard ISO 14001: 2015. A full recertification assessment was carried out in March 2017 and a surveillance audit conducted in September 2017. Continued certification was confirmed following each audit.

The Company's carbon footprint reporting framework is certified under the Certified Emissions Measurement and Reduction Scheme for compliance with ISO 14064-1:2006. The last full audit was undertaken in October 2017 where continued certification was confirmed. Initiatives including the implementation of telematics in fleet vehicles have facilitated a further improvement in reducing the Company's carbon footprint during the Regulatory Year to 17,745 tonnes (2017: 22,339 tonnes).

In support of the target to further reduce oil and fluid loss, the 2017 annual environmental improvement plan included replacing fluid-filled cables and locating cable fluid leaks more quickly which resulted in a total fluid loss of 17,745 litres (2017: 22,339). Additional activity to minimise the Company's impact on the environment included placing overhead lines underground in National Parks and Areas of Outstanding Natural Beauty and protecting wildlife and habitat.

Sustainability

Strategic focus: To help facilitate the UK's transition to a low-carbon economy in the Company's capacity as a major participant in the UK energy industry and in terms of its own carbon footprint.

Performance during the Regulatory Year: As the country takes action to make significant reductions in its carbon emissions, the way in which electricity is produced and used is expected to have a substantial impact on the electricity network. This has already been seen through the number of low-carbon technology installations such as photovoltaic solar panels, electric vehicles and heat pumps. The volume and total capacity of decentralised energy generation has also been growing steadily and, given the greater range of load and generation technologies now connected to the network, the Company is taking action to develop innovative solutions that will reduce the need for traditional and potentially expensive reinforcement of the network.

From an innovation perspective, the Company is running a portfolio of projects in the priority areas of smart grids, smart meters, digital-enabled customer service and affordability.

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REVIEW OF THE REGULATORY YEAR (CONTINUED)

A partnership with Nissan is supporting new electric vehicle projects for the trialling of 'vehicle to grid' technology to enable car users to supply power to the electricity network. In addition, a new project is developing hybrid battery technology to expedite the restoration of the electricity supply following a power cut. Collaboration with Northern Gas Networks at the Integrel demonstrator site continues to assess the potential future benefits of integrating both gas and electricity energy systems. The Company continues to scope the role of distribution system operator ("DSO") through a project to explore the value of the transition for customers and to understand the business changes required to realise those benefits.

The Northern Powergrid Group climate change adaptation strategy recognises the impact that climate change is anticipated to have on the business, the risks this poses and the proposed actions to mitigate these risks including vegetation management, network specifications for changing temperatures and improved weather prediction. The installation of flood defences is one such key activity that is already underway and the delivery of the committed programme in the ED1 period remains on track.

REGULATORY INTEGRITY

| | |
|---|---|
|  | REGULATORY INTEGRITY |
| Strategic objective | KPI |
| Trustworthy, fair and balanced, creating win-win outcomes. | Completion of a quarterly regulatory compliance affirmation process |

Strategic focus: To manage the Company's business to the highest behavioural standards and adhere to a policy of strict compliance with all relevant standards, legislation and regulatory conditions.

Performance during the Regulatory Year: Under the RIIIO (revenue = incentives + innovation + outputs) model for regulation, price controls are set for eight years. The ED1 price control became effective on 1 April 2015 and is due to end on 31 March 2023. The Company's base allowed revenue (excluding the effects of Incentive schemes and any deferred revenues from the prior price control) before inflation reduced by 1.0% for the Regulatory Year ended 31 March 2018, relative to the previous Regulatory Year. Base allowed revenues before inflation remain constant for each subsequent Regulatory Year through to the 31 March 2023. Nominal base allowed revenues will increase in line with inflation (as measured by the UK's Retail Prices Index ("RPI")).

In order to assure compliance with licence and other regulatory obligations, the Company operates a regulatory compliance affirmation process, under which ownership of approximately 1,950 regulatory obligations are assigned to around 80 managers. Those managers are required to review compliance with the relevant obligations on a quarterly basis and report on any identified non-compliances or perceived risks which are then addressed by members of the executive team. To minimise the risk of the Company breaching its licence conditions and other statutory requirements, the board of directors review the outcome of each quarter's exercise.

The Company submitted a risk-based data-assurance plan for the regulatory year ahead, together with a report detailing the assurance work actually carried out in the Regulatory Year and the findings of that work.

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STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

PRINCIPAL RISKS AND UNCERTAINTIES

The Northern Powergrid Group operates a structured and disciplined approach to the management of risk as part of its overall risk management policy and in support of its financial reporting practices. A robust system is in place to facilitate the identification of new risks, including those associated with the achievement of the Northern Powergrid Group's strategic objectives and Core Principles. Once identified, key risks and their respective controls and mitigation plans are continually assessed and formally reviewed by the Governance and Risk Management Group ("GRMG"), which reports to the Audit Committee.

Supported by the internal audit function, the risk management programme includes regular reviews of the crisis management, disaster recovery and major incident plans. To determine the level of disaster preparedness and responsiveness against threats to business continuity, risk management plans and processes are periodically tested. This self-evaluation approach is reinforced by that of the Berkshire Hathaway Energy group, which benchmarks risk management activities across its business units and shares significant lessons learned.

| Risk | Mitigations |
|--|---|
| Financial risks: the exposure to interest rate, tax, liquidity and treasury risks | <ul style="list-style-type: none">- Monitored by the Treasury Committee- The Company is financed by long-term borrowings at fixed rates and has access to short-term borrowing facilities at floating rates of interest- As at 31 March 2018, 100% of the Company's long-term borrowings were at fixed rates and the average maturity for these borrowings was 12 years- Financial covenant monitoring is in place |
| Pension costs: the cost of the DB Scheme and possible effect on the current deficit position | <ul style="list-style-type: none">- The cost of the DB Scheme, including deficit repair payments, is managed in triennial cycles by negotiation with the trustees of the DB Scheme- On-going and repair costs form part of the assessment of cost made by Ofgem in each price control, and if judged efficient, these costs are permitted to be recovered through revenues at a stable level to provide certainty for customers- The Company works with DB Scheme trustees to ensure that scheme judgements reflect this indirect obligation to customers |
| RPI fluctuation: costs increase or change by more than RPI having a direct impact on financial results. The rate of inflation as measured by RPI is taken into account in setting the Company's allowed income in respect of each regulatory year | <ul style="list-style-type: none">- Performance against regulatory allowances including forecasts for the remainder of the price period is monitored- Appropriate corrective actions are taken to ensure the Company remains within regulatory allowances |

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PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

| Risk | Mitigations |
|--|---|
| Regulatory Policy: merging role of DSO, changing future outlook of the distribution industry and emerging technology resulting in a negative impact on the business model | <ul style="list-style-type: none"> - The Company's policy position supporting the expanded role of DSO is being set out - Innovation projects in place to develop and demonstrate future technologies and commercial practices - Regulatory and stakeholder engagement programme |
| Network Resilience: adverse weather or terrorism attacks causing network disruption and the interruption of essential services resulting in reduced customer service, penalties and a reduction in the number of units delivered on which income is charged | <ul style="list-style-type: none"> - Major incident and crisis management policies, plans and governance arrangements are in place - An industry mutual aid agreement exists - Network investment ensures grid resilience - Grid resilience programme and audits |
| Resource availability: access to and availability of skilled resource resulting in an inability to deliver work programmes during the ED1 period | <ul style="list-style-type: none"> - Mix of direct labour and contracted resource is used - Workforce renewal programmes in place to recruit and retain employees - On-going training and development builds internal capability - Employee engagement and health and well-being initiatives are in place |
| Health and Safety incident: hazards that could harm an employee, customer or third party resulting in reputational and financial damage | <ul style="list-style-type: none"> - Overseen by the Health and Safety Committee - Clear policies and procedures exist that comply with legislation to ensure the safety of the employees and customers and protect the environment - Health and safety training is provided to employees on a continuous basis - Audit programme and inspection regimes are in place - ISO18001 safety management system in place |
| Environmental Incident: failure to prevent network assets having a negative impact on the environment resulting in financial penalties and reputational loss | <ul style="list-style-type: none"> - Incident response process and robust policies and procedures in place - Programme to reduce fluid loss and the Northern Powergrid Group's business carbon footprint - Investment in technology to minimise environmental incidents and 'self-heal' the network - Asset inspection programme |
| Cyber-attack or cyber-security breach: affecting hardware, systems, customer data or intellectual property resulting in compromise to the safe operation of the network or interruption to services supplied to customers | <ul style="list-style-type: none"> - Robust cyber security risk mitigation programme is in place - Accreditation under the ISO 27001 Information Security (process security) standard for certain discrete business areas - Compliance with the Centre for Internet Security Critical Security Controls - Monitored by the Information Security Committee and the board |

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

STRATEGIC REPORT FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Internal Control

A rigorous internal control environment exists within the Northern Powergrid Group to support the financial reporting process, the key features of which include regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of internal audit recommendations. In addition, the Northern Powergrid Group utilises comprehensive business planning procedures, regularly reviews KPIs to assess progress towards its goals, and has a strong internal audit function to provide independent scrutiny. Financial controls include a centralised treasury operations and established procedures for the planning, approving and monitoring of major capital expenditure.

In accordance with Berkshire Hathaway Energy's requirements to comply with the US Sarbanes-Oxley Act, the Company undertakes a quarterly risk control assessment confirming that the effectiveness of the system of internal controls has been reviewed during the Regulatory Year. A self-certification process is in place, in support of this review, whereby certain senior managers are required to confirm that the system of internal control in their area of the business is operating effectively. Consequently, the directors believe that a robust system of risk assessment and management is in place.

The Company does not have a specific human rights policy. However, in accordance with the Core Principles, it remains fully committed to operating ethically and responsibly and with fairness and integrity. This is implemented through the policies and procedures it has in place which are applicable to all stakeholder groups and encompasses employees' health, safety and welfare, dealings with customers, particularly those who are vulnerable, the impact of the Company on the environment and the contribution to sustainability.

The Northern Powergrid Group is committed to maintaining the highest ethical standards in the conduct of its business and, implements Berkshire Hathaway Energy's code of business conduct, details of which can be found on page 16. The Company has robust procedures in place to meet the requirements of the Bribery Act 2010. Every employee must undertake the code of business conduct training each year, which includes training in respect of the Northern Powergrid Group's anti-corruption and anti-bribery policy.

Viability Statement

The directors have chosen an eight-year period from 1 April 2015 for the purposes of making this statement as it equates to the ED1 Period regulatory period for which the Company's income has been set. Various factors were contemplated when making an assessment of Company's prospects including the general stability associated with the regulatory environment, the principal risks and uncertainties facing the Company, the Company's business model and strategy, the forecasts developed as part of the Company's annual business plan and the commitments made in the well-justified business plan. Consideration was also given to the obligations contained in the Company's licence to provide Ofgem with annual certificates, confirming that the directors have a reasonable expectation that the Company will have sufficient financial resources, financial facilities and operational resources available for the continuation of business for a period of 12 months. The board determined any material variations to the assumptions used when providing those certificates was unlikely.

Based on the results of their review, the directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the ED1 period.

ON BEHALF OF THE BOARD:



P A Jones
Director

12 July 2018

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

The directors present their report together with the audited financial statements and the auditor's report for the Regulatory Year ended 31 March 2018.

DIVIDENDS

During the Regulatory Year, an interim dividend of £22.7 million was paid (2017: £21.8 million). The directors recommend that no final dividend be paid in respect of the Regulatory Year (2017: £nil).

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 Regulatory Year. In addition, the level of dividends is set to maintain sufficient equity in the Company so as not to jeopardise its investment grade issuer credit rating.

RESEARCH AND DEVELOPMENT

The Company supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. The new projects initiated during the Regulatory Year have been detailed in the 'sustainability' section on page 12.

During the Regulatory Year, the Company invested £2.1 million (2017: £0.5 million) (Note 6 to the financial statements) in its research and development activities.

FUTURE DEVELOPMENTS AND FUTURE OUTLOOK

The financial position of the Company, as at 31 March 2018, is shown in the statement of financial position on page 30. There have been no significant events since the Regulatory Year end. The directors intend that the Company will continue to implement its well-justified business plan during the remainder of the ED1 price control and by delivering the strategic objectives linked to the Core Principles, the Company will continue to develop its business by efficiently investing in the network and improving the quality of supply and service provided to customers. There are no plans to change the existing business model.

DIRECTORS

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

| | |
|---------------|--|
| R Dixon | Non-executive Director (retired 26 October 2017) |
| T E Fielden | Finance Director |
| J M France | Regulation Director (resigned 5 April 2018) |
| T H France | General Counsel |
| N M Gill | Operations Director |
| P A Jones | President and Chief Executive Officer |
| A J MacLennan | Business Development Director |
| A R Marshall | Non-executive Director |
| P C Taylor | Non-executive Director |

During and as at the end of the Regulatory Year, none of the directors was interested in any contract, which was significant in relation to the business of the Company.

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

FINANCIAL RISK MANAGEMENT

Details of financial risks are included in the Principal Risks and Uncertainties on pages 14 of the Strategic Report.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

FINANCIAL DERIVATIVES

As at 31 March 2018 and during the Regulatory Year it was the Company's policy not to hold any derivative financial instruments.

POLITICAL DONATIONS

No contributions were made to political organisations during the Regulatory Year (2017: £nil).

EMPLOYEES

Employee consultation

A constitutional framework agreed with trade union representatives exists in respect of employee consultation. The management team keep employees and trade union representatives informed of and involved as appropriate in developments that may impact them now or in the future.

Employee engagement continues to show improvement with local action plans augmented by routine communication channels including regular staff briefings, meetings with staff and their representatives, and utilising the Northern Powergrid Group's intranet.

During the Regulatory Year, the President and Chief Executive Officer of the Northern Powergrid Group continued to provide employees with updates on the Northern Powergrid Group's financial, organisational, safety and customer service performance through regular electronic briefings.

Disabled employees

The Company is committed to equality at work and, as such, its policy is to provide all protected groups, including disabled people, with equality at work in respect of employment, training, career development and promotion, having regard to their aptitudes and abilities. Should any member of staff become disabled during their employment, the Company will make reasonable adjustments, wherever possible.

NON-FINANCIAL INFORMATION STATEMENT

The non-financial reporting information pursuant to Section 414CB of the Companies Act 2006 has been reported throughout the Strategic Report and the summary of principal risks and uncertainties. Detail in respect of the relevant policies, risks and associated mitigations and non-financial KPIs can be found on the pages referenced below:

- Environmental: pages 12 and 15
- Employee: pages 10 and 11
- Social: page 8
- Human Rights: page 16
- Anti-bribery matters: pages 11 and 16

In accordance with Section 414C of the Companies Act 2006, disclosures concerning relations with employees and greenhouse gas emissions can be found on pages 12 and 18 of the Strategic Report.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

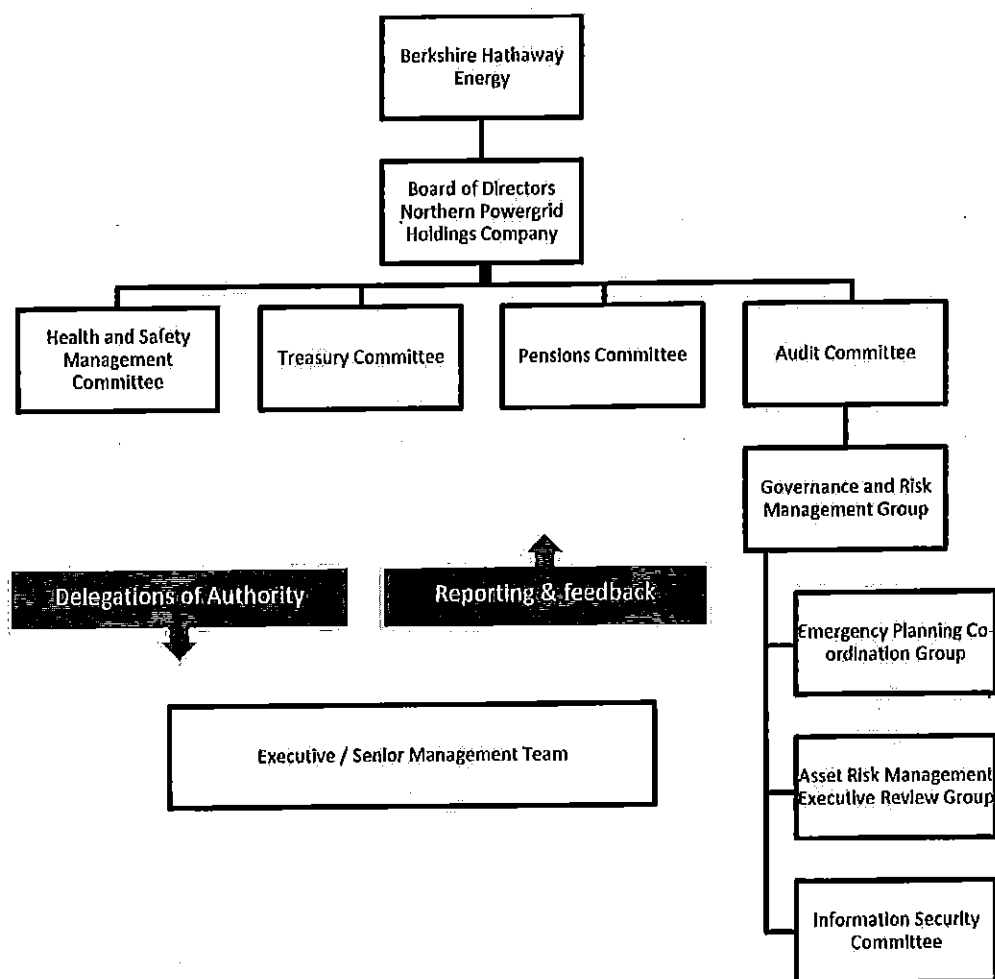
CORPORATE GOVERNANCE STATEMENT

The Company has voluntarily sought to apply a number of the main principles and certain supporting principles and provisions in the UK Corporate Governance Code 2016 (the "Code")¹ in so far as it considers them to be appropriate to a privately owned group and a Company without a premium listing of equity shares.

The directors confirm that the governance framework in place is appropriate to the circumstances of the Company and, where possible, the spirit of the Code has been applied. The framework is agreed with the Northern Powergrid Group's ultimate shareholder, Berkshire Hathaway Energy, with whom the Company has a strong relationship, maintained through regular reporting and meetings with the President and Chief Executive Officer of Berkshire Hathaway Energy and senior management team. The Company has not complied with main principles A2, A3, B2, B6, B7, D1, D2 and E2 for the reasons explained in the pages that follow.

Governance Framework

The governance framework provides oversight to all companies within the Northern Powergrid Group and illustrates the system by which they are directed and controlled.



¹ A copy of the Code is available from the Financial Reporting Council website at <https://www.frc.org.uk/>

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

CORPORATE GOVERNANCE STATEMENT

The Role of the Board

The board comprises five executive directors and two non-executive directors. The President and Chief Executive Officer is ultimately responsible for the leadership of the board, which includes setting the board's agenda and ensuring its effectiveness. Although the board does not include a balanced number of executive and non-executive directors, the board believes that it possesses the requisite skills and experience necessary to provide effective leadership, stewardship and control of the Company. The independent non-executive directors constructively challenge the executive board and management team on the delivery of the Company's strategic objectives.

All board directors have overall responsibility for the management of risk and the internal control environment which is designed to address Berkshire Hathaway Energy's US Sarbanes-Oxley Act requirement, the key features of which can be found on pages 22 to 23 of the Strategic Report. Matters reserved for board approval include but are not limited to, the declaration of dividends, the approval of the annual statutory and regulatory accounts and changes to capital structure.

To facilitate the delivery of their duties, the directors continually update their knowledge of and familiarity with the operations of the Company. This is supported by robust reporting arrangements, access to the Company's operations and interaction with its employees. Information is provided to the board in a timely manner to enable directors to commit sufficient time to the preparation for and attendance at board meetings. In addition, updates and briefings are circulated during the course of the regular board meeting cycle. The directors are able to utilise the advice and services of the Company Secretary and her team. Upon request, the directors have access to independent professional advice.

The board meets on a quarterly basis to review business performance, strategic initiatives and operational and risk-related issues. Additional board meetings are held as required. Meetings of the board are chaired by the President and Chief Executive Officer who has overall accountability for the operational management of both the Company and the Northern Powergrid Group.

Attendance at meetings by board members during the year was as follows:

| | | |
|---------------|--|-----|
| R Dixon | Non-executive Director (retired 26 October 2017) | 3/4 |
| T E Fielden | Finance Director | 6/6 |
| J M France | Regulation Director (resigned 5 April 2018) | 4/6 |
| T H France | General Counsel | 5/6 |
| N M Gill | Operations Director | 5/6 |
| P A Jones | President and Chief Executive Officer | 6/6 |
| A J MacLennan | Business Development Director | 6/6 |
| A R Marshall | Non-executive Director | 5/6 |
| P C Taylor | Non-executive Director | 3/6 |

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

CORPORATE GOVERNANCE STATEMENT

The Role of the Board (CONTINUED)

Relations with the Northern Powergrid Group's shareholder

The Northern Powergrid Group (which include the Company) has an established relationship with its shareholder, Berkshire Hathaway Energy, reflected by the leadership structure, whereby the President and Chief Executive Officer of the Northern Powergrid Group reports directly to the President and Chief Executive Officer of Berkshire Hathaway Energy.

Regular interaction and dialogue with Berkshire Hathaway Energy ensures that strategic views of the Northern Powergrid Group's shareholder are understood and aligned, and that appropriate values and standards are set. The relationship between the Northern Powergrid Group and its shareholder also negates the necessity to establish a nominations committee for the purpose of identifying board appointments and a remuneration committee to consider directors' and senior managers' remuneration. Both of these functions are undertaken by the appropriate representative of Berkshire Hathaway Energy and the President and Chief Executive Officer. All board appointments are considered with due regard to the board's overall composition including the balance of skills and experience ahead of recommendations being put to the board.

Executive directors' and senior managers' remuneration is considered by the appropriate representative of Berkshire Hathaway Energy on an annual basis and is explicitly linked to the performance evaluation process. Each individual's effectiveness is measured against both personal and Berkshire Hathaway Energy goals with all resulting awards based on merit and linked to the delivery of stretching accountabilities. All remuneration is designed to promote the long term success of the Company and the Northern Powergrid Group with no individual involved in determining their own remuneration.

Non-executive director remuneration is reviewed on an annual basis. Any increases are made in line with the wider Northern Powergrid Group's employee population and is subject to continued satisfactory performance. As the Company's Articles of Association do not require the periodic retirement and re-election of directors, the letters of appointment in place for each of the non-executive directors are reviewed regularly allowing for a mutual evaluation of the benefit of individuals remaining in post.

The board does not undertake an annual evaluation of its performance, as performance is continually monitored and assessed by Berkshire Hathaway Energy through the delivery of an agreed annual business plan. The committees reporting into the board are evaluated through the activity delivered in accordance with their terms of reference.

Management of the Company

Operational management of the Company's business is delegated to a single senior management team with specific functional responsibilities in respect of operations, safety, health and environment, asset management, customer service, business development, policy and markets, regulation, human resources, organisation development, legal and finance. The broader management team meets with the senior management team of the Northern Powergrid Group on a weekly and monthly basis to monitor performance and address issues of policy. A schedule of key delegations of authority has been approved by the board which enables senior managers to make decisions up to certain financial limits. These limits reflect the board's level of risk appetite.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

Diversity Policy

The Northern Powergrid Group has adopted a number of policies (including the policy on diversity at work and code of business conduct) that collectively comprise the policy on diversity. Diversity is actively supported through recruitment, educational programmes, employee opportunities and the Global Days of Service charitable support programme. All appointments (which includes board, board committee, and senior management appointments) are based on merit with due regard for diversity, including gender.

Board and Management Committees

During the year, there were a number of committees in operation, acting under delegated terms of reference which oversee the Northern Powergrid Group and report regularly on their activities.

| Committee | Composition | Duties |
|---|---|--|
| Health and Safety Management To manage the health and safety policy and performance of the Northern Powergrid Group | Chairman: P A Jones Members: - G M Earl, Director of Safety, Health and Environment - T E Fielden, Finance Director - T H France, General Counsel - N M Gill, Operations Director - A J MacLennan, Business Development Director | Meets bi-annually to - oversee the implementation and review the effectiveness of health and safety policy - develop the strategy for managing health and safety issues - monitor health and safety performance across the Northern Powergrid Group - consider policy changes - report to the board |
| Treasury To oversee and implement treasury policies | Chairman: T E Fielden Members: - W J Fehrman, President of Berkshire Hathaway Energy Company; - P J Goodman, Executive Vice-President and Chief Financial Officer, Berkshire Hathaway Energy - P A Jones, President and Chief Executive Officer - S J Lockwood, Group Financial Controller - L Bennett, Treasurer and Investor Reporting Manager - D Brady, Treasury and Reporting Manager | Meets as required to - oversee cash and liquidity management; - manage interest rate and foreign exchange risk; - manage bank relationships and secure long-term funding; - report to the board. |

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

| Committee | Composition | Duties |
|--|--|---|
| Pensions To oversee the Northern Powergrid Group's approach to the pension schemes | Chairman: T E Fielden Members: - S J Lockwood, Group Financial Controller - K Mawson, Head of Regulatory Finance and Systems; - N A Applebee, Director of People and Customer Service - G Pearson, Head of Performance and Quality - R Dougherty, Pensions Manager. | Meets quarterly to - exercise duties in respect of the DB Scheme and defined contribution scheme; - consider any matters impacting or requiring amendment relating to the DB Scheme or defined contribution scheme; report to the board. |
| Audit Committee To consider the application of corporate reporting, risk management and internal control principles | Chairman: J N Reynolds, non-executive Director (appointed as Chairman on 26 October 2017) Members: - R Dixon, non-executive Director (retired 26 October 2017) - T E Fielden, Finance Director | Meets annually to - carry out the functions required by DTR 7.1.3R; - oversee the GRMG - monitor the internal audit plan; - sub-delegate activities to another person or body as see fit. In December 2017, duties were sub-delegated to Berkshire Hathaway Energy's audit committee; - report to the board. |
| Governance and Risk Management Group To ensure effective corporate governance and risk management processes are in place | Chairman: T E Fielden Members: - N A Applebee, Director of People and Customer Service - M Drye, Director of Asset Management - G M Earl, Director of Safety, Health and Environment - P Erwin, Policy and Markets Director - T E Fielden, Finance Director - T H France, General Counsel - N M Gill, Operations Director - A J MacLennan, Business Development Director - A J Patterson, Director of Organisation Development | Meets three times per annum to - monitor the risk management framework; - oversee the Asset Risk Management Executive Review Group; - oversee Emergency Planning Co-ordination Group; - oversee the Information Security Committee; - report to the Audit Committee. |

Internal Control and Risk Management

Details of the main features of the Company's internal control and risk management systems can be found on pages 14 to 15.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

In preparing these financial statements, International Accounting Standard 1 requires the directors to:

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

Each of the directors as at the date of the Annual Reports and financial statements, whose names and functions are set out on page 3 in the Report of the Directors confirms that, to the best of their knowledge the Company's financial statements, prepared in accordance with applicable UK law and in conformity with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Strategic Report and the Report of the Directors include a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties it faces.

NON-FINANCIAL INFORMATION STATEMENT

In accordance with Section 414CB(7) of the Companies Act 2006, the directors have elected to set out the information required by Section 414CB (1) to (6) in the group annual report and audited consolidated financial statements of Northern Powergrid Holdings Company, a copy of which can be found on Northern Powergrid's corporate website.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER: 02906593

REPORT OF THE DIRECTORS FOR THE REGULATORY YEAR ENDED 31 MARCH 2018

GOING CONCERN

A review of the Company's business activities during the Regulatory Year, together with details regarding its future development, performance and position, its objectives, policies and processes for managing its capital, its financial risk management objectives and details of its exposures to trading risk, credit risk and liquidity risk are set out in the Strategic Report, the Report of the Directors and the appropriate notes to the financial statements.

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

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

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

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITOR

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

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

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

AUDITOR

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

ON BEHALF OF THE BOARD:



P A Jones
Director

12 July 2018

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

Independent Auditors' report to the Gas and Electricity Markets Authority (the "Regulator") and to Northern Powergrid (Northeast) Limited (the "Company")

Report on the audit of the Regulatory Accounts

Opinion

We have audited the regulatory accounts of Northern Powergrid (Northeast) Limited ("the Company") for the year ended 31 March 2018 which comprise the profit and loss account, the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of changes in equity, the principal accounting policies and the related notes 1 to 27. These Regulatory Accounts have been prepared under the accounting policies set out therein. The financial reporting framework that has been applied in their preparation is Standard Special Condition A30 of the Gas Distribution Licence (the "Regulatory Licence") and the accounting policies set out in the principal accounting policies on pages 33 to 43.

In our opinion, Northern Powergrid (Northeast) Limited's regulatory accounts presents fairly, in all material respects, in accordance with Standard Special Condition A30 of the Regulatory Licence and the Company's accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditor's responsibilities for the audit of the Regulatory Accounts section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the Regulatory Accounts in the UK, including the Financial Reporting Council's Ethical Standard, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw your attention to Note 1 of the Regulatory Accounts, which describes the basis of accounting. The Regulatory Accounts are separate from the statutory financial statements of the Company and are to meet the requirements of Standard Special Condition A30 of the Regulatory Licence. As a result, the Regulatory Accounts may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

Independent Auditors' report to the Gas and Electricity Markets Authority (the "Regulator") and to Northern Powergrid (Northeast) Limited (the "Company")

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounts is not appropriate; or
- the directors have not disclosed in the Regulatory Accounts any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Regulatory Accounts are authorised for issue.

Other Information

The other Information comprises all of the information in the annual report other than the Regulatory Accounts and our auditor's report thereon. The directors are responsible for the other Information. Our opinion on the Regulatory Accounts does not cover the other Information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the Regulatory Accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement or inconsistency of this other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on pages 24-25, the directors are responsible for the preparation of the Regulatory Accounts in accordance with Standard Special Condition A30 of the Regulatory Licence and the Company's accounting policies.

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Regulatory Accounts that are free from material misstatement, whether due to fraud or error.

In preparing the Regulatory Accounts, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

Independent Auditors' report to the Gas and Electricity Markets Authority (the "Regulator") and to Northern Powergrid (Northeast) Limited (the "Company")

Auditors' responsibilities for the Audit of the Regulatory Accounts

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Regulatory Accounts.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the Regulator in order to meet the requirements of Standard Special Condition A30 of the Regulatory Licence. Our audit work has been undertaken so that we might state to the Group and the Regulator those matters that we have agreed to state to them in an independent auditor's report, in order (a) to assist the company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Regulator, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounts within the annual report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 December 2017 on which we reported on 25 April 2018, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Dave Johnson, Senior Statutory Auditor

for and on behalf of Deloitte LLP
Statutory auditor
Newcastle, United Kingdom



19 July 2018

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2018

| | Notes | 2018 £m | 2017 £m |
|---|-------|----------------|----------------|
| Revenue | 3 | 327.9 | 336.4 |
| Cost of sales | | <u>(13.1)</u> | <u>(14.1)</u> |
| Gross profit | | 314.8 | 322.3 |
| Distribution costs | | <u>(110.6)</u> | <u>(103.1)</u> |
| Administrative costs | | <u>(75.5)</u> | <u>(65.8)</u> |
| Operating profit | 6 | 128.7 | 153.4 |
| Profit on disposal of property, plant and equipment | | 0.3 | 0.4 |
| Investment income | 7 | - | 0.4 |
| Finance costs | 8 | <u>(28.6)</u> | <u>(29.0)</u> |
| Profit before tax | | 100.4 | 125.2 |
| Income tax expense | 9 | <u>(19.8)</u> | <u>(5.7)</u> |
| Profit on ordinary activities after taxation | | 80.6 | 119.5 |

All activities relate to continuing operations.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2018

There has been no other comprehensive income for the Company. Therefore, total comprehensive income for the year is £80.6 million (2017: £119.5 million).

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2018

| | Notes | 2018 £m | 2017 £m |
|---------------------------------------|-------|----------------|----------------|
| Assets | | | |
| Non-current assets | | | |
| Property, plant and equipment | 11 | 2,364.9 | 2,267.4 |
| Intangible assets | 12 | 49.2 | 42.1 |
| | | <u>2,414.1</u> | <u>2,309.5</u> |
| Current assets | | | |
| Inventories | 14 | 13.3 | 11.5 |
| Trade and other receivables | 15 | 50.6 | 48.4 |
| | | <u>63.9</u> | <u>59.9</u> |
| Total assets | | <u>2,478.0</u> | <u>2,369.4</u> |
| Equity | | | |
| Called-up share capital | 21 | 200.0 | 200.0 |
| Retained earnings | 22 | 798.8 | 740.9 |
| Total equity | | <u>998.8</u> | <u>940.9</u> |
| Liabilities | | | |
| Current liabilities | | | |
| Trade and other payables | 16 | 84.9 | 88.8 |
| Tax payable | 16 | 11.1 | 13.4 |
| Borrowings | 17 | 172.3 | 102.4 |
| Deferred revenue | 19 | 22.8 | 21.4 |
| Provisions | 20 | 1.1 | 0.7 |
| | | <u>292.2</u> | <u>226.7</u> |
| Non-current liabilities | | | |
| Borrowings | 17 | 507.0 | 547.0 |
| Deferred tax | 18 | 91.4 | 88.5 |
| Deferred revenue | 19 | 588.6 | 566.2 |
| Provisions | 20 | 0.1 | 0.1 |
| | | <u>1,187.1</u> | <u>1,201.8</u> |
| Total liabilities | | <u>1,479.3</u> | <u>1,428.5</u> |
| Totally equity and liabilities | | <u>2,478.0</u> | <u>2,369.4</u> |

The financial statements were approved by the board of directors and authorised for issue on 12 July 2018 and were signed on its behalf by:



P A Jones
Director

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2018

| | Share Capital (Note 21) £m | Retained Earnings (Note 22) £m | Total Equity £m |
|---|-------------------------------------|---|-----------------------|
| At 1 April 2016 | 200.0 | 643.2 | 843.2 |
| Total comprehensive income for the year | - | 119.5 | 119.5 |
| Dividends paid | - | (21.8) | (21.8) |
| At 31 March 2017 | 200.0 | 740.9 | 940.9 |
| Total comprehensive income for the year | - | 80.6 | 80.6 |
| Dividends paid | - | (22.7) | (22.7) |
| At 31 March 2018 | 200.0 | 798.8 | 998.8 |

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2018

| | Notes | 2018 £m | 2017 £m |
|--|-------|----------------|----------------|
| Cash Flows from operating activities | | | |
| Cash generated from operations | 23 | 189.6 | 217.7 |
| Finance costs paid | | (31.5) | (31.0) |
| Tax paid | | (19.3) | (3.8) |
| Net cash from operating activities | | 138.8 | 182.9 |
| Cash flows used in investing activities | | | |
| Purchase of property, plant and equipment | | (178.6) | (194.2) |
| Purchase of intangible assets | | (12.4) | (12.5) |
| Proceeds from disposals of property, plant and equipment | | 0.3 | 0.4 |
| Customer contributions receipts | | 44.5 | 50.5 |
| Net cash used in investing activities | | (146.2) | (155.8) |
| Cash flows from financing activities | | | |
| Equity dividends paid | | (22.7) | (21.8) |
| Repayments of external borrowings | | (40.0) | - |
| Movement in short-term loans from Group undertaking | | 60.1 | (5.3) |
| Utilisation of external short-term borrowings | | 10.0 | - |
| Net cash from/(used in) financing activities | | 7.4 | (27.1) |
| Net movement in cash and cash equivalents | | - | - |
| Cash and cash equivalents at beginning of year | | - | - |
| Cash and cash equivalents at end of year | | - | - |

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018

1 GENERAL INFORMATION

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

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

2 ACCOUNTING POLICIES

Accounting convention and basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The financial statements have also been prepared in accordance with IFRS 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 except where license conditions apply using the same accounting rules as the Statutory accounts.

The financial statements have been prepared under the historical cost convention. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

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

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

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date;

Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3 inputs are unobservable inputs for the asset or liability.

The principal accounting policies are set out below.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Application of new and revised IFRSs

In the current year, the Company has a number of amendments to IFRSs issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for an accounting period that begins on or after 1 January 2017:

- | | |
|--|--|
| - Amendments to IAS 7 Statement of Cash Flows | The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The directors of the Company do not anticipate the application of these amendments has had no material impact on the Company's financial statements. |
| - Amendments to IAS 12 Income Taxes | The amendments to IAS 12 Income Taxes clarify when a deferred tax asset should be recognised for unrealised losses. The application of the amendments has not resulted in any impact on the financial performance or financial position of the company. |
| - Annual Improvements to IFRSs 2014-2016 Cycle | The annual improvements to IFRSs 2014-2016 Cycle include a number of amendments to IFRSs. The application of these amendments has had no effect on the Company's financial statement. |

New and revised standards in issue but not yet effective

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective for the year ended 31 March 2018:

- | | |
|--|---|
| - IFRS 9 - Financial Instruments (1 January 2018). | <p>A revised version of IFRS 9, Financial Instruments, was issued in July 2014 mainly to include: a) impairment requirements for financial assets; and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' ("FVTOCI") measurement category for certain simple debt instruments.</p> <p>The directors of the Company anticipate that the application of IFRS 9 will not have a material impact on amounts reported in respect of the Company's financial assets and financial liabilities.</p> |
|--|---|

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

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

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

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

The directors of the Company anticipate that the application of IFRS 15 will not have a material impact on amounts reported in respect of the Company's financial position or performance.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

- FRS 16 - Leases (1 January 2019)

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

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

As of 31 March 2018, the Company has non-cancellable operating lease commitments of £26.3 million. IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Company will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16. The new requirement to recognise a right-of-use asset and a related lease liability is expected to have a significant impact on the amounts recognised in the Company's statement of financial position and the directors are currently assessing its potential impact. The directors of the Company anticipate that the application of IFRS 16 is unlikely to have a material impact on amounts reported in the statement of profit or loss.

Critical judgements in applying accounting policies

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

- The allocation of overheads to property, plant and equipment which results in higher capital expenditure and a reduction in operating costs. Costs are capitalised where it is probable that future economic benefits associated with the asset will flow to the enterprise; and the cost of the item can be reliably measured.

The allocation of overheads to capital is derived from a detailed analysis of the costs and their relevant cost drivers, which is reviewed on an annual basis. There has been no change in the methodology since the prior year.

The amount of overheads capitalised in the year was £40.0m (2017: £38.3m).

Key sources of estimation uncertainty

In the preparation of financial statements in conformity with IFRS the Directors did not identify any key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Revenue

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

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

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

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

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

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

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

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

Research costs

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

Operating profit

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Taxation

The income tax expense represents the sum of the tax currently payable and deferred tax.

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

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

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

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

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

Foreign Currencies

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment and depreciation

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

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

| | |
|--|-----------------------------------|
| Distribution system assets..... | 45 years |
| Distributed generation assets included in distribution system assets..... | 15 years |
| Metering equipment included in distribution system assets | up to 5 years |
| Information technology equipment included in distribution system assets..... | up to 10 years |
| Non-operational assets: | |
| Buildings – freehold..... | up to 60 years |
| Buildings – leasehold..... | lower of lease period or 60 years |
| Fixtures and equipment..... | up to 10 years |

Freehold land is not depreciated.

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

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Internally-generated intangible assets

An internally generated intangible asset arising from development is recognised if the conditions set out in IAS 38 relating to the recognition of intangible assets are met. The amount initially recognised for internally-generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria. Amortisation is recognised on a straight-line basis over their estimated useful lives.

Impairment of tangible and intangible assets

At the balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired.

Where the recoverable amount is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Software development costs

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

Investments

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

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. Raw materials and goods for resale are valued at purchase cost on an average price basis. Work in progress is valued at the cost of direct materials and labour plus attributable overheads based on the normal level of activity less progress payments.

Leases

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

Operating lease rentals are charged to the statement of profit or loss in equal annual amounts over the lease term.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Trade receivables

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

Trade payables

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

Borrowings

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in profit or loss in the period which they are incurred.

Financial instruments

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

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

Provisions

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

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

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

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.

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Fair value measurements

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

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

Financial Assets

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

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

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

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

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

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

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

2 ACCOUNTING POLICIES (CONTINUED)

Capital management

The Group manages its capital centrally to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from 2016.

Pensions

The Company contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "DB Scheme"), a defined benefit scheme. There is no contractual agreement or policy to allow for accounting for the company's share of the defined benefit scheme's liabilities and assets therefore the scheme has been accounted for as a defined contribution scheme.

The company's share of the net defined benefit cost is in relation to ordinary contribution and deficit repair payments. The contribution is determined by the number of current employees in the Company in the pension scheme. The deficit repair payments are agreed by the Group with the Trustees, these deficit repair payments are allocated by the group according to the liability relating to previous and current employees on the scheme within Northern Electric plc, Northern Powergrid (Yorkshire) plc, and Northern Powergrid (Northeast) Ltd. The estimated amount of contributions expected to be paid to the pension scheme by the Company during the next financial year is £17.7m (2017: £19.7m).

The Company also participates in a defined contribution scheme. Contributions payable to the defined contribution scheme are charged to the statement of profit or loss in the year or capitalised as appropriate when employees have rendered service entitling them to the contributions.

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

NORTHERN POWERGRID (NORTHEAST) LIMITED

REGISTERED NUMBER 02906593

NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

3 SEGMENTAL REPORTING

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief Executive Officer of the Northern Powergrid Group in order to allocate resources to those segments and to assess their performance.

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

| | Distribution 2018 £m | Distributed Generation 2018 £m | Excluded Services 2018 £m | Metering 2018 £m | De Minimis 2018 £m | Total 2018 £m |
|------------------------------------|----------------------------|---|------------------------------------|------------------------|-----------------------------|---------------------|
| STATEMENT OF PROFIT OR LOSS | | | | | | |
| Revenue | 298.1 | 3.6 | 1.5 | 3.9 | 20.9 | 327.9 |
| Cost of sales | (10.7) | - | (1.1) | - | (1.2) | (13.1) |
| Gross profit | 287.4 | 3.6 | 0.4 | 3.9 | 19.7 | 314.8 |
| Distribution costs | (102.2) | (6.9) | - | (1.6) | - | (110.6) |
| Administration costs | (55.4) | - | (0.4) | (0.4) | (19.4) | (75.6) |
| Operating profit/(loss) | 129.8 | (3.4) | - | 2.0 | 0.3 | 128.7 |
| OTHER INFORMATION | | | | | | |
| Capital tangible additions | 138.3 | 16.1 | 21.7 | - | - | 176.1 |
| Capital intangible additions | 11.7 | 0.3 | 0.4 | - | - | 12.4 |
| | Distribution 2017 £m | Distributed Generation 2017 £m | Excluded Services 2017 £m | Metering 2017 £m | De Minimis 2017 £m | Total 2017 £m |
| STATEMENT OF PROFIT OR LOSS | | | | | | |
| Revenue | 307.4 | 3.1 | 1.7 | 4.4 | 19.8 | 336.4 |
| Cost of sales | (12.0) | - | (1.0) | - | (1.1) | (14.1) |
| Gross profit | 295.4 | 3.1 | 0.7 | 4.4 | 18.7 | 322.3 |
| Distribution costs | (96.1) | (5.4) | - | (1.6) | - | (103.1) |
| Administration costs | (46.8) | - | (0.3) | (0.4) | (10.3) | (65.8) |
| Operating profit/(loss) | 152.5 | (2.3) | 0.4 | 2.4 | 0.4 | 153.4 |
| OTHER INFORMATION | | | | | | |
| Capital tangible additions | 149.9 | 20.6 | 24.1 | - | - | 194.6 |
| Capital intangible additions | 12.6 | - | - | - | - | 12.6 |

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

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4 STAFF COSTS

| | 2018 £m | 2017 £m |
|---|---------------|---------------|
| Salaries | 51.5 | 50.1 |
| Social security costs | 5.6 | 5.7 |
| Defined benefit pension costs | 26.1 | 21.2 |
| Defined contribution pension costs | 2.1 | 1.6 |
| | <u>85.3</u> | <u>78.6</u> |
| Less charged to property, plant and equipment | <u>(43.2)</u> | <u>(41.7)</u> |
| | <u>42.1</u> | <u>36.9</u> |

A large proportion of the Company's employees are members of the Northern Powergrid Group of the ESPS, details of which are given in Note 24.

The average monthly number of employees during the year was:

| | 2018 No. | 2017 No. |
|----------------|--------------|--------------|
| Technical | 339 | 331 |
| Industrial | 438 | 438 |
| Administration | 191 | 194 |
| Other | 117 | 96 |
| | <u>1,085</u> | <u>1,059</u> |

5 DIRECTORS' & KEY PERSONNEL REMUNERATION

| DIRECTORS' REMUNERATION | 2018 £000 | 2017 £000 |
|---|--------------|--------------|
| <u>Highest Paid</u> | | |
| Short-term employee benefits | 402 | 321 |
| Post-employment benefits | - | - |
| Other long-term benefits | 435 | 370 |
| | <u>837</u> | <u>691</u> |
| | 2018 £000 | 2017 £000 |
| <u>Total</u> | | |
| Short-term employee benefits | 837 | 674 |
| Post-employment benefits | 44 | 38 |
| Other long-term benefits | 682 | 624 |
| | <u>1,563</u> | <u>1,336</u> |
| Directors who are members of the defined benefit scheme | <u>3</u> | <u>3</u> |
| Accrued pension benefit relating to highest paid director | <u>-</u> | <u>-</u> |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

5 DIRECTORS' & KEY PERSONNEL REMUNERATION (CONTINUED)

| OTHER KEY PERSONNEL REMUNERATION | 2018 £000 | 2017 £000 |
|----------------------------------|--------------|--------------|
| <u>Total</u> | | |
| Short-term employee benefits | 451 | 404 |
| Post-employment benefits | 70 | 81 |
| Other long-term benefits | 228 | 238 |
| | <u>749</u> | <u>723</u> |

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

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

6 OPERATING PROFIT

| | 2018 £m | 2017 £m |
|--|--------------|--------------|
| This is stated after charging/(crediting): | | |
| Staff costs (Note 4) | 42.1 | 36.9 |
| Research and Development | 2.1 | 0.5 |
| Depreciation of property, plant and equipment | 78.6 | 74.7 |
| Amortisation of deferred revenue | (21.6) | (19.7) |
| Amortisation of intangibles | 5.3 | 4.1 |
| Impairment loss on trade and other receivables | 0.2 | 0.4 |
| Analysis of auditor's remuneration is as follows: | 2018 £000 | 2017 £000 |
| Fees payable to the Company's auditor for the statutory audit of the Company's annual accounts | 121 | 125 |
| Other services supplied pursuant to legislation in respect of regulatory accounts | 45 | 45 |
| Other services | <u>15</u> | <u>-</u> |

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

7 INVESTMENT INCOME

| | 2018 £m | 2017 £m |
|---|------------|------------|
| Interest receivable from Group undertakings | <u>-</u> | <u>0.4</u> |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

8 FINANCE COSTS

| | 2018 £m | 2017 £m |
|---|------------|------------|
| Interest payable on loans from Group undertakings | 23.3 | 23.2 |
| Interest payable on other loans | 8.2 | 8.4 |
| Total interest expense | 31.5 | 31.6 |
| Amounts included in the cost of qualifying assets | (2.9) | (2.6) |
| Total finance costs | 28.6 | 29.0 |

Interest is capitalised at 5.27% (2017: 5.26%).

9 INCOME TAX

| | 2018 £m | 2017 £m |
|--|------------|------------|
| Analysis of tax expense | | |
| Corporation tax | 16.9 | 12.7 |
| Deferred tax | 2.9 | (7.0) |
| Total tax expense in statement of profit or loss | 19.8 | 5.7 |

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

| | 2018 £m | 2017 £m |
|---|------------|------------|
| Profit on ordinary activities before income tax | 100.4 | 125.2 |
| The total charge can be reconciled to the accounting profit as follows: Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 19% (2017: 20%) | 19.1 | 25.0 |
| Effects of: | | |
| Changes in legislation | (0.6) | (5.0) |
| Under/(over) provision for prior years | 1.4 | (14.0) |
| Non-taxable income | (0.1) | (0.3) |
| Tax expense | 19.8 | 5.7 |

NORTHERN POWERGRID (NORTHEAST) LIMITED**REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)****9 INCOME TAX EXPENSE (CONTINUED)**

| | 2018 £m | 2017 £m |
|---|------------|------------|
| Tax expense comprises: | | |
| Current tax expense: | | |
| Corporation tax charge for the year | 17.3 | 23.4 |
| Over provision for prior years | (0.4) | (10.7) |
| Total current tax charge | 16.9 | 12.7 |
| Deferred tax: | | |
| Deferred tax expenses relating to the origination and reversal of temporary differences | 3.5 | (2.0) |
| Effect of changes in legislation | (0.6) | (5.0) |
| Total deferred tax charge/(credit) | 2.9 | (7.0) |
| Tax on profit before tax | 19.8 | 5.7 |

The Finance Act No 2 2015 included provisions to reduce the corporation tax to 19% with effect from 1 April 2017 and Finance Act 2016 introduced a further reduction in the main rate corporation tax to 17% from 1 April 2020. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

10 DIVIDENDS

| | 2018 Pence per share | 2017 Pence per share | 2018 £m | 2017 £m |
|---------------|-------------------------|-------------------------|------------|------------|
| Dividend paid | 11.3 | 10.9 | 22.7 | 21.8 |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

11 PROPERTY, PLANT AND EQUIPMENT

| | Distribution system | Fixtures and Equipment | Non- Operational Land & Buildings | Total |
|---------------------------------|------------------------|------------------------------|--|----------------|
| | £m | £m | £m | £m |
| COST | | | | |
| At 1 April 2016 | 2,657.8 | 35.3 | 4.2 | 2,697.3 |
| Additions | 189.6 | - | - | 194.6 |
| Disposals | (8.0) | (0.6) | - | (8.6) |
| At 1 April 2017 | 2,839.4 | 39.7 | 4.2 | 2,883.3 |
| Additions | 173.9 | 2.2 | - | 176.1 |
| Disposals | (8.9) | (0.2) | - | (9.1) |
| At 31 March 2018 | <u>3,004.4</u> | <u>41.7</u> | <u>4.2</u> | <u>3,050.3</u> |
| ACCUMULATED DEPRECIATION | | | | |
| At 1 April 2016 | 523.5 | 24.3 | 1.9 | 549.7 |
| Charge for the year | 70.8 | 3.6 | 0.3 | 74.7 |
| Disposals | (7.9) | (0.6) | - | (8.5) |
| At 1 April 2017 | 586.4 | 27.3 | 2.2 | 615.9 |
| Charge for the year | 74.3 | 4.0 | 0.3 | 78.6 |
| Disposals | (8.9) | (0.2) | - | (9.1) |
| At 31 March 2018 | <u>651.8</u> | <u>31.1</u> | <u>2.5</u> | <u>685.4</u> |
| Net book value at 31 March 2018 | <u>2,352.6</u> | <u>10.6</u> | <u>1.7</u> | <u>2,364.9</u> |
| Net book value at 31 March 2017 | <u>2,253.0</u> | <u>12.4</u> | <u>2.0</u> | <u>2,267.4</u> |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

11 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Assets in the course of construction included above

| | Distribution system | Fixtures and Equipment | Non- Operational Land & Buildings | Total |
|-------------------|------------------------|------------------------------|--|---------|
| | £m | £m | £m | £m |
| At 1 April 2016 | 162.0 | - | - | 162.0 |
| Additions | 189.6 | - | - | 189.6 |
| Available for use | (162.1) | - | - | (162.1) |
| At 1 April 2017 | 189.5 | - | - | 189.5 |
| Additions | 173.9 | - | - | 173.9 |
| Available for use | (146.9) | - | - | (146.9) |
| At 31 March 2018 | 216.5 | - | - | 216.5 |

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

| | 2018 £m | 2017 £m |
|----------------|------------|------------|
| Freehold | 1.3 | 1.5 |
| Long-leasehold | 0.4 | 0.5 |
| | 1.7 | 2.0 |

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £17.7m (2017: £22.1m).

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)**12 INTANGIBLE ASSETS**

| | Software Development Costs £m |
|---------------------------------|--|
| COST | |
| At 1 April 2016 | 58.7 |
| Additions | 12.6 |
| | 71.3 |
| At 1 April 2017 | 12.4 |
| Additions | |
| | 83.7 |
| At 31 March 2018 | |
| AMORTISATION | |
| At 1 April 2015 | 25.1 |
| Charge for the year | 4.1 |
| | 29.2 |
| At 1 April 2017 | 5.3 |
| Charge for the year | |
| | 34.5 |
| At 31 March 2018 | |
| Net book value at 31 March 2018 | 49.2 |
| Net book value at 31 March 2017 | 42.1 |

13 INVESTMENTS

Details of the investments held by the Company as at 31 March 2018 are listed below:

| Name of Company | Country of Registration | Holding of Ordinary Shares | Proportion | Nature of Business |
|--------------------------------------|----------------------------|----------------------------------|------------|--|
| Electralink Limited | England and Wales | 619 at 10p | 6.7% | Data transfer network operator |
| MRA Service Company Limited | England and Wales | 1 at £1 | 1.0% | Governance of the electricity industry's Master Registration Agreement |
| DCUSA Limited | England and Wales | 1 at £1 | 1.7% | Management and governance of the Distribution Connection and Use of System Agreement |
| Smart Energy Code Company Limited | England and Wales | 1 at £1 | 0.9% | Management and governance of the Smart Energy Code |
| 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 (2017: £62), MRA Service Company Limited £1 (2017: £1), DCUSA Limited £1 (2017: £1), Smart Energy Code Company Limited £1 (2017: £1) and Northern Electric Finance plc £50,000 (2017: £50,000). The registered office address of Northern Electric Finance plc is Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)**14 INVENTORIES**

| | 2018 £m | 2017 £m |
|-------------------------------|-------------|-------------|
| Raw materials and consumables | 12.8 | 11.2 |
| Work in progress | 0.5 | 0.3 |
| | <u>13.3</u> | <u>11.5</u> |

15 TRADE AND OTHER RECEIVABLES

| | 2018 £m | 2017 £m |
|--|-------------|-------------|
| Distribution use of system receivables | 45.3 | 45.8 |
| Amounts receivable from sale of goods and services | 2.4 | 0.2 |
| Prepayments and accrued income | 1.7 | 1.0 |
| Other receivables | 1.2 | 1.4 |
| | <u>50.6</u> | <u>48.4</u> |

The directors consider that the carrying amount of trade and other receivables approximates their fair value calculated by discounting the future cash flows at the market rate at the statement of financial position date. The maximum exposure to risk to the Company is the book value of these receivables less any provisions for impairment. The fair valuation of assets is based on Level 1 inputs.

Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 20% of distribution revenues in the regulatory year to 31 March 2018 (2017: 23%); and British Gas accounting for approximately 14% of distribution revenues in the regulatory year to 31 March 2018 (2017: 15%). 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 £1.4m as at 31 March 2018 (2017: £0.4m).

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £0.3m which have been placed into administration and provided in full at the regulatory year-end (2017: £0.3)

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.

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

15 TRADE AND OTHER RECEIVABLES (CONTINUED)

Amounts receivable from sale of goods and services (continued)

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £2.1m (2017: £1.1m) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.5m (2017: £0.3m) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 295 days (2017: 223 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.1m (2017: £0.1m). These amounts are past due at the reporting date and the Company has not provided for any amounts as not being recoverable because there has not been a significant change in credit quality and the amounts are still considered recoverable. The Company does not hold any collateral over these balances. The average age of these receivables is 99 days (2017: 78 days).

Ageing of past due but not impaired receivables

| | 2018 £m | 2017 £m |
|--------------|------------|------------|
| 30-60 days | - | 0.1 |
| 60-120 days | 0.1 | - |
| 120-210 days | - | - |
| Total | 0.1 | 0.1 |

Movement in the allowance for doubtful debts

| | £m | £m |
|---|------------|------------|
| At 1 April | 0.6 | 0.2 |
| Amounts recognised in statement of profit or loss | 0.2 | 0.4 |
| Amounts utilised/written off in the year | - | - |
| At 31 March | 0.8 | 0.6 |

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

Included in the allowance for doubtful debts are specific trade receivables, with a balance of £0.4m (2017: £0.2m), for companies 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.

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

15 TRADE AND OTHER RECEIVABLES (CONTINUED)

Categories of financial assets

| | 2018 £m | 2017 £m |
|---|--------------------|--------------------|
| Loans and receivables at amortised cost | <u>48.9</u> | <u>47.4</u> |
| Total financial assets | <u>48.9</u> | <u>47.4</u> |
| Non-current assets | 2,414.1 | 2,309.5 |
| Inventories | 13.3 | 11.5 |
| Prepayments and accrued income | <u>1.7</u> | <u>1.0</u> |
| Total non-financial assets | <u>2,429.1</u> | <u>2,322.0</u> |
| Total Assets | <u>2,478.0</u> | <u>2,369.4</u> |

16 OTHER FINANCIAL LIABILITIES

Trade and other payables

| | 2018 £m | 2017 £m |
|--|--------------------|--------------------|
| Payments received on account | 45.1 | 45.6 |
| Trade payables | 8.2 | 1.5 |
| Amounts owed to Group undertakings (Note 26) | 0.5 | 0.5 |
| Other taxes and social security costs | 5.4 | 3.7 |
| Accruals | 20.1 | 32.3 |
| Other payables | <u>5.6</u> | <u>5.3</u> |
| | <u>84.9</u> | <u>88.9</u> |

Current income tax liabilities

| | 2018 £m | 2017 £m |
|-----------------|--------------------|--------------------|
| Corporation tax | <u>11.1</u> | <u>13.4</u> |

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the statement of financial position date. The fair valuation of liabilities is based on Level 1 inputs. Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Invoices are paid at the end of the month following the date of the invoice. The Company has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

16 OTHER FINANCIAL LIABILITIES (CONTINUED)

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

| | Less than 3 months £m | 3 months To 1 year £m | 1 to 5 Years £m | 5+ Years £m | Total £m |
|-------------------------------|--------------------------------|-----------------------------|-----------------------|-------------------|----------------|
| 2018: | | | | | |
| Non-interest bearing | 39.8 | - | - | - | 39.8 |
| Variable interest rate | | - | - | - | |
| liability | 111.7 | | | | 111.7 |
| Fixed interest rate liability | 2.6 | 66.4 | 225.1 | 584.1 | 878.2 |
| | <u>154.1</u> | <u>66.4</u> | <u>225.1</u> | <u>584.1</u> | <u>1,029.7</u> |
| 2017: | | | | | |
| Non-interest bearing | 43.3 | - | - | - | 43.3 |
| Variable interest rate | | - | - | - | |
| liability | 51.6 | | | | 51.6 |
| Fixed interest rate liability | 2.6 | 68.0 | 277.4 | 600.7 | 948.7 |
| | <u>97.5</u> | <u>68.0</u> | <u>277.4</u> | <u>600.7</u> | <u>1,043.6</u> |

Categories of financial liabilities

| | 2018 £m | 2017 £m |
|--------------------------------------|----------------|----------------|
| Loans and payables at amortised cost | 693.6 | 656.2 |
| Total financial liabilities | <u>693.6</u> | <u>656.2</u> |
| Payments received on account | 45.1 | 45.6 |
| Income tax liabilities | 102.5 | 101.8 |
| Other taxes and social security | 5.4 | 3.7 |
| Accruals | 20.1 | 32.8 |
| Deferred revenue | 611.4 | 587.6 |
| Provisions | 1.2 | 0.8 |
| Total non-financial liabilities | <u>785.7</u> | <u>772.3</u> |
| Total liabilities | <u>1,479.3</u> | <u>1,428.5</u> |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

17 BORROWINGS

The Directors' consideration of liquidity and interest rate is described in the Strategic Report on page 5.

| | Book value | | Fair value | |
|---|--------------|--------------|--------------|--------------|
| | 2018 | 2017 | 2018 | 2017 |
| | £m | £m | £m | £m |
| Loans | 210.3 | 240.5 | 219.0 | 258.9 |
| Amounts owed to Group undertakings | 469.0 | 408.9 | 586.6 | 547.8 |
| | 679.3 | 649.4 | 805.6 | 806.7 |
| The borrowings are repayable as follows: | | | | |
| On demand or within one year | 172.3 | 102.4 | 172.3 | 103.6 |
| After one years | 507.0 | 547.0 | 633.3 | 703.1 |
| | 679.3 | 649.4 | 805.6 | 806.7 |
| Analysis of borrowings: | | | | |
| Short-term loan | 10.0 | - | 10.0 | - |
| Yorkshire Electricity Group plc short-term loan | 111.7 | 51.6 | 111.7 | 51.6 |
| Northern Electric Finance plc 2020 – 8.875% | 104.1 | 104.1 | 122.2 | 131.0 |
| Northern Electric Finance plc 2035 – 5.125% | 50.4 | 50.4 | 68.2 | 70.7 |
| Yorkshire Electricity Group plc 2037 – 5.9% | 101.5 | 101.5 | 148.2 | 153.5 |
| Northern Electric Finance plc 2037 – 5.125% | 101.3 | 101.3 | 136.3 | 141.0 |
| European Investment Bank 2018 – 4.065%* | - | 40.2 | - | 41.4 |
| European Investment Bank 2019 – 4.241%* | 40.2 | 40.2 | 40.2 | 42.9 |
| European Investment Bank 2020 – 4.386%* | 39.2 | 39.2 | 41.5 | 43.4 |
| European Investment Bank 2027 – 2.564% | 120.9 | 120.9 | 127.3 | 131.2 |
| | 679.3 | 649.4 | 805.6 | 806.7 |

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

* The 2018, 2019 and 2020 borrowings from the European Investment Bank were drawn down in twelve tranches. The interest rates shown below are average rates for those repayment dates. The spread of interest rates is as follows:

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)**17 BORROWINGS (CONTINUED)**

Interest on short-term loans and inter-company short term loans is charged at a floating rate of LIBOR plus 0.35%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £0.8m 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 March 2018 totalled £669.2m. Using the RAV value as at March 2018, as outlined by Ofgem in its electricity distribution price control financial model published in November 2016, and adjusting for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at 31 March 2018 of £1,335.9m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 49.4% (2017: 49.3%).

At 31 March 2018, the Company had available £84.0m (2017: £94.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

18 DEFERRED TAX

| | Accelerated Tax Depreciation £m | Other £m | Total £m |
|---------------------------------------|--|-------------|-------------|
| At 1 April 2016 | 95.7 | (0.2) | 95.5 |
| Credit to statement of profit or loss | (6.9) | (0.1) | (7.0) |
| At 1 April 2017 | 88.8 | (0.3) | 88.5 |
| Credit to statement of profit or loss | 2.9 | - | 2.9 |
| At 31 March 2018 | 91.7 | (0.3) | 91.4 |

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

19 DEFERRED REVENUE

| | 2018 £m | 2017 £m |
|-------------------------------------|--------------|--------------|
| At 1 April 2017 | 587.6 | 553.4 |
| Additions | 45.4 | 53.9 |
| Amortisation | (21.6) | (19.7) |
| At 31 March 2018 | <u>611.4</u> | <u>587.6</u> |
| | 2018 £m | 2017 £m |
| Included in current liabilities | 22.8 | 21.4 |
| Included in non-current liabilities | <u>588.6</u> | <u>566.2</u> |
| | <u>611.4</u> | <u>587.6</u> |

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

20 PROVISIONS

| | Claims £m | Other £m | Total £m |
|--|--------------|-------------|-------------|
| At 1 April 2016 | 0.9 | 0.6 | 1.5 |
| Utilised/paid in the year | (0.8) | (0.3) | (1.1) |
| Charged to the statement of profit or loss | <u>0.4</u> | <u>0.1</u> | <u>0.6</u> |
| At 1 April 2017 | 0.5 | 0.3 | 0.8 |
| Utilised/paid in the year | (0.6) | (0.1) | (0.7) |
| Charged to statement of profit or loss | <u>1.0</u> | <u>0.1</u> | <u>1.1</u> |
| At 31 March 2018 | <u>0.9</u> | <u>0.3</u> | <u>1.2</u> |
| | 2018 £m | 2017 £m | |
| Included in current liabilities | 1.1 | 0.8 | |
| Included in non-current liabilities | <u>0.1</u> | <u>0.1</u> | |
| | <u>1.2</u> | <u>0.9</u> | |

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

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

21 SHARE CAPITAL

| | 2018 No./£ | 2017 No./£ |
|------------------------------------|--------------------|--------------------|
| Ordinary shares of £1 each | 200.0 | 200.0 |
| Allotted, called-up and fully paid | <u>200,000,100</u> | <u>200,000,100</u> |

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

22 RETAINED EARNINGS

| | Retained Earnings £m |
|---|----------------------------|
| At 1 April 2016 | 643.2 |
| Total comprehensive income for the year | 119.5 |
| Dividends paid | <u>(21.8)</u> |
| At 31 March 2017 | 740.9 |
| Total comprehensive income for the year | 80.6 |
| Dividends paid | <u>(22.7)</u> |
| At 31 March 2018 | <u>798.8</u> |

23 RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS

| | 2018 £m | 2017 £m |
|--|--------------|--------------|
| Profit before income tax | 100.4 | 125.2 |
| Depreciation and amortisation | 83.9 | 78.8 |
| Profit on disposal of fixed assets | (0.3) | (0.4) |
| Amortisation of deferred revenue | (21.6) | (19.7) |
| Movement in provisions | 0.4 | (0.6) |
| Finance costs | 28.6 | 29.0 |
| Investment Income | - | (0.4) |
| Operating cash flows before movements in working capital | <u>191.4</u> | <u>211.9</u> |
| Increase in inventories | (1.7) | - |
| (Increase)/decrease in receivables | (2.6) | 4.5 |
| Increase in payables | <u>2.6</u> | <u>1.3</u> |
| Cash generated from operations | <u>189.6</u> | <u>217.7</u> |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS

Introduction

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

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

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

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

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

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

The DB Scheme 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 defined benefit cost for the plan as a whole to individual companies within the Northern Powergrid Group and, accordingly, the Company accounts for the DB Scheme as if it were a defined contribution scheme.

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

Role of Trustees

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

Funding requirements

UK legislation requires that pension schemes are funded prudently (i.e. to a level in excess of the current expected cost of providing benefits). The last actuarial valuation of the DB scheme was carried out by the Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2016. Such valuations are required by law to take place at intervals of no more than three years. Following each valuation, the Trustees and the Northern Powergrid Group must agree the contributions required (if any) to ensure the DB Scheme is fully funded over time on the basis of suitable, prudent assumptions. Contributions agreed in this manner constitute a minimum funding requirement. The current funding valuation was completed as at 31 March 2016. The Trustees and Company will be conducting the next valuation as at 31 March 2019.

Agreement was reached during August 2017 with the Trustees to repair a funding deficit of £194.9m as at 31 March 2016 over the 9 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2016 being borne out in practice. The agreement includes cash payments of £19.0m per annum over the period to 31 March 2017, followed by payments to be made over the remaining 8 years of the recovery plan of £27.4m per annum. All payments are made on a monthly basis. All contributions set out above are in 2017/18 prices and will be increased each year in line with increases in RPI over the period until they fall due. The expected employer contribution for the year ended 31 March 2019 is £28.3m.

The contributions payable by the Northern Powergrid Group to the DB Scheme in respect of future benefits, which are accruing, are 43.6% of pensionable pay. These contributions were determined as part of the 31 March 2016 actuarial valuation and are payable in addition to the deficit repair contributions mentioned above. These rates will remain in place until such a time as a new schedule of contributions is agreed between the Trustees and Northern Electric plc as part of the 31 March 2019 valuation. In addition, the Company pays 3.6% of pensionable pay to the DB Scheme in respect of the expenses of running the DB Scheme.

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

Pensions' Regulation

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

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

The Pensions Regulator has various powers including the power to:

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

Profile of the DB Scheme

The Defined Benefit Obligation ("DBO") includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 17 years based on the results of the 31 March 2016 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

Broadly, about 40% of the liabilities are attributable to current employees (duration about 24 years), 10% to former employees (duration about 25 years) and 50% to current pensioners (duration about 14 years).

Risks associated with the DB Scheme

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

| Risk | Description | Mitigation |
|------------------------|--|--|
| Volatile asset returns | The DBO is calculated using a discount rate set with reference to corporate bond yields. If assets underperform this discount rate, this will create an element of deficit. The DB Scheme aims to hold a significant proportion (44%) of its assets in growth assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term. | The allocation to growth assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from growth seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation. |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

| Risk | Description | Mitigation |
|------------------------|---|---|
| Changes in bond yields | A decrease in corporate bond yields will increase the value placed on the DBO for accounting purposes, although this will be partially offset by an increase in the value of the DB Scheme's bond holdings. | The DB Scheme also holds a substantial proportion of its assets (61%) as bonds, which provide a hedge against falling bond yields (falling yields which increase the DBO will also increase the value of the bond assets). There are some differences in the credit quality of bonds held by the DB Scheme and the bonds analysed to decide the DBO discount rate, such that there remains some risk should yields on different quality bond/swap assets diverge. |
| Inflation risk | A significant proportion of the DBO is indexed in line with price inflation (specifically in line with RPI) and higher inflation will lead to higher liabilities. | The DB Scheme holds around 30% in UK government index-linked bonds which provide a hedge against higher than expected inflation increases of the DBO (rising inflation will increase both the DBO and the value of the index-linked bond portfolio). |
| Currency risk | To increase diversification, the DB Scheme invests in overseas assets. This leads to a risk that foreign currency movements negatively impact the value of assets in Sterling terms. | The DB Scheme hedges a proportion of the overseas investments currency risk for those overseas currencies that can be hedged efficiently. The DB Scheme's currency hedging ratio is currently 50% in respect of overseas developed market currencies. |
| Life expectancy | The majority of the DB Scheme's obligations are to provide benefits for the pensionable lifetime of the member, so increases in life expectancy will result in an increase in the liabilities. | The DB Scheme regularly reviews actual experience of its membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption. |

The Company and Trustees have agreed a long-term strategy for reducing investment risk as and when appropriate. This includes the use of Liability Driven Investment (LDI) from October 2016 to more closely match the nature and duration of the DB Scheme's liabilities through the use of derivatives such as swaps and repurchase agreements. The portfolio is designed to hedge a proportion of the interest rate and inflation risk inherent in the Scheme's liabilities. The target hedging level is currently 75% of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

The Trustees insure certain benefits payable on death before retirement

Other risks

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

A particular legislative risk exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"), a quasi-state benefit accrued by many UK plans over the period 1978 to 1997 as a result of a UK government programme allowing pension plans to "contract out" of the State Second Pension.

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

The UK Government has announced its intention to ensure that these benefits, which currently pay out at different levels for men and women, are gender-equalised in accordance with sex-discrimination legislation.

This would increase the DBO but it is not possible to fully quantify the impact of this change at this stage. However it could lead to an increase in the order of 2% to the DBO for a typical scheme

Reporting at 31 December 2017

For the purposes of this disclosure, the current and future pension costs of the Northern Powergrid Group have been assessed by Aon Hewitt, a qualified independent actuary, using the assumptions set out below, which the actuary has confirmed represent a reasonable best estimate of those costs. This review has been based on the same membership and other data as at 31 March 2016. The board of Northern Powergrid Holdings Company has accepted the advice of the actuary and formally approved the use of these assumptions for the purpose of calculating the pension cost of the Northern Powergrid Group.

The results of the latest funding valuation at 31 March 2016 have been adjusted to 31 December 2017. Those adjustments take account of experience over the period since 31 March 2016, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the DBO and the related current service cost were measured using the Projected Unit Credit Method.

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

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

| Main financial assumptions | December 2017 | December 2016 |
|--|------------------|------------------|
| | % p.a. | % p.a. |
| RPI Inflation | 2.95 | 3.00 |
| Rate of long-term increase in salaries | 3.45 | 3.00 |
| Pension increases | 2.85 | 2.90 |
| Discount rate for scheme liabilities | 2.60 | 2.70 |

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

| Main demographic assumptions | December 2017 | December 2016 |
|---|------------------|------------------|
| | | |
| Life expectancy for a male currently aged 60 | 26.7 | 27.1 |
| Life expectancy for a female currently aged 60 | 28.8 | 28.8 |
| Life expectancy at 60 for a male currently aged 45 | 28.1 | 28.6 |
| Life expectancy at 60 for a female currently aged 45 | 29.9 | 30.6 |
| Proportion of pension exchanged for additional cash at retirement | 10% | 10% |

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

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

| Asset allocation | December 2017 £m | December 2016 £m |
|----------------------------------|---------------------------------|---------------------------------|
| Developed market equity | 187.9 | 338.6 |
| Emerging market equity | 7.4 | 12.9 |
| Property | 164.7 | 91.4 |
| Reinsurance | 83.0 | 71.3 |
| Listed infrastructure | 112.7 | 99.2 |
| Investment grade corporate bonds | 423.5 | 366.9 |
| Other debt | 43.4 | 30.3 |
| Fixed interest gilts | 28.2 | 52.4 |
| Index-linked gilts | - | 3.1 |
| Liability driven investment | 644.2 | 581.2 |
| Cash | 51.0 | 107.1 |
| Total | 1,746.0 | 1,754.4 |

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

As at 31 December 2017, the fair value of the DB Scheme's assets, which related to self-investment, amounted to Nil% (2016: Nil%).

| Changes to the present value of the DBO during the year | December 2017 £m | December 2016 £m |
|---|---------------------------------|---------------------------------|
| Opening DBO | 1,722.9 | 1,453.2 |
| Current service cost | 17.9 | 14.9 |
| Interest expense on defined benefit obligation | 45.1 | 53.0 |
| Contributions by DB Scheme participants | 0.9 | 1.0 |
| Actuarial gains on DB Scheme liabilities arising from changes in demographic assumptions | (33.3) | - |
| Actuarial (gains)/losses on DB Scheme liabilities arising from changes in financial assumptions | 49.7 | 311.5 |
| Actuarial (gains)/losses on DB Scheme liabilities arising from experience | (19.8) | (25.9) |
| Net benefits paid out | (52.5) | (84.8) |
| Liabilities extinguished on settlements | (101.8) | - |
| Closing DBO | 1,629.1 | 1,722.9 |

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

24 PENSION COMMITMENTS (CONTINUED)

| Changes in the fair value of DB Scheme assets of the Northern Powergrid Group during the year | December 2017 £m | December 2016 £m |
|---|---------------------|---------------------|
| Opening fair value of DB Scheme assets | 1,754.4 | 1,541.3 |
| Interest income on DB Scheme assets | 46.9 | 56.7 |
| Re-measurement (losses)/gains on DB Scheme assets | 64.7 | 200.9 |
| Contributions by the employer | 45.0 | 40.5 |
| Contributions by DB Scheme participants | 0.9 | 1.0 |
| Net benefits paid out | (52.5) | (84.8) |
| Administration costs incurred | (1.3) | (1.2) |
| Assets distributed on settlements | (112.1) | - |
| Closing fair value of DB Scheme assets | 1,746.0 | 1,754.4 |

| Actual return on DB Scheme assets | December 2017 £m | December 2016 £m |
|--|---------------------|---------------------|
| Interest income on DB Scheme assets | 46.9 | 56.7 |
| Re-measurement (losses)/gain on DB Scheme assets | 64.7 | 200.9 |
| Actual return on DB Scheme assets | 111.6 | 257.6 |

Sensitivity to key assumptions

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

| | Changes in DBO £'000 | Revised DBO £'000 |
|---|-------------------------|----------------------|
| Scheme defined benefit obligations | 1,629.1 | |
| Following a 10 bps decrease in the discount rate | 31.9 | 1,756.7 |
| Following a 10 bps increase in the discount rate | (31.5) | 1,689.7 |
| Following a 10 bps increase in the inflation assumption | 27.0 | 1,752.9 |
| Following a 10 bps decrease in the inflation assumption | (26.7) | 1,693.3 |
| Following a 1 year increase in life expectancy | 68.5 | 1,790.0 |
| Following a 1 year decrease in life expectancy | (67.1) | 1,655.9 |

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

NORTHERN POWERGRID (NORTHEAST) LIMITED**REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)****25 OPERATING LEASE ARRANGEMENTS**

| | 2018 £m | 2017 £m |
|--|------------|------------|
| Minimum lease payments under operating leases recognised in the year | <u>7.2</u> | <u>6.8</u> |

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

| | 2018 £m | 2017 £m |
|---------------------------------------|-------------|-------------|
| Within one year | 4.8 | 4.5 |
| In the second to fifth year inclusive | 17.0 | 14.5 |
| After five years | <u>4.5</u> | <u>5.2</u> |
| | <u>26.3</u> | <u>24.2</u> |

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

NORTHERN POWERGRID (NORTHEAST) LIMITED**REGISTERED NUMBER 02906593****NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)****26 RELATED PARTY TRANSACTIONS**

The Company has advanced loans to companies in the Northern Powergrid Group. The total interest included in Investment income in the statement of profit or loss for the year ended 31 March 2018 was £nil (2017: £0.4m).

The Company has received loans from other companies in the Northern Powergrid Group. The total interest included in finance costs in the statement of profit or loss for the year ended 31 March 2018 was £23.3m (2017: £23.2m). Included within borrowings is £469.0m as at 31 March 2018 (2017: £408.9m).

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

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

| Related Party | Sales to Related Party | Purchases from Related Party | Amounts Owed to Related Party (Note 16) |
|---|------------------------------|------------------------------------|--|
| | £m | £m | £m |
| 2018: | | | |
| Integrated Utility Services Limited | 0.3 | 3.0 | - |
| Integrated Utility Services Limited (registered in Eire) | - | 1.1 | - |
| Northern Electric plc | - | 5.5 | - |
| Northern Powergrid Metering Limited | - | 0 | - |
| Northern Powergrid (Yorkshire) plc | 20.1 | 15.1 | - |
| Vehicle Lease and Service Limited | - | 3.9 | 0.5 |
| 2017: | | | |
| Integrated Utility Services Limited | 0.4 | 2.8 | - |
| Integrated Utility Services Limited (registered in Eire) | - | 1.3 | 0.1 |
| Northern Electric plc | - | 6.0 | - |
| Northern Powergrid Metering Limited | 0.1 | - | - |
| Northern Powergrid (Yorkshire) plc | 19.2 | 13.2 | - |
| Vehicle Lease and Service Limited | - | 3.9 | 0.4 |

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

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

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NOTES TO THE REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2018 (CONTINUED)

27 IMMEDIATE PARENT UNDERTAKING AND CONTROLLING PARTY

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

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

